KB HOME
Form 10-Q
October 10, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended August 31, 2008.

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from [ ] to [ ].

Commission File No. 001-09195

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(Exact name of registrant as specified in its charter)

Delaware	95-3666267
(State of incorporation)	(IRS employer identification number)

10990 Wilshire Boulevard
Los Angeles, California 90024
(310) 231-4000
(Address and telephone number of principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of August 31, 2008.
Common stock, par value $1.00 per share: 89,623,718 shares outstanding, including 12,020,382 shares held by the Registrant s Grantor Stock Ownership Trust and excluding 25,483,921 shares held in treasury.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

KB HOME
CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Amounts Unaudited)

	Nine Months Ended August 31,		Three Months Ended August 31,	
	2008	2007	2008	2007
Total revenues	$ 2,114,899	$ 4,345,946	$ 681,610	$ 1,543,900
Homebuilding:				
Revenues	$ 2,107,517	$ 4,335,242	$ 679,115	$ 1,540,607
Construction and land costs	(2,322,213)	(4,658,065)	(653,732)	(2,002,381)
Selling, general and administrative expenses	(379,914)	(595,971)	(133,211)	(197,164)
Goodwill impairment	(24,570)	(107,926)		(107,926)
Operating loss	(619,180)	(1,026,720)	(107,828)	(766,864)
Interest income	29,240	18,882	6,686	8,614
Loss on early redemption of debt	(10,388)	(12,990)	(10,388)	(12,990)
Equity in loss of unconsolidated joint ventures	(91,564)	(62,727)	(46,203)	(21,027)
Homebuilding pretax loss	(691,892)	(1,083,555)	(157,733)	(792,267)
Financial services:				
Revenues	7,382	10,704	2,495	3,293
Expenses	(3,317)	(3,524)	(1,085)	(1,113)
Equity in income of unconsolidated joint venture	12,880	14,558	4,578	4,367
Financial services pretax income	16,945	21,738	5,988	6,547
Loss from continuing operations before income taxes	(674,947)	(1,061,817)	(151,745)	(785,720)
Income tax benefit	6,100	419,700	7,000	307,100
Loss from continuing operations	(668,847)	(642,117)	(144,745)	(478,620)
Income from discontinued operations, net of income taxes		47,252		4,904
Gain on sale of discontinued operations, net of income taxes		438,104		438,104
Net loss	$ (668,847)	$ (156,761)	$ (144,745)	$ (35,612)
Basic and diluted earnings (loss) per share:				
Continuing operations	$ (8.63)	$ (8.32)	$ (1.87)	$ (6.19)
Discontinued operations		6.29		5.73

Basic and diluted loss per share	$	(8.63)	$	(2.03)	$	(1.87)	$	(.46)
Basic and diluted average shares outstanding		77,464		77,120		77,565		77,265
Cash dividends declared per common share	$	.75	$	.75	$		$	.25

See accompanying notes.

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CONSOLIDATED BALANCE SHEETS
(In Thousands Unaudited)

	August 31, 2008	November 30, 2007
Assets		
Homebuilding:		
Cash and cash equivalents	$ 942,451	$ 1,325,255
Receivables	188,312	295,739
Inventories	2,562,682	3,312,420
Investments in unconsolidated joint ventures	250,425	297,010
Deferred income taxes	222,458	222,458
Goodwill	43,400	67,970
Other assets	109,943	140,712
	4,319,671	5,661,564
Financial services	58,274	44,392
Total assets	$ 4,377,945	$ 5,705,956
Liabilities and stockholders equity		
Homebuilding:		
Accounts payable	$ 646,185	$ 699,851
Accrued expenses and other liabilities	705,978	975,828
Mortgages and notes payable	1,877,362	2,161,794
	3,229,525	3,837,473
Financial services	14,650	17,796
Common stock	115,108	114,976
Paid-in capital	862,556	851,628
Retained earnings	1,239,473	1,968,881
Accumulated other comprehensive loss	(22,923)	(22,923)
Grantor stock ownership trust, at cost	(130,620)	(132,608)
Treasury stock, at cost	(929,824)	(929,267)
Total stockholders equity	1,133,770	1,850,687
Total liabilities and stockholders equity	$ 4,377,945	$ 5,705,956

See accompanying notes.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands Unaudited)

	Nine Months Ended August 31, 2008	Nine Months Ended August 31, 2007
Cash flows from operating activities:		
Net loss	$ (668,847)	$ (156,761)
Income from discontinued operations, net of income taxes		(47,252)
Gain on sale of discontinued operations, net of income taxes		(438,104)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Equity in loss of unconsolidated joint ventures	78,684	48,169
Distributions of earnings from unconsolidated joint ventures	9,125	27,215
Amortization of discounts and issuance costs	2,942	1,898
Depreciation and amortization	7,542	13,361
Loss on early redemption of debt	10,388	12,990
Provision for deferred income taxes		(237,870)
Tax benefit associated with exercise of stock options	2,097	(714)
Stock-based compensation expense	3,830	6,103
Inventory impairments and land option contract abandonments	401,073	948,534
Goodwill impairment	24,570	107,926
Changes in assets and liabilities:		
Receivables	109,032	(3,207)
Inventories	230,307	205,221
Accounts payable, accrued expenses and other liabilities	(196,540)	(498,970)
Other, net	16,040	33,380
Net cash provided by operating activities continuing operations	30,243	21,919
Net cash provided by operating activities discontinued operations		297,397
Net cash provided by operating activities	30,243	319,316
Cash flows from investing activities:		
Sale of discontinued operations, net of cash divested		739,764
Investments in unconsolidated joint ventures	(61,464)	(56,969)
Sales (purchases) of property and equipment, net	6,124	(2,582)
Net cash provided (used) by investing activities continuing operations	(55,340)	680,213
Net cash used by investing activities discontinued operations		(12,112)
Net cash provided (used) by investing activities	(55,340)	668,101
Cash flows from financing activities:		
Redemption of term loan		(400,000)
Redemption of senior subordinated notes	(305,814)	(258,968)
Payments on mortgages, land contracts and other loans	(3,066)	(114,119)
Issuance of common stock under employee stock plans	5,111	10,823
Excess tax benefit associated with exercise of stock options		714
Payments of cash dividends	(58,102)	(57,844)

Repurchases of common stock	(557)	(4,909)
Net cash used by financing activities continuing operations	(362,428)	(824,303)
Net cash used by financing activities discontinued operations		(306,527)
Net cash used by financing activities	(362,428)	(1,130,830)
Net decrease in cash and cash equivalents	(387,525)	(143,413)
Cash and cash equivalents at beginning of period	1,343,742	804,182
Cash and cash equivalents at end of period	$ 956,217	$ 660,769

See accompanying notes.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted.

In the opinion of KB Home (the Company), the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the Company s consolidated financial position as of August 31, 2008, the results of its consolidated operations for the nine months and three months ended August 31, 2008 and 2007, and its consolidated cash flows for the nine months ended August 31, 2008 and 2007. The consolidated balance sheet at November 30, 2007 has been taken from the audited consolidated financial statements as of that date. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended November 30, 2007, which are contained in the Company s Annual Report on Form 10-K for that period.

Seasonality

Historically, the homebuilding industry has experienced seasonal fluctuations in quarterly operating results. The Company has also experienced such seasonal fluctuations. Therefore, the results of the Company s consolidated operations for the nine months and three months ended August 31, 2008 are not necessarily indicative of the results to be expected for the year ending November 30, 2008.

Earnings (loss) per share

Basic earnings (loss) per share is calculated by dividing net income (loss) by the average number of common shares outstanding for the period. Diluted earnings (loss) per share is calculated by dividing net income (loss) by the average number of common shares outstanding including all potentially dilutive shares issuable under outstanding stock options. All outstanding stock options were excluded from the diluted loss per share calculation for the nine months and three months ended August 31, 2008 and 2007 because the effect of their inclusion would be antidilutive, or would decrease the reported loss per share.

Comprehensive loss

The Company s comprehensive loss was $144.7 million and $35.6 million for the three months ended August 31, 2008 and 2007, respectively, and $668.8 million and $156.8 million for the nine months ended August 31, 2008 and 2007, respectively.

Accumulated other comprehensive loss

The balances of accumulated other comprehensive loss reported in the consolidated balance sheets as of August 31, 2008 and November 30, 2007 are comprised solely of an adjustment of $22.9 million recorded directly to accumulated other comprehensive loss at the end of 2007 to initially apply Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R), which requires an employer to recognize the funded status of a defined postretirement benefit plan as an asset or liability on the balance sheet and requires any unrecognized prior service costs and actuarial gains/losses to be recognized in accumulated other comprehensive income (loss).

Reclassifications

Certain amounts in the consolidated financial statements of prior periods have been reclassified to conform to the 2008 presentation.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

2. Stock-Based Compensation

The Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment (SFAS No. 123(R)), using the modified prospective transition method effective December 1, 2005. SFAS No. 123(R) requires a public entity to measure compensation cost associated with awards of equity instruments based on the grant-date fair value of the awards over the requisite service period. SFAS No. 123(R) requires public entities to initially measure compensation cost associated with awards of liability instruments based on their current fair value. The fair value of that award is to be remeasured subsequently at each reporting date through the settlement date. Changes in fair value during the requisite service period will be recognized as compensation cost over that period.

Stock Options

In accordance with SFAS No. 123(R), the Company estimates the grant-date fair value of its stock options using the Black-Scholes option-pricing model, which takes into account assumptions regarding the dividend yield, the risk-free interest rate, the expected stock-price volatility and the expected term of the stock options. The following table summarizes the stock options outstanding as of August 31, 2008 as well as activity during the nine months then ended:

	Options	Weighted Average Exercise Price
Options outstanding at beginning of period	8,173,464	$ 30.17
Exercised	(131,354)	18.88
Cancelled	(138,861)	43.54
Options outstanding at end of period	7,903,249	$ 30.13
Options exercisable at end of period	7,194,279	$ 29.14

As of August 31, 2008, the weighted average remaining contractual lives of stock options outstanding and stock options exercisable were 9.3 years and 9.4 years, respectively. There was $3.1 million of total unrecognized compensation cost related to unvested stock option awards as of August 31, 2008. For the three months ended August 31, 2008 and 2007, stock-based compensation expense associated with stock options totaled $1.2 million and $2.6 million, respectively. For the nine months ended August 31, 2008 and 2007, stock-based compensation expense totaled $3.8 million and $6.1 million, respectively. The aggregate intrinsic value of both stock options outstanding and stock options exercisable was $9.5 million as of August 31, 2008. (The intrinsic value of a stock option is the amount by which the market value of a share of the Company s common stock exceeds the exercise price of the stock option.) The aggregate intrinsic value of stock options exercised during the nine months ended August 31, 2008 was $.9 million.

Other Stock-Based Awards

From time to time, the Company grants restricted stock, phantom shares and stock appreciation rights to various employees. The Company recognized total compensation expense of $3.0 million in the three months ended August 31, 2008 and $1.5 million in the three months ended August 31, 2007 related to these stock-based awards.

The Company recognized total compensation expense of $9.6 million in the nine months ended August 31, 2008 and $3.8 million in the nine months ended August 31, 2007 related to restricted stock, phantom shares and stock appreciation rights.

3. Segment Information

As of August 31, 2008, the Company has identified five reporting segments, comprised of four homebuilding reporting segments and one financial services reporting segment, within its consolidated operations in

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

3. Segment Information (continued)

accordance with Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information. As of August 31, 2008, the Company s homebuilding reporting segments conducted ongoing operations in the following states:

West Coast: California
Southwest: Arizona and Nevada
Central: Colorado and Texas
Southeast: Florida, Georgia, North Carolina and South Carolina

The Company s homebuilding reporting segments are engaged in the acquisition and development of land primarily for residential purposes and offer a wide variety of homes that are designed to appeal to first-time, first move-up and active adult buyers.

The Company s homebuilding reporting segments were identified based primarily on similarities in economic and geographic characteristics, as well as similar product type, regulatory environments, methods used to sell and construct homes and land acquisition characteristics. The Company evaluates segment performance primarily based on pretax income.

The Company s financial services reporting segment provides title and insurance services to the Company s homebuyers and provided escrow coordination services until the second quarter of 2007, when the Company terminated the escrow coordination business. The segment also provides mortgage banking services to the Company s homebuyers indirectly through Countrywide KB Home Loans, LLC (Countrywide KB Home Loans), a joint venture between a Company subsidiary and CWB Venture Management Corporation, a subsidiary of Countrywide Financial Corporation. On July 1, 2008, Bank of America Corporation completed its purchase of Countrywide Financial Corporation. On October 1, 2008, Bank of America, N.A. purchased 100% of the stock of CWB Venture Management Corporation. Accordingly, as of October 1, 2008, Countrywide KB Home Loans and CWB Venture Management Corporation are operating subsidiaries of Bank of America, N.A. At this time, the Company does not believe that these transactions will have a material effect on the joint venture s activities. The Company s financial services reporting segment conducts operations in the same markets as the Company s homebuilding reporting segments.

The Company s reporting segments follow the same accounting policies used for the Company s consolidated financial statements. Operational results of each segment are not necessarily indicative of the results that would have occurred had the segment operated as an independent, stand-alone entity during the periods presented and are not necessarily indicative of the results to be expected for the full year.

The following tables present financial information relating to the Company s reporting segments (in thousands):

	Nine Months Ended August 31,		Three Months Ended August 31,	
	2008	2007	2008	2007
Revenues:				
West Coast	$ 700,301	$ 1,475,662	$ 259,362	$ 553,366
Southwest	459,672	963,930	95,471	292,232
Central	442,650	703,456	142,175	254,116

Southeast	504,894	1,192,194	182,107	440,893
Total homebuilding revenues	2,107,517	4,335,242	679,115	1,540,607
Financial services	7,382	10,704	2,495	3,293
Total revenues	$ 2,114,899	$ 4,345,946	$ 681,610	$ 1,543,900

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

3. Segment Information (continued)

	Nine Months Ended August 31, 2008	Nine Months Ended August 31, 2007	Three Months Ended August 31, 2008	Three Months Ended August 31, 2007
Income (loss) from continuing operations before income taxes:				
West Coast	$ (191,455)	$ (532,802)	$ (18,020)	$ (351,086)
Southwest	(186,634)	(150,356)	(68,553)	(179,930)
Central	(48,850)	(50,281)	(7,070)	(16,876)
Southeast	(185,783)	(144,945)	(40,891)	(106,088)
Corporate and other (a)	(79,170)	(205,171)	(23,199)	(138,287)
Total homebuilding loss from continuing operations before income taxes	(691,892)	(1,083,555)	(157,733)	(792,267)
Financial services	16,945	21,738	5,988	6,547
Total loss from continuing operations before income taxes	$ (674,947)	$ (1,061,817)	$ (151,745)	$ (785,720)
Interest cost:				
West Coast	$ 30,557	$ 33,220	$ 14,241	$ 19,173
Southwest	22,856	30,842	7,916	13,577
Central	17,717	15,916	8,292	4,809
Southeast	24,863	26,704	11,268	16,977
Corporate and other	653	6,266	31	4,814
Total (b)	$ 96,646	$ 112,948	$ 41,748	$ 59,350
Equity in income (loss) of unconsolidated joint ventures:				
West Coast	$ (17,346)	$ (10,527)	$ (6,540)	$ (2,767)
Southwest	(24,330)	1,942	(18,314)	(3,327)
Central	(4,519)	(2,417)	75	(677)
Southeast	(45,369)	(51,725)	(21,424)	(14,256)
Total	$ (91,564)	$ (62,727)	$ (46,203)	$ (21,027)

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