

KB Home (KBH)

\$22.18 (As of 04/24/20)

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:C

Value: B

Growth: C

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, the company's first-quarter fiscal 2020 results were released prior to the declaration of COVID-19 as pandemic. KB Home has undertaken certain actions to regulate the business in this uncertain period. It has decided to curtail land acquisition and development until the market conditions become more stabilized. Its shares have declined significantly in the year-to-date period, which reflects the rapidly evolving market conditions due to the pandemic.

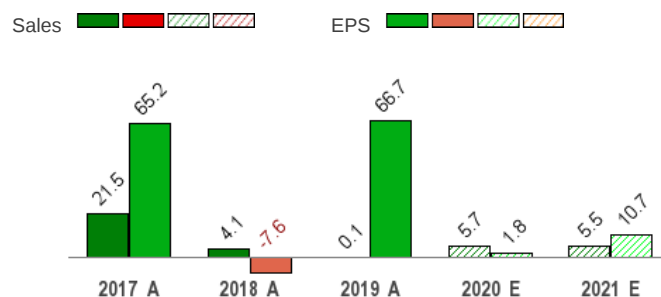
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$40.51 - \$9.82
20 Day Average Volume (sh)	3,181,056
Market Cap	\$2.0 B
YTD Price Change	-35.3%
Beta	1.61
Dividend / Div Yld	\$0.36 / 1.6%
Industry	Building Products - Home Builders
Zacks Industry Rank	Bottom 13% (220 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	46.5%
Last Sales Surprise	13.2%
EPS F1 Est- 4 week change	-14.0%
Expected Report Date	NA
Earnings ESP	-9.6%
P/E TTM	7.0
P/E F1	7.7
PEG F1	0.9
P/S TTM	0.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	867 E	1,067 E	1,146 E	1,536 E	5,079 E
2020	1,076 A	1,191 E	1,157 E	1,413 E	4,813 E
2019	811 A	1,022 A	1,161 A	1,559 A	4,553 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.29 E	\$0.55 E	\$0.66 E	\$1.15 E	\$3.21 E
2020	\$0.63 A	\$0.61 E	\$0.67 E	\$1.05 E	\$2.90 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 04/24/2020. The reports text is as of 04/27/2020.

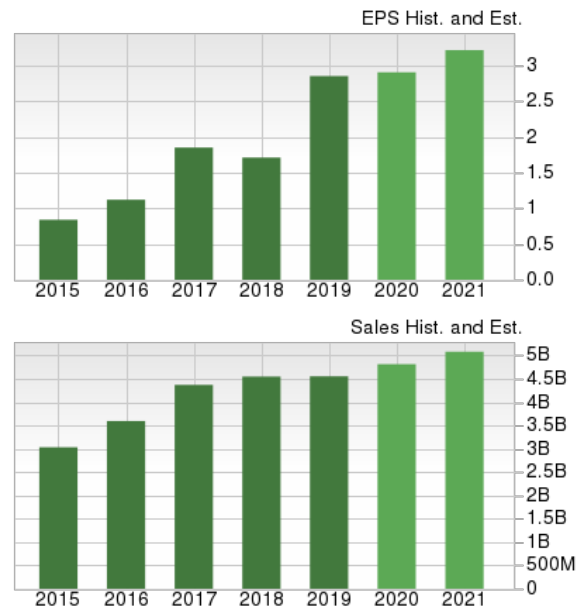
Overview

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 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 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 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), 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. 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.

As of Feb 29, 2020, lots owned or under contract totaled 63,234. Out of these, 39,033 owned lots represented approximately 3.1 years' supply, based on homes delivered in the trailing 12 months.

Reasons To Sell:

▼ **Coronavirus-Led Shutdowns Likely to Weigh on Near-Term Results:** The coronavirus pandemic has caused shutdown of production units, retail stores and infrastructure activities. KB Home also announced closure of its sales centers, model homes and design studios to the general public in mid-March. Although the company is still building homes and working remotely, shortage of building lots and fear of general economic slowdown raise concern.

The coronavirus outbreak and higher land and labor costs are likely to weigh on the bottom line.

The company has temporarily curtailed land acquisition and land development. In view of the widespread shutdowns, KB Home has decided to suspend its fiscal 2020 guidance for now. In addition, the company has been witnessing slowdown in traffic and sales, which in turn will put pressure on the upcoming results.

▼ **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. In first-quarter fiscal 2020, adjusted housing gross margin — which excludes inventory-related charges and the amortization of previously capitalized interest — declined 20 basis points year over year.

▼ **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 Beats Q1 Earnings Estimates, Posts Solid Deliveries

KB Home reported impressive results in first-quarter fiscal 2020 (ended Feb 29, 2020). Earnings and revenues topped their respective Zacks Consensus Estimate, and registered notable improvement on a year-over-year basis.

Jeffrey Mezger, the company's chairman, president and chief executive officer, said, "While our performance in the first quarter was strong, with underlying market conditions that were robust, these results preceded the COVID-19 pandemic declaration, and we are now taking actions to adjust our business in this period of uncertainty."

The company has curtailed land acquisition and development until the market conditions become more stabilized. Nonetheless, KB Home is well positioned even amid the current scenario, given strong balance sheet and liquidity of more than \$1.2 billion.

Quarter Ending **02/2020**

Report Date	Mar 26, 2020
Sales Surprise	13.21%
EPS Surprise	46.51%
Quarterly EPS	0.63
Annual EPS (TTM)	3.18

Earnings & Revenue Discussion

The company reported quarterly earnings of 63 cents per share, outpacing the consensus estimate of 43 cents by 46.5%. On a further encouraging note, the metric more than doubled from the year-ago figure of 31 cents.

Total revenues of \$1.08 billion also topped the consensus mark of \$950.6 million by 13.2% and grew by a notable 33% year over year, mainly due to higher home deliveries and average selling price (ASP). This marked the company's highest first-quarter revenues since 2007.

Segment Details

Homebuilding: In the quarter under review, the segment's revenues of \$1.07 billion advanced 32.6% from the prior-year period. Under the homebuilding umbrella, land generated \$0.6 million revenues (significantly down from \$10.6 million a year ago), while housing revenues totaled \$1,071.8 million (increasing 34.3% from the prior year).

Number of homes delivered increased 28% from the year-ago level to 2,752 units. Deliveries increased in all the four regions served (West Coast, Southwest, Central and Southeast). ASP also rose 5% from a year ago to \$389,500.

At the end of the reported quarter, average community count was up marginally from a year ago to 250. Notably, net orders per community averaged 4.6 per month in the quarter, up from 3.7 recorded in the prior-year period. Net orders grew 31% from the prior-year quarter to 3,495 homes, increasing in all regions served by the company. Value of net orders also increased a whopping 35% from the year-ago quarter to \$1.38 billion.

The company's quarter-end backlog totaled 5,821 homes (as of Feb 29, 2020), up 26% from a year ago. Potential housing revenues from backlog grew 28% from the prior-year period to \$2.12 billion. Both the metrics marked their highest first-quarter levels in the past 13 years.

Margins

Homebuilding operating margin (excluding inventory-related charges) improved 180 basis points (bps) to 5.6%. Within homebuilding, housing gross margin (excluding inventory-related charges) improved 30 bps year over year. The increase was attributed to favorable impact of improved operating leverage owing to higher housing revenues and lower amortization of previously capitalized interest, partly offset by a mix shift of homes delivered.

Adjusted housing gross margin — which excludes inventory-related charges and the amortization of previously capitalized interest — registered a decline of 20 bps year over year to 21.1%. As a percentage of housing revenues, selling, general and administrative expenses improved 160 bps from the year-ago figure.

Financial Services revenues grew 31.8% year over year to \$3.55 million.

Financial Position

KB Home had cash and cash equivalents of \$429.7 million as of Feb 29, 2020, lower than \$453.8 million on Nov 30, 2019. Inventories marginally increased to \$3.73 billion from \$3.7 billion as of Nov 30, 2019. Lots owned or under contract were 63,234, slightly down from fiscal 2019-end. Of these, 39,033 owned lots represented approximately 3.1 years' supply, based on homes delivered in the trailing 12 months. Its debt-to-capital ratio was 41.7% (which improved 60 bps from Nov 30, 2019). Net debt-to-capital ratio was 35.1% as of Feb 29, 2020.

Guidance

In view of widespread shutdowns in the wake of the coronavirus pandemic, KB Home has withdrawn its fiscal 2020 guidance for now. However, solid balance sheet and significant liquidity allow it to deliver homes and generate revenues, while working closely with its business partners and monitoring cash outflows in this evolving environment.

Valuation

KB Home shares are down 33.7% in the year-to-date period and 12.1% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Construction sector are down 29.3% and 27.4% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 18.6% and 17.1%, respectively.

The S&P 500 index is down 12% in the year-to-date period and 4.2% in the past year.

The stock is currently trading at 7.32X forward 12-month earnings, which compares to 7.65X for the Zacks sub-industry, 13.52X for the Zacks sector and 19.83X 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 9.94X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$24 price target reflects 7.69X 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	7.32	7.65	13.52	19.83
	5-Year High	16.8	14.36	17.94	19.83
	5-Year Low	2.96	6.27	10.76	15.19
	5-Year Median	9.94	10.72	15.87	17.45
P/B TTM	Current	0.82	0.92	2.21	3.76
	5-Year High	1.73	2.29	6.73	4.55
	5-Year Low	0.41	0.66	1.7	2.84
	5-Year Median	0.98	1.54	3.28	3.64
P/S F12M	Current	0.7	1	2.16	4.79
	5-Year High	0.7	1.21	2.16	4.79
	5-Year Low	0.19	0.57	1.17	2.54
	5-Year Median	0.42	0.93	1.6	3.01

As of 04/24/2020

Industry Analysis Zacks Industry Rank: Bottom 13% (220 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Taylor Morrison Home Corporation (TMHC)	Outperform	4
Century Communities, Inc. (CCS)	Neutral	5
M.D.C. Holdings, Inc. (MDC)	Neutral	3
M/I Homes, Inc. (MHO)	Neutral	3
Meritage Homes Corporation (MTH)	Neutral	4
PulteGroup, Inc. (PHM)	Neutral	3
TRI Pointe Group, Inc. (TPH)	Neutral	4
Beazer Homes USA, Inc. (BZH)	Underperform	5

Industry Comparison Industry: Building Products - Home Builders				Industry Peers		
	KBH	X Industry	S&P 500	MHO	MTH	TMHC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Outperform
Zacks Rank (Short Term)	3	-	-	3	4	4
VGM Score	C	-	-	A	A	A
Market Cap	2.01 B	1.57 B	19.57 B	558.51 M	1.60 B	1.48 B
# of Analysts	6	5	14	1	8	3
Dividend Yield	1.62%	0.00%	2.2%	0.00%	0.00%	0.00%
Value Score	B	-	-	A	A	A
Cash/Price	0.22	0.19	0.05	0.01	0.20	0.21
EV/EBITDA	4.10	6.54	11.66	6.52	6.78	8.84
PEG Ratio	0.98	0.86	2.27	NA	1.45	NA
Price/Book (P/B)	0.82	0.82	2.60	0.54	0.83	0.46
Price/Cash Flow (P/CF)	6.53	5.86	10.50	3.64	5.88	3.28
P/E (F1)	8.08	7.54	18.25	4.07	9.79	3.84
Price/Sales (P/S)	0.42	0.45	2.02	0.22	0.44	0.31
Earnings Yield	13.07%	13.25%	5.35%	24.56%	10.21%	26.04%
Debt/Equity	0.00	0.50	0.72	0.77	0.52	0.78
Cash Flow (\$/share)	3.40	3.90	7.01	5.36	7.25	3.36
Growth Score	C	-	-	A	A	A
Hist. EPS Growth (3-5 yrs)	40.92%	20.24%	10.92%	28.57%	16.66%	13.25%
Proj. EPS Growth (F1/F0)	1.87%	-1.83%	-5.06%	3.67%	-32.24%	-3.58%
Curr. Cash Flow Growth	2.99%	-3.09%	5.92%	12.15%	9.16%	8.16%
Hist. Cash Flow Growth (3-5 yrs)	24.28%	21.78%	8.55%	26.52%	12.53%	38.63%
Current Ratio	1.71	4.26	1.23	6.31	1.13	6.76
Debt/Capital	0.00%	33.26%	43.90%	43.52%	34.05%	43.79%
Net Margin	6.20%	7.04%	11.32%	5.10%	6.83%	5.35%
Return on Equity	12.86%	12.80%	16.60%	14.13%	13.52%	12.86%
Sales/Assets	0.96	0.98	0.55	1.18	1.05	0.91
Proj. Sales Growth (F1/F0)	5.71%	0.00%	-0.78%	4.38%	-12.51%	33.03%
Momentum Score	C	-	-	C	B	A
Daily Price Chg	9.37%	3.97%	1.38%	7.36%	5.45%	6.99%
1 Week Price Chg	-6.11%	-5.01%	0.42%	-10.53%	-10.31%	-9.96%
4 Week Price Chg	16.25%	-0.09%	5.63%	-2.40%	-2.47%	-7.55%
12 Week Price Chg	-41.66%	-42.80%	-20.44%	-58.20%	-41.93%	-57.83%
52 Week Price Chg	-13.22%	-24.99%	-13.44%	-29.71%	-16.27%	-41.54%
20 Day Average Volume	3,181,056	411,147	2,802,273	371,166	570,896	2,553,026
(F1) EPS Est 1 week change	0.00%	0.00%	-0.10%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-13.98%	-12.17%	-6.64%	0.00%	-36.19%	-5.90%
(F1) EPS Est 12 week change	-19.73%	-11.69%	-11.78%	-9.77%	-35.65%	-10.21%
(Q1) EPS Est Mthly Chg	-16.21%	-5.91%	-10.38%	0.00%	-46.92%	-5.56%

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	B
Growth Score	C
Momentum Score	C
VGM Score	C

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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