

NEW RISK ALERT: (KBH)

KB Home Warns Acquisition of Key Mortgage Lender Could Hurt Sales or Delay Closings

New language in latest 10-K warns relationship with formerly bankrupt mortgage provider uncertain.

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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.

KB Home Warns It May Not Be Treated As Well by Mortgage Partner Now Under New Management

Unlike home builders with a wholly-owned mortgage lender, KB Home relies on third-party lenders to provide mortgage loans to home buyers. KBHS Home Loans is the company's finance portal but doesn't actually originate mortgage loans. Instead, it relies on Stearns Lending, a mortgage originator that recently went bankrupt.

In its 2019 10-K, KB Home disclosed:

"While KBHS was not materially affected by Stearns' parent company's successfully completed bankruptcy process in 2019, if KBHS performs poorly and our customers use another lender, the income from and value of our KBHS equity interest would decline."

Two weeks prior to filing its most recent 10-K, Stearns was acquired by Guaranteed Rate, Inc.. The acquisition announcement, according to KBH, indicates Guaranteed plans to use Stearns to scale its joint venture platform. Still, KB Home included this warning:

"...we can offer no assurance that KBHS' operations will continue in their current form, or at all, after Guaranteed Rate closes its acquisition of Stearns. Even if KBHS' operations are maintained, its performance may be negatively affected by acquisition or post-acquisition integration activities and/or related management or other personnel changes..."

KB Home is likely referring to Stearns employees close to Louie Colatriano when it warns of personnel changes. Colatriano was EVP of Finance at Stearns prior to launching and becoming

President of KBHS Home Loans. If the business relationship is disrupted, KBH warns of potentially severe consequences:

“...significantly delay home closings, disrupting our production schedules and delivery forecasts, or cause home purchase contract cancellations.”

KB Home More Reliant on KBHS Than It Leads Investors to Believe

In the 2020 10-K, KBH says home building operations accounted for 99.6% of the company's revenue. The other 0.37%—our calculation—of revenue is derived from Financial services, which includes insurance and title products as well as mortgage loans from unconsolidated joint venture (JV) KBHS.

The impact on operations is much greater.

Though less than 0.4% of revenue, Financial services account for a much greater portion of KB Home's operating income; 3.47% in 2020 and 3.14% in 2019. If acquisition synergies are realized—meaning Stearns employees that Colatriano was close to are let go—several hundred basis points of KB Home's operating income may be in jeopardy.