

KB Home (KBH)

\$23.00 (As of 03/13/20)

Price Target (6-12 Months): **\$24.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/12/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: A

Growth: A

Momentum: C

Summary

Shares of KB Home have outperformed its industry in a year. Ongoing execution of the company's returns-focused growth plan, balanced approach of allocating cash flow, improvement in gross margin and community count growth realization are commendable. Notably, it is well positioned for fiscal 2020, given solid backlog level (\$1.81 billion in fiscal first quarter 2020), declining mortgage rates, steady economic growth and favorable demographics. However, lower average selling price and rising labor costs remain major headwinds. Estimates for fiscal 2020 have moved south over the past 30 days, reflecting analysts' concern over the company's earnings growth potential.

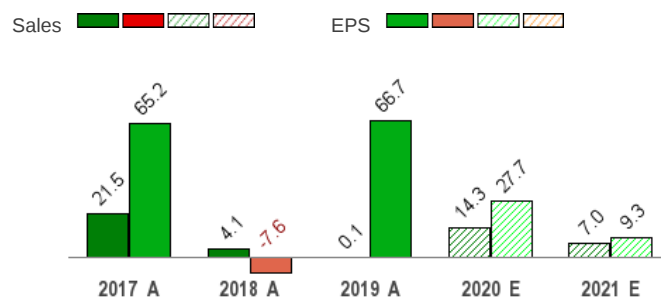
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$40.51 - \$18.00
20 Day Average Volume (sh)	2,070,035
Market Cap	\$2.1 B
YTD Price Change	-32.9%
Beta	1.13
Dividend / Div Yld	\$0.36 / 1.6%
Industry	Building Products - Home Builders
Zacks Industry Rank	Top 7% (18 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.6%
Last Sales Surprise	-2.9%
EPS F1 Est- 4 week change	-1.0%
Expected Report Date	03/26/2020
Earnings ESP	0.4%
P/E TTM	8.0
P/E F1	6.3
PEG F1	0.8
P/S TTM	0.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,069 E	1,299 E	1,442 E	1,774 E	5,568 E
2020	950 E	1,230 E	1,350 E	1,676 E	5,206 E
2019	811 A	1,022 A	1,161 A	1,559 A	4,553 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.52 E	\$0.79 E	\$1.09 E	\$1.63 E	\$3.98 E
2020	\$0.43 E	\$0.73 E	\$1.00 E	\$1.54 E	\$3.64 E
2019	\$0.31 A	\$0.51 A	\$0.73 A	\$1.31 A	\$2.85 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/13/2020. The reports text is as of 03/16/2020.

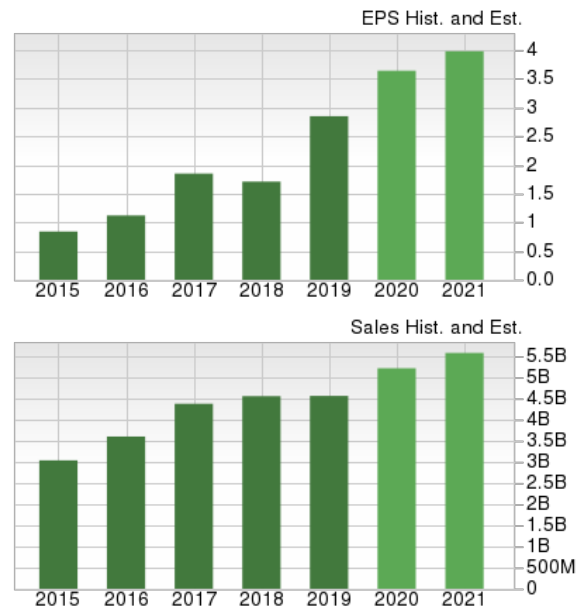
Overview

Based in Los Angeles, CA, **KB Home** is a well-known homebuilder in the United States and one of the largest in the state. The company's revenues are generated from its **Homebuilding** (accounting for 99.7% of fourth-quarter fiscal 2019 total revenues) and **Financial Services** (0.3%) operations.

The company's Homebuilding operations include building and designing homes that cater to first time, move-up and active adult homebuyers on acquired or developed lands. KB Home also builds attached and detached single-family homes, town homes and condominiums.

There are four main reportable segments based on geographical presence: West Coast (comprising Washington and California), Southwest (comprising Arizona and Nevada), Central (constituting Colorado, and Texas) and Southeast (including Florida, North Carolina).

KB Home's Financial Services operations offer mortgage banking, title and insurance services to homebuyers.



Reasons To Buy:

- ▲ **Growth Initiatives to Drive Profits:** Since 2016, KB Home has been pursuing a Returns-Focused Growth Plan that is designed to drive revenues and homebuilding operating income margin, return on invested capital, return on equity and leverage ratio. The plan's main components are executing the company's core business strategy, improving asset efficiency and monetizing significant deferred tax assets.

With the Returns-Focused Growth Plan in place, revenues and operating margin are expected to significantly improve in the near future.

With the conclusion of the third year of this plan, the company's return on equity increased 590 basis points (bps) to 12.2% from 2016 level. Moreover, the company expects to realize an improvement in excess of 100 basis points in this metric in 2020 as well.

The plan has helped KB Home to generate significant cash from operations of \$251 million in fiscal 2019 (up 13.1% from fiscal 2018 level), which it has utilized to invest \$5 billion in land acquisition and development, repay approximately \$850 million in debt and return \$73 million in capital to stockholders in the form of dividends and share repurchases. The investment for growth is being realized as is evident from its community count. In 2019, average community count was up 12% and ending community count was up 5%, both on a year over year basis.

The company is also focused on its core KB2020 business strategy which aims to boost scale in existing geographic footprint, improve profitability per unit, generate higher operating margin, drive earnings while generating positive cash flow to redeploy for growth and debt reduction.

- ▲ **Built-to-Order Approach Gives Competitive Advantage:** The company's Built-to-Order process provides buyers a wide range of choices in the major aspects of their future home along with a personalized customer experience through in-house community teams. This highly consumer-centric approach helps homebuyers to design a home with the features and amenities of their choice. Not only has this approach given KB Home competitive advantage over its peers, it has led to low-cost production.

The company follows a strategy of initiating construction only after a purchase agreement has been executed. This reduces inventory risk, enhances efficiencies in construction and provides greater visibility as well as predictability on future deliveries.

The company's built-to-order model provides higher revenues from premiums (lots, plans, and elevations), and design studio and structural options.

- ▲ **Aggressive Land Acquisition Strategy:** The company invests aggressively in land acquisition and development, mainly in high-end locations, which is critical for community count as well as top-line growth. This has eventually helped the company in reducing debt. It remains optimistic that this blend of rising active inventory, while reducing its annual interest incurred, is expected to boost future gross margin and returns.

In fiscal 2019, the company invested \$1.6 billion in land acquisitions and development. This has helped the company to generate \$251 million of net operating cash flow in fiscal 2019. KB Home expects the land investments to drive additional community openings throughout 2020 and produce year-over-year growth in average community count in the mid-single digit range in fiscal 2020.

As of Nov 30, 2019, lots owned or under contract totaled 64,910 compared with 64,812 as of Nov 30, 2018. Out of the 64,910 lots, 59% in the pipeline were owned and 41% were under contract including about 9,200 lots under contract with refundable deposits. The company's own lots at the end of fiscal 2019 represented a 3.2-year supply based on homes delivered in fiscal 2019.

- ▲ **Improved Housing Market Fundamentals:** The U.S. housing market started building up strength since the beginning of 2019, after a torrid second-half 2018. Declining mortgage rates and moderate home prices have been adding strength to KB Home and other homebuilders. The overall homebuilding industry remains positive owing to ongoing traffic trends that indicate higher inclination of buyers, thereby reflecting a slow but steady housing recovery. Notably, declining interest/mortgage rates, low unemployment and increasing wages are somewhat offsetting the other ongoing headwinds. Moreover, as more and more millennials are leaving their parents' home, a sharp spike in household formation is likely to translate into higher demand for new homes.
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Reasons To Sell:

▼ **Lower Average Selling Price a Major Concern:** Although the U.S. housing market is gradually improving, ongoing headwinds, lower average selling prices, given the company's intentional shift to more affordable price points, is a pressing concern. Notably, KB Home primarily caters to first time, as well as first move up buyers. In the fiscal fourth quarter, deliveries to first time buyers rose to 56% of total, the highest share of this segment in many years.

Lower ASP, higher construction and labor costs, along with competitive pricing pressure are pressing concerns.

During fiscal 2019, ASP fell 5% to \$380,000, mainly due to a shift in the geographic mix of homes delivered. In fiscal fourth quarter, the overall average selling price of homes delivered declined slightly to 392,500, primarily due to a shift in mix in West Coast region towards lower price communities within Bay area operation. For first-quarter fiscal 2020, the company expects an overall average selling price of approximately \$375,000. Also, it expects average selling price within the range of \$380,000 to \$400,000 for fiscal 2020.

▼ **Rising Labor and Land Costs:** Rising labor costs are threatening margins as they limit homebuilders' pricing power. Labor shortages are leading to higher wages and delays in construction, which eventually hurts the number of homes delivered.

Also, land prices are increasing due to limited availability. More inflation is anticipated, going ahead. This is somewhat exerting pressure on homebuilders' margins considering that home prices are moderately increasing.

Meanwhile, U.S.-China trade tensions raise a concern. Notably, on May 9, 2019, the Trump administration raised tariffs from 10% to 25% on \$200 billion in China-made products. This prolonged trade war with China is gradually heating up, thereby creating challenges for the industry players.

▼ **Supply Constraints:** Several years of production deficits during the housing downturn limited the supply of both rental and new homes in the country. At present, a shortage of buildable lots, skilled labor and available capital for smaller builders are limiting home production, thereby lowering the inventory of homes, both new and existing. The labor market has also tightened with limited availability of labor arresting the rapid growth in housing production.

▼ **Federal Government Actions:** The housing industry is cyclical and affected by consumer confidence levels, prevailing economic conditions and interest rates. The federal government's actions related to economic stimulus, taxation and borrowing limits could affect consumer confidence and spending levels, which in turn could hurt both the economy and housing market.

Although strong economy and labor market strength provide the basis for strong demand, rising interest and mortgage rates may influence the rate-sensitive homebuilding industry. High mortgage rates dilute the demand for new homes as mortgage loans become expensive. This lower purchasing power of the buyers hurts volumes, revenues and profits of homebuilders.

Last Earnings Report

KB Home Q4 Earnings Beat Estimates, Revenue Miss

KB Home ended fiscal 2019 on an impressive note, with fourth-quarter fiscal 2019 earnings beating analysts' expectation.

That said, strong demand for its built-to-order products at affordable price points, together with limited inventory in markets served drove net order growth of 38% in the quarter. Strong backlog and impressive housing gross margins will enable KB Home to improve profitability and return on equity in fiscal 2020.

Quarter Ending **11/2019**

Report Date	Jan 09, 2020
Sales Surprise	-2.86%
EPS Surprise	1.55%
Quarterly EPS	1.31
Annual EPS (TTM)	2.86

Earnings & Revenue Discussion

Quarterly earnings of \$1.31 per share outpaced the Zacks Consensus Estimate of 1.29 cents by 1.6% and increased 36% from a year ago.

Total revenues of \$1,558.7 million missed the consensus mark of \$1,599 million by 2.9%. That said, the top line grew by a notable 15.6% year over year, mainly due to higher home deliveries, partly offset by lower average selling price (ASP) of homes delivered.

Segment Details

Homebuilding Revenues: In the reported quarter, the segment's revenues advanced 15.6% from the prior-year period to \$1,553.3 million due to higher deliveries. Under the homebuilding umbrella, land generated \$11.1 million revenues (up from \$4.7 million a year ago), while housing revenues totaled \$1,542.2 million (increasing 15.2% from \$1,339.3 million in the prior year).

Moreover, number of homes delivered increased 15.9% from the year-ago level to 3,929 units. Deliveries increased in all the four regions served (West Coast, Southwest, Central and Southeast). However, ASP fell 0.7% from a year ago to \$392.5, mainly due to a decline in ASP in the West Coast and Southeast regions.

At the end of the reported quarter, average community count was 253, up 9% year over year. Notably, net orders per community averaged 3.7 per month in the quarter, up from 2.9 recorded in the prior-year quarter.

Net orders grew 38% from the prior-year quarter to 2,777 homes, increasing in double digits across all regions served by the company, baring Southeast. Value of net orders also increased by a whopping 43% from the year-ago quarter to \$1.06 billion.

The company's backlog totaled 5,078 homes (as of Nov 30, 2019), up 23.6% from a year ago. Potential housing revenues from backlog grew 26.4% from the prior-year period to \$1.81 billion.

Margins

Housing gross margin expanded 150 basis points (bps) year over year to 19.6% in the quarter. Excluding inventory-related charges, housing gross profit margin increased 120 bps to 19.9%. The increase reflects lower amortization of previously capitalized interest and the adoption of a new accounting standard.

As a percentage of housing revenues, selling, general and administrative (SG&A) expenses were 9.1%, up 10 bps from the year-ago figure. The rise was mainly due to the impact of ASC 606 adoption.

Homebuilding operating margin improved 140 bps on a year-over-year basis to 10.5%. After adjusting for inventory-related charges, operating margin came in at 10.7%, up 100 bps.

Financial Services revenues grew 6.7% year over year to \$5.3 million.

Financial Position

KB Home had homebuilding cash and cash equivalents of \$453.8 million as of Nov 30, 2019, lower than \$574.4 million on Nov 30, 2018. Inventories were \$3,704.6 million, up from \$3,582.8 million as of Nov 30, 2018. KB Home had total liquidity of \$1.23 billion at the end of fiscal 2019.

The company invested \$1.6 billion in land acquisitions and development in fiscal 2019, and generated \$251 million of net operating cash flow.

Its debt-to-capital ratio was 42.3% (which improved 740 bps from Nov 30, 2018). Net debt-to-capital ratio was 35.2% as of Nov 30, 2019.

Fiscal 2019 Highlights

Earnings came in at \$2.85 per share for the full year, reflecting an increase of 67.1% from \$1.71 a year ago. Total revenues of \$4,552.7 million also grew 0.1% from the fiscal 2018 level. Homebuilding revenues also improved marginally from a year ago to \$4,537.7 million. Homes delivered jumped 5% year over year to 11,871, while ASP decreased 5% to \$380,000.

Guidance

KB Home expects average community count to increase in the mid-single-digit range in first-quarter fiscal 2020 and in the low to mid-single-digit range in fiscal 2020.

It expects first-quarter housing revenues in the range of \$910-\$917 million, indicating an increase of 18% from the year-ago period, considering

the midpoint of the range. For fiscal 2020, it still anticipates housing revenues in the range of \$4.9-\$5.3 billion.

ASP is expected to be approximately \$375,000 for the fiscal first quarter, while the same is expected between \$380,000 and \$400,000 for the full year.

Assuming no inventory-related charges, the company expects housing gross margin to improve 40 bps year over year to the range of 17.8-18.2% for the fiscal first quarter. For fiscal 2020, the metric is expected in the range of 18.7-19.3%, indicating an improvement of 30 bps (considering the midpoint of the range) from the prior year.

For the fiscal first quarter, homebuilding operating margin — excluding the impact of any inventory-related charges — is expected within 4.9-5.3% (up 80 bps at the midpoint from a year ago). For the full year, the metric is expected between 7.9% and 8.5%, suggesting an improvement of 50 bps at the midpoint from the prior year.

Moreover, SG&A ratio is projected in the range of 12.7-13.1% for the quarter and 10.5-11.1% for the year.

Effective tax rate is estimated to be approximately 20% for the quarter and 23% for the year.

Recent News

KB Home on Expansion Spree, Opens New Community in Kent - Jan 12, 2020

In a bid to expand its presence across Seattle, KB Home recently announced the opening of Ridgecrest — a new single-family home community — located at the city of Kent.

The affordably-priced communities will have two-story single-family homes with up to five bedrooms and three baths with a floor area of 1550-2750 square feet. Moreover, these communities will be built per the latest ENERGY STAR guidelines, which will enable homebuyers save a reasonable amount in utility costs. The new, personalized KB home comes with a price tag of \$490,000.

Valuation

KB Home shares are down 45.8% in the year-to-date period and 19.8% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Construction sector are down 23.6% and 24.5% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 3.7% and 8.1%, respectively.

The S&P 500 index is down 15.8% in the year-to-date period and 5.3% in the past year.

The stock is currently trading at 6.06X forward 12-month price to earnings, which compares to 7.46X for the Zacks sub-industry, 11.81X for the Zacks sector and 15.72X for the S&P 500 index.

Over the past five years, the stock has traded as high as 16.8X and as low as 5.53X, with a 5-year median of 10.03X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$24 price target reflects 0.65X forward 12-month earnings.

The table below shows summary valuation data for KBH

Valuation Multiples - KBH					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	6.06	7.46	11.81	15.72
	5-Year High	16.8	15.14	18.86	19.34
	5-Year Low	5.53	7.33	10.71	15.18
	5-Year Median	10.03	10.75	15.93	17.42
P/B TTM	Current	0.87	1	2.31	3.64
	5-Year High	1.73	2.29	7.23	4.55
	5-Year Low	0.52	1	2.19	2.85
	5-Year Median	0.98	1.55	3.39	3.63
P/S F12M	Current	0.39	0.7	1.43	2.9
	5-Year High	0.7	1.24	2.23	3.43
	5-Year Low	0.25	0.65	1.25	2.54
	5-Year Median	0.43	0.93	1.65	3

As of 03/13/2020

Industry Analysis Zacks Industry Rank: Top 7% (18 out of 253)



Top Peers

M.D.C. Holdings, Inc. (MDC)	Outperform
Meritage Homes Corporation (MTH)	Outperform
PulteGroup, Inc. (PHM)	Outperform
TRI Pointe Group, Inc. (TPH)	Outperform
Century Communities, Inc. (CCS)	Neutral
Taylor Morrison Home Corporation (TMHC)	Neutral
Beazer Homes USA, Inc. (BZH)	Underperform
M/I Homes, Inc. (MHO)	Underperform

Industry Comparison Industry: Building Products - Home Builders				Industry Peers		
	KBH Neutral	X Industry	S&P 500	MHO Underperform	MTH Outperform	TMHC Neutral
VGM Score	A	-	-	A	A	A
Market Cap	2.07 B	1.87 B	19.05 B	686.75 M	1.79 B	1.95 B
# of Analysts	6	5	13	1	10	3
Dividend Yield	1.57%	0.00%	2.31%	0.00%	0.00%	0.00%
Value Score	A	-	-	A	A	A
Cash/Price	0.16	0.12	0.05	0.01	0.12	0.11
EV/EBITDA	4.21	7.13	11.57	7.15	7.32	10.16
PEG Ratio	0.59	0.69	1.68	NA	0.77	NA
Price/Book (P/B)	0.85	0.88	2.56	0.66	0.91	0.60
Price/Cash Flow (P/CF)	6.77	6.65	10.18	4.48	6.46	4.33
P/E (F1)	4.88	7.15	14.94	5.01	6.84	4.76
Price/Sales (P/S)	0.46	0.50	2.02	0.27	0.49	0.41
Earnings Yield	15.83%	14.02%	6.67%	19.98%	14.63%	21.01%
Debt/Equity	0.00	0.49	0.70	0.77	0.52	0.78
Cash Flow (\$/share)	3.40	3.90	7.01	5.36	7.25	3.36
Growth Score	A	-	-	A	A	A
Hist. EPS Growth (3-5 yrs)	39.40%	20.24%	10.85%	28.57%	16.66%	13.25%
Proj. EPS Growth (F1/F0)	27.78%	14.18%	5.99%	3.67%	6.65%	2.46%
Curr. Cash Flow Growth	2.99%	2.99%	6.15%	12.15%	9.16%	8.16%
Hist. Cash Flow Growth (3-5 yrs)	24.28%	22.34%	8.52%	26.52%	12.53%	38.63%
Current Ratio	1.68	3.35	1.24	6.31	1.13	6.76
Debt/Capital	0.00%	32.66%	42.57%	43.52%	34.05%	43.79%
Net Margin	5.90%	6.78%	11.64%	5.10%	6.83%	5.35%
Return on Equity	11.99%	12.00%	16.74%	14.13%	13.52%	12.86%
Sales/Assets	0.90	0.98	0.54	1.18	1.05	0.91
Proj. Sales Growth (F1/F0)	14.35%	3.66%	3.54%	4.38%	2.70%	43.48%
Momentum Score	C	-	-	A	F	B
Daily Price Chg	-1.37%	0.00%	8.21%	1.95%	4.79%	4.91%
1 Week Price Chg	-2.27%	0.00%	-0.67%	-1.45%	5.86%	-3.64%
4 Week Price Chg	-41.73%	-34.99%	-22.67%	-44.15%	-35.77%	-47.14%
12 Week Price Chg	-29.64%	-22.82%	-20.46%	-39.85%	-24.10%	-33.00%
52 Week Price Chg	-2.75%	-6.86%	-10.79%	-8.28%	7.91%	-17.36%
20 Day Average Volume	2,070,035	291,615	3,061,271	277,981	625,467	3,208,933
(F1) EPS Est 1 week change	-1.58%	0.00%	0.00%	0.00%	-0.15%	0.00%
(F1) EPS Est 4 week change	-1.00%	0.00%	-0.32%	0.00%	-0.15%	0.00%
(F1) EPS Est 12 week change	5.03%	2.65%	-0.65%	-6.61%	1.44%	-4.58%
(Q1) EPS Est Mthly Chg	-0.54%	0.00%	-0.62%	0.00%	0.00%	0.00%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	A
Momentum Score	C
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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