NEW RISK ALERT: (DHI)

D.R. Horton Shifts Strategy, Inflates Operating Cash Flows

New strategy prompts homebuilder to reclassify rental property sales as operating rather than investing activities.

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This alert compares the language used in the company's latest filing with the period before. Research suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

D.R. Horton Shifts Strategy, Cash Flows, and Inventory Treatment

Expect significant changes in D.R. Horton's operating cash flows following a change in strategy that has the homebuilder moving deeper into the rental segment. In its latest 10-Q, D.R. Horton included new language revealing a "change in strategic focus" that includes:

> *"...increased levels of activity in the current quarter and plans for future investment in the Company's single and multi-family rental operations."*

The increased focus on the rental space allows the company to reclassify bulk sales of rental properties as revenue and cost of sales. On the balance sheet, rental assets previously recorded as property and equipment have been reclassified as inventory. Prior to the change, bulk sales of rental properties were presented on a net basis as a gain on sale of assets.

Previously, the majority of cash flows from bulk sales of rental properties were included as investing activities. The change allows D.R. Horton to present these cash flows in a manner investors may find more appealing:

> *"...related cash flows for the single and multi-family rental operations are now included in operating activities."*

Bulk sales of rental properties will now be included in D.R. Horton's homebuilding segment. In the company's fiscal third quarter, D.R. Horton sold a single-family rental community for $23.1 million and collected $2.9 million in rental income.

One other notable change investors should consider is the different treatments D.R. Horton applies to its rental properties. The company includes the $303.1 million in single-family rental community inventory in its homebuilding segment. But D.R. Horton includes the $436.3 million in multi-family rental property inventory in its “Other” segment.

The shift in strategy allows D.R. Horton to present more of its cash flows as operating, which should appeal to investors. Splitting single and multi-family inventories also provides the company flexibility to highlight strength in a particular segment— single-family in “Homebuilding” and multi-family in “Other”— during times when one is weaker than the other.