

KB Home (KBH)

\$31.26 (As of 07/15/20)

Price Target (6-12 Months): **\$33.00**

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: D

Summary

Shares of KB Home have outperformed the industry in the past three months. Ongoing execution of the company's returns-focused growth plan, balanced approach of allocating cash flow and improvement in gross margin are commendable. Although its fiscal second-quarter revenues missed expectation and decreased 11% as home deliveries were down 10%, owing to COVID-19 disrupted operations and ASP was affected by at least 1% by a mix shift of homes, the company's commentary for fiscal 2020 was encouraging for KB Home as well as for the industry as a whole. Strong financial position and measures taken to overcome the uncertainties are also commendable. However, its focus on the built-to-order model versus specs may have been a temporary competitive disadvantage. Again, renewed fear of the COVID-19 outbreak may impact its performance going forward.

Data Overview

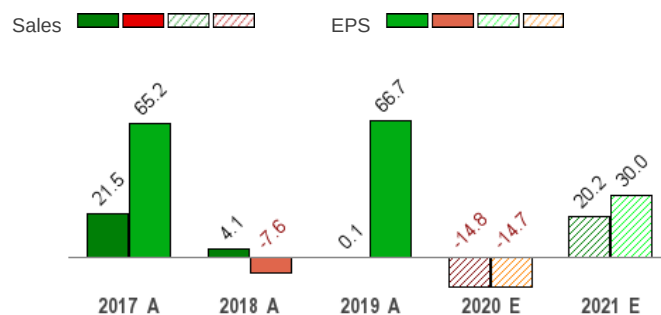
52 Week High-Low	\$40.51 - \$9.82
20 Day Average Volume (sh)	2,456,533
Market Cap	\$2.8 B
YTD Price Change	-8.8%
Beta	1.98
Dividend / Div Yld	\$0.36 / 1.2%
Industry	Building Products - Home Builders
Zacks Industry Rank	Top 5% (13 out of 251)

Last EPS Surprise	-3.5%
Last Sales Surprise	-14.8%
EPS F1 Est- 4 week change	-6.8%
Expected Report Date	09/23/2020
Earnings ESP	0.0%
P/E TTM	9.7
P/E F1	12.9
PEG F1	1.6
P/S TTM	0.6

Price, Consensus & Surprise



Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	987 E	1,130 E	1,241 E	1,461 E	4,661 E
2020	1,076 A	914 A	849 E	1,040 E	3,877 E
2019	811 A	1,022 A	1,161 A	1,559 A	4,553 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.54 E	\$0.77 E	\$0.94 E	\$1.29 E	\$3.16 E
2020	\$0.63 A	\$0.55 A	\$0.46 E	\$0.79 E	\$2.43 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 07/15/2020. The reports text is as of 07/16/2020.

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 fiscal 2019 total revenues) and **Financial Services** (0.3%) operations.

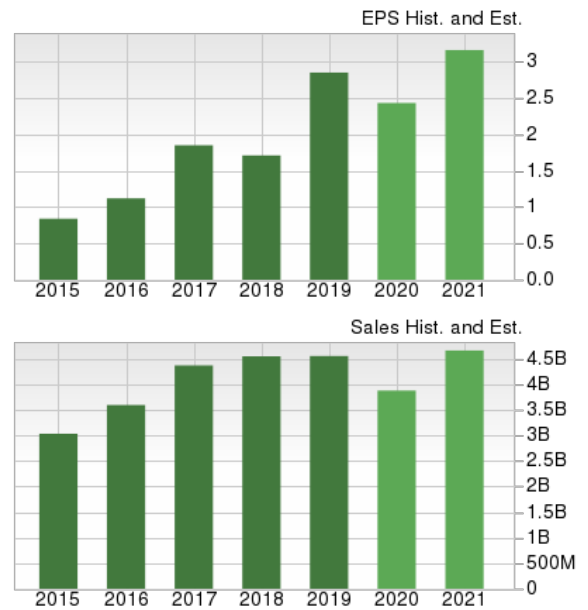
The company's Homebuilding operations include building and designing homes that cater to first time, move-up and active adult homebuyers on acquired or developed lands. KB Home also builds attached and detached single-family homes, town homes and condominiums.

There are four main reportable segments within the homebuilding reporting segment 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. This segment earns revenues mainly from insurance commissions and provision of title services.

KB Home ended second quarter of fiscal 2020 with \$575 million cash and cash equivalents, and \$787.6 million of available capacity on the \$800-million unsecured revolving credit facility, resulting in a total liquidity of \$1.36 billion. KB Home reduced net debt to capital to 32.4% by fiscal second quarter-end from 35.1% in the fiscal first quarter.

KB Home's backlog totaled 5,080 homes (as of May 31, 2020), down 14.3% from a year ago. Potential housing revenues from backlog declined 12.4% from the prior-year period to \$1.9 billion.



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 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% in fiscal 2019 from 2016 level.

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. In first-quarter fiscal 2020, it had \$430 million in cash and more than \$1.2 billion of total liquidity.

The current macro-economic conditions owing to the coronavirus outbreak might not be in favor of the company, as it is difficult to assess the impact of this pandemic. Nonetheless, strong financial position of the company and measures taken to overcome the uncertainties are commendable.

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), as well as design studio and structural options. KB Home's focus on the built-to-order model (which accounted approximately 75% of KB Home's business in the fiscal second quarter) versus specs may have been a temporary competitive disadvantage as the latest housing market rebound was mostly attributable to solid gains from the resale market. That said, the company's commentary was encouraging for KB Home as well as the industry as a whole for fiscal 2020. Although it expects lower revenues for fiscal 2020, improving gross margins should offset the headwinds.

- ▲ **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. In first-quarter fiscal 2020, it invested \$405 million in land acquisition and development. Although the company has terminated further investment due to coronavirus-induced global economic uncertainty, land investments made prior to the outbreak of COVID-19 are expected to drive additional community openings throughout 2020 and beyond.

Meanwhile, despite lower land spend, KB Home ended the fiscal second quarter with an ample supply of lots. As of May 31, 2020, lots owned or under contract totaled 60,480. Out of these, 62% were owned and 38% were under contracts. The company's 37,589 owned lots represented approximately 3.1 years' supply, based on homes delivered in the trailing 12 months.

- ▲ **Strong Balance Sheet Position:** KB Home is well positioned to tide over the unfavorable demand trends owing to the pandemic, backed by a strong balance sheet and more than \$1.36 billion of liquidity.

The company ended the fiscal second quarter with \$575 million cash and cash equivalents, and \$787.6 million of available capacity on the \$800-million unsecured revolving credit facility. KB Home reduced net debt to capital to 32.4% by fiscal second quarter-end from 35.1% in the first quarter. Notably, KB Home has not borrowed under the facility in 2020.

The company's 7.00% senior notes of \$450.0 million are scheduled to mature on Dec 15, 2021, which indicates that it has no significant debt maturities in the next 12 months.

Reasons To Sell:

▼ **Coronavirus-Led Shutdowns Weigh on Q2 Results:** Owing to the coronavirus pandemic, the company has been witnessing a slowdown in traffic and sales, which impacted its fiscal second-quarter results. It witnessed 57% order decline in the fiscal second quarter, with a 36% decrease on a net basis, reflecting cancellations from largely non-started units. KB Home has relatively high concentration in regions like California, Florida and Texas that were more affected by the COVID-19 pandemic and job losses. While the worst of the pandemic seems to be over, given improved orders in June and anticipation of persistent margin improvement in the second half of fiscal 2020, renewed fears of a second wave of the virus may impact KB Home in the near term.

Coronavirus-related disruptions, and higher land and labor costs are likely to weigh on the bottom line.

▼ **Higher Labor and Land Costs:** Higher 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.

▼ **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.

Last Earnings Report

KB Home's (KBH) Q2 Earnings Miss Estimate, Margin Up Y/Y

KB Home reported lackluster results for second-quarter fiscal 2020 (ended May 31, 2020), wherein earnings and revenues lagged the respective Zacks Consensus Estimate. On a year-over-year basis, its bottom line increased while top line declined on lower deliveries and average selling price (ASP).

Earnings & Revenue Discussion

The company's quarterly earnings of 55 cents per share missed the consensus estimate of 57 cents by 3.5%. Nonetheless, the metric grew 7.8% from the year-ago figure of 51 cents per share owing to improvement in housing gross profit margin and pretax income.

Total revenues of \$914 million lagged the consensus mark of \$1.07 billion by 14.8% and fell more than 10% year over year.

Segment Details

Homebuilding: In the quarter under review, the segment's revenues of \$910.3 million decreased 10.6% from the prior-year period. Under the homebuilding umbrella, land generated \$0.3 million revenues (significantly down from \$0.87 million a year ago), while housing revenues totaled \$910 million (declining 10.6% from the prior year).

Number of homes delivered slipped 9.7% from the year-ago level to 2,499 units. Deliveries decreased in all the four regions served by the company (West Coast, Southwest, Central and Southeast). ASP also fell 1% from a year ago to \$364,100.

Net orders decreased 57% from the prior-year quarter to 1,758 homes. Value of net orders also decreased a whopping 55.1% from the year-ago quarter to \$688.4 million. Net orders were down 10% in March, 107% in April and 55% in May.

In the reported quarter, average community count was down 2% from a year ago to 247. Quarter-end community count was 244, down 4% from the prior year. Net orders per community averaged 2.4 per month compared with 5.4 a year ago, which marked the highest second-quarter net order pace in the past several years.

Cancellation rate, as a percentage of gross orders, grew 43% year over year. The metric came in at 20%, 114% and 34% in March, April and May, respectively. The gradual improvement in cancellation was mainly due to proactive efforts undertaken by the company amid the unprecedented nationwide economic and employment disruptions resulting from the pandemic.

Its quarter-end backlog totaled 5,080 homes (as of May 31, 2020), down 14.3% from a year ago. Potential housing revenues from backlog declined 12.4% from the prior-year period to \$1.9 billion.

Margins

Homebuilding operating margin (excluding inventory and severance related charges) improved 140 basis points (bps) to 6.9%. Within homebuilding, housing gross margin (excluding inventory-related charges) improved 110 bps year over year. The increase was attributed to a mix shift of homes delivered and lower amortization of previously capitalized interest, partly offset by reduced operating leverage due to low housing revenues.

Adjusted housing gross margin — which excludes inventory-related charges and the amortization of previously capitalized interest — registered an improvement of 60 bps year over year to 21.9%. As a percentage of housing revenues, selling, general and administrative expenses grew 50 bps from the year-ago figure.

Financial Services revenues grew 17.8% year over year to \$3.69 million on the back of strength in its mortgage banking joint venture, KBHS Home Loans, LLC ("KBHS"). Notably, KBHS originated 76% of the residential mortgage loans that the company's customers obtained compared with 69% in the prior year.

Financial Position

KB Home had cash and cash equivalents of \$575 million as of May 31, 2020, up from \$453.8 million on Nov 30, 2019. The company had total liquidity of \$1.36 billion, including \$787.6 million of available capacity under the unsecured revolving credit facility.

Inventories marginally decreased to \$3.61 billion from \$3.7 billion as of Nov 30, 2019. Lots owned or under contract were 60,480, down 7% from fiscal 2019-end, reflecting fewer optioned lots. Of these, 37,589 owned lots represented approximately 3.1 years' supply, based on homes delivered in the trailing 12 months.

Its debt to capital was 41.5% (which improved 80 bps from Nov 30, 2019). Net debt to capital was 32.4% as of May-end, up 280 bps.

Company Views

KB Home has effectively resumed nearly all core operations and witnessed an improvement in gross and net orders, as well as the cancellation rate in the first three weeks of June. The sequential improvement is an indicator of underlying strength in the overall housing market.

Gross and net orders for the first three weeks of June increased 4% and 2% year over year, respectively. On a sequential basis, the metrics were up 22% and 48%, respectively. Cancellation rate for this period was 21%, nearly flat with the year-earlier figure.

Quarter Ending **05/2020**

Report Date	Jun 24, 2020
Sales Surprise	-14.84%
EPS Surprise	-3.51%
Quarterly EPS	0.55
Annual EPS (TTM)	3.22

Guidance

As the economy tends to recover, the company expects the housing market to improve. However, the speed, trajectory and strength of any such recovery remain highly uncertain. Given this uncertainty, it will proceed with land acquisition and development, as well as preserve cash and liquidity.

The company expects third-quarter housing revenues within \$820-\$880 million. Also, it projects housing revenues between \$3.75 billion and \$3.95 billion for 2020. ASP for the third quarter is likely to be in the range of \$395,000-\$400,000. For 2020, the metric is projected within \$385,000-\$395,000.

Housing gross margin is projected within 18.8-19.4% for the third quarter and 18.6-19.2% for 2020. SG&A will likely be in the 12.7-13.3% range for the third quarter and 11.8-12.4% for 2020 (excluding severance charges).

Third-quarter homebuilding operating margin, excluding inventory related charges, is expected in the range of 5.7-6.5%. For 2020, it expects the metric — excluding inventory and severance charges — in the range of 6.4-7.2%.

Average community count for the third quarter is likely to decline in low-single digits. For the full year, the company projects no change in the average community count on a year-over-year basis.

Valuation

KB Home shares are down 8.8% in the year-to-date period but up 16.7% over the trailing 12-month period. Stocks in the Zacks sub-industry are up 5.6% but down 4.5% in the Zacks Construction sector in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 20.9% and 9%, respectively.

The S&P 500 index is up 0.4% in the year-to-date period and 8.8% in the past year.

The stock is currently trading at 10.81X forward 12-month earnings, which compares to 11.69X for the Zacks sub-industry, 19.18X for the Zacks sector and 22.72X for the S&P 500 index.

Over the past five years, the stock has traded as high as 16.8X and as low as 2.96X, with a 5-year median of 9.88X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$33 price target reflects 11.42X 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 F12M	Current	10.81	11.69	19.18	22.72
	5-Year High	16.8	14.36	19.18	22.72
	5-Year Low	2.96	6.34	10.74	15.25
	5-Year Median	9.88	10.72	15.86	17.52
P/B TTM	Current	1.14	1.37	3.95	4.38
	5-Year High	1.73	2.29	6.74	4.56
	5-Year Low	0.41	0.66	1.71	2.83
	5-Year Median	1	1.5	3.28	3.7
P/S F12M	Current	0.65	1.04	1.97	3.55
	5-Year High	0.7	1.21	2.12	3.55
	5-Year Low	0.19	0.57	1.17	2.53
	5-Year Median	0.42	0.92	1.63	3.02

As of 07/15/2020

Industry Analysis Zacks Industry Rank: Top 5% (13 out of 251)



Top Peers

Company (Ticker)	Rec	Rank
M.D.C. Holdings, Inc. (MDC)	Outperform	1
Meritage Homes Corporation (MTH)	Outperform	1
TRI Pointe Group, Inc. (TPH)	Outperform	1
Beazer Homes USA, Inc. (BZH)	Neutral	3
Century Communities, Inc. (CCS)	Neutral	1
MI Homes, Inc. (MHO)	Neutral	3
PulteGroup, Inc. (PHM)	Neutral	3
Taylor Morrison Home Corporation (TMHC)	Neutral	1

Industry Comparison Industry: Building Products - Home Builders				Industry Peers		
	KBH	X Industry	S&P 500	MHO	MTH	TMHC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Outperform	Neutral
Zacks Rank (Short Term)	3	-	-	3	1	1
VGM Score	A	-	-	B	B	C
Market Cap	2.83 B	2.84 B	22.66 B	1.02 B	3.09 B	2.84 B
# of Analysts	6	5	14	1	8	2
Dividend Yield	1.15%	0.00%	1.83%	0.00%	0.00%	0.00%
Value Score	A	-	-	B	D	C
Cash/Price	0.21	0.20	0.07	0.02	0.27	0.18
EV/EBITDA	5.87	8.53	12.99	8.97	11.24	17.22
PEG Ratio	1.57	2.06	2.97	NA	4.89	NA
Price/Book (P/B)	1.14	1.11	3.12	0.99	1.55	0.83
Price/Cash Flow (P/CF)	9.20	9.00	12.14	6.70	11.34	6.54
P/E (F1)	12.94	12.58	22.04	10.85	12.42	12.54
Price/Sales (P/S)	0.60	0.68	2.38	0.39	0.80	0.55
Earnings Yield	7.77%	7.96%	4.32%	9.22%	8.05%	7.98%
Debt/Equity	0.00	0.45	0.76	0.79	0.76	1.10
Cash Flow (\$/share)	3.40	3.90	6.94	5.36	7.25	3.36
Growth Score	A	-	-	C	B	C
Hist. EPS Growth (3-5 yrs)	39.59%	20.52%	10.85%	28.35%	19.17%	15.98%
Proj. EPS Growth (F1/F0)	-14.68%	-14.12%	-9.64%	-28.51%	3.08%	-41.28%
Curr. Cash Flow Growth	2.99%	-2.58%	5.51%	12.15%	9.16%	8.16%
Hist. Cash Flow Growth (3-5 yrs)	24.28%	18.38%	8.55%	26.52%	12.53%	38.63%
Current Ratio	1.76	4.26	1.30	6.38	9.05	8.01
Debt/Capital	0.00%	32.16%	44.46%	44.17%	43.27%	52.48%
Net Margin	6.43%	6.93%	10.59%	5.45%	7.68%	3.32%
Return on Equity	12.65%	12.67%	15.75%	14.93%	15.47%	12.35%
Sales/Assets	0.94	0.99	0.54	1.21	1.07	0.86
Proj. Sales Growth (F1/F0)	-14.84%	-2.87%	-2.52%	-7.98%	1.52%	25.92%
Momentum Score	D	-	-	D	B	B
Daily Price Chg	3.24%	2.62%	1.91%	4.27%	3.34%	3.05%
1 Week Price Chg	3.95%	5.02%	-0.41%	4.02%	8.04%	15.16%
4 Week Price Chg	-7.60%	3.44%	1.88%	0.31%	8.95%	11.03%
12 Week Price Chg	52.04%	53.38%	16.37%	102.08%	109.93%	109.15%
52 Week Price Chg	16.64%	8.18%	-4.22%	19.66%	49.80%	2.24%
20 Day Average Volume	2,456,533	296,877	2,266,132	270,204	422,451	1,664,387
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.83%
(F1) EPS Est 4 week change	-6.83%	0.00%	0.00%	0.00%	8.10%	5.35%
(F1) EPS Est 12 week change	-11.19%	-8.93%	-5.76%	-31.04%	52.13%	-15.55%
(Q1) EPS Est Mthly Chg	-19.77%	0.00%	0.00%	0.00%	16.01%	7.64%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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	D
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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