

Final Project
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Intro:

In this paper we will be looking at the *construction industry* and its main three players Granite, KB Home, and Horizon Offshore. One might hypothesize that the heavy construction industry is stable due to the constant demand and thus there can be no risky investments in this area. We will look at this and other possibilities that might change our investment choices but first let us look at the industry as a whole and evaluate its future potential.

Future still looks bright for construction industry:

To start out on a positive note, according to F.W. Dodge-Division of McGraw-hill it is estimated that the construction industry is expanding for the tenth straight year. Another groups, CIT Group Inc, announced that its annual construction industry forecast results show greatest optimism in five years. Both West, East and South Central regions had posted the greatest optimism. The great optimism might be due to equipment and rental markets being overly hopeful which is a big bonus for the construction industry.

Now let us point out some areas of concern for the future of the industry. This years' increase in optimism might be significant, but it is much less than the last years' climb. Furthermore this year is the third year in the row the growth rate has slowed. As stated previously, the equipment and rental markets show positive performance that benefits the construction industry, however the rising insurance and financing costs are adding big chunks to the overall industry concern. Furthermore, Dodge expects the growth rate to slow down in single-family housing and electric utility construction. The growth rate of federal highway spending, institution building sector, private income properties and industrial construction is expected to increase according to Dodge.

Now that we have looked at the current condition of the construction industry, let us examine our three main companies in detail.

The three big players:

Granite Construction Inc specializes in heavy civil construction with private and public sectors. Within its public sector it focuses on building structures such as dams, bridges, roads, highways and airport infrastructures. Within its private sector its focus lies in site preparation and infrastructure services as well as residential commercial and industrial development as well as plants and other facilities. The company owns some of its material plants and leases and owns some of its aggregate reserves. Granite consists of the branch division and heavy construction division specializing in local and national projects respectively. It is important to note that its branch division is performing much better than its heavy construction division.

KB Home is a homebuilder in the United States. It offers a variety of homes which can appeal to a range of buyers. The company is widely spread across the U.S. operating in 14 states serving 39 markets. It also has a subsidiary homebuilder in France Kaufman & Broad S.A. The company had built 37,140 homes in 541 communities in the fiscal year of 2005 ending November 30th. KB Home also operates in two business segments: financial and construction. Its construction segment focuses on home building whereas the financial segment focuses on handling mortgages which KB Home finances through Countrywide KB Home loans which is a joint venture with Countrywide Financial Corporation.

Horizon Offshore Inc offers services in marine construction for the offshore gas, oil and other energy related industries in the United States Gulf of Mexico, Latin America, Southeast Asia and West Africa. It provides services in repairing marine pipelines, laying burying, installing production platforms and other structures. It owns nine operational vessels acquiring another one in February 2006 (Texas Horizon) which is a diving support and deepwater reel pipe-lay vessel.

The finances:

Granite has strong returns on assets over the 5 years as well as impressive profit margin. Its current ratio as well as the quick ratio is well within the industry norm which signifies it handles its assets correctly. The assets as well as the inventory turnover is also impressive compared to the industry average as well as a notable receivables turnover of only 4.8 days compared with the industry average of 10.9 days. The company pays dividends, the construction industry is in good shape, thus there are no obvious red flags with this company.

KB Home is a another strong player in the residential construction market with sales, net income, profit margin, return on assets as well as inventory turnover having impressive values compared to the industry. It also pays impressive dividends (0.25). The company's recent disturbing news, however, shows red flags. The company's CEO Bruce Karatz was accused of backdating of employee stock options without properly accounting for the maneuver, this exaggerated corporate profits and improperly lowered taxes. Karatz will voluntary resign as a CEO. Full news article is attached in an appendix for reference.

Horizon offshore, upon initial examination might appear like a profitable company (Net income is much higher than the industry average) but upon closer look a negative return on equity as well as on assets and capital over the last 5 years makes it clear that this company is in trouble. The company's price to cash flow has fallen way below the industry average, and it is indeed the cash-flow that actually pays all of the company's bills, which can only mean one thing, Horizon is not making money and must sell off its assets in order in order to acquire money (which is perhaps why the current and the quick ratios are much higher that the industry average).

The Recommendation:

Granite has well balanced ratios as described previously, plus according to Reuters Estimates its earnings in fiscal 2006 are expected to exceed the total earnings results in fiscal 2005. This company is the strongest out of the three.

KB Home does have troubling current news that makes it a riskier investment. Its past, however, shows only the bright side with ratios above the industry average and statistics like 37,000 homes in U.S. and France built last year. Only the current news makes this company be listed as second strongest out of the three.

Horizon Offshore has estimated revenues in line with those of analysts, but its troubled cash-flow and poor current and quick ratios as well as the fact that it actually owns all of its boats that it uses for its work make it the worst company out of the three on our list.

Appendix:**Key Ratios**

	<i>Granite</i>	<i>Horizon Off.</i>	Industry (Heavy Constr)
Growth Rates %			
Sales (Qtr vs year ago qtr)	9	54.9	25.7
Net Income (YTD vs YTD)	63.9	NA	128.3
Net Income (Qtr vs year ago qtr)	12.5	577.5	86.3
Sales (5-Year Annual Avg.)	14.39	15.15	9.61
Net Income (5-Year Annual Avg.)	8.3	NA	-1.57
Price Ratios			
Current P/E Ratio	18.7	NA	112.7
P/E Ratio 5-Year High	30.4	NA	68.9
P/E Ratio 5-Year Low	11.4	NA	9.9
Price/Sales Ratio	0.73	0.91	2.24
Price/Book Value	3.11	1.8	20.58
Price/Cash Flow Ratio	11.7	10	52.5
Profit Margins %			
Gross Margin	11.8	25.4	10.5
Pre-Tax Margin	5.9	8.4	3.9
Net Profit Margin	3.9	4	2.6
5Yr Gross Margin (5-Year Avg.)	11.8	11.1	11.6
5Yr PreTax Margin (5-Year Avg.)	5	-14.4	1.8
5Yr Net Profit Margin (5-Year Avg.)	3.4	-14.4	0.5
Financial Condition			
Debt/Equity Ratio	0.17	0.42	1.34
Current Ratio	1.4	2.7	1.1
Quick Ratio	1.3	2.7	0.8
Interest Coverage	NA	2.2	3.7
Leverage Ratio	2.5	1.8	12.5
Book Value/Share	16.48	8.67	8.49
Investment Returns %			
Return On Equity	17.8	10.6	8.1
Return On Assets	7	5.1	3
Return On Capital	13.7	6.9	5.7
Return On Equity (5-Year Avg.)	12.4	-26.1	5.7
Return On Assets (5-Year Avg.)	6.2	-10.4	0.7
Return On Capital (5-Year Avg.)	9.9	-14.3	1.6
Income/Employee	22,131	28,567	8,995
Revenue/Employee	563,313	711,547	349,941
Receivable Turnover	4.8	6.4	10.9
Inventory Turnover	33.3	NA	8.4
Asset Turnover	1.8	1.3	1.2

KB Home Industry (Residential Construction)

Growth Rates %

Sales (Qtr vs year ago qtr)	21.7	8.1
Net Income (YTD vs YTD)	25.2	16.6
Net Income (Qtr vs year ago qtr)	13.8	-2.4
Sales (5-Year Annual Avg.)	19.16	18.81
Net Income (5-Year Annual Avg.)	32.03	31.25
	37.97	21.55

Price Ratios

Current P/E Ratio	4.8	9.1
P/E Ratio 5-Year High	22.1	22.7
P/E Ratio 5-Year Low	4.1	4.2
Price/Sales Ratio	0.44	0.69
Price/Book Value	1.52	1.57
Price/Cash Flow Ratio	4.9	5.9

Profit Margins %

Gross Margin	26.7	21.3
Pre-Tax Margin	13.6	13.5
Net Profit Margin	8.8	8.9
5Yr Gross Margin (5-Year Avg.)	23.7	28.7
5Yr PreTax Margin (5-Year Avg.)	10.5	12.1
5Yr Net Profit Margin (5-Year Avg.)	7	7.9

Financial Condition

Debt/Equity Ratio	1.2	1
Current Ratio	NA	0.4
Quick Ratio	NA	0.3
Interest Coverage	508.8	73.2
Leverage Ratio	3.1	2.6
Book Value/Share	32.79	32.55

Investment Returns %

Return On Equity	34.3	22.7
Return On Assets	11.7	9.2
Return On Capital	16.2	12.9
Return On Equity (5-Year Avg.)	28.6	22.7
Return On Assets (5-Year Avg.)	9.6	8.7
Return On Capital (5-Year Avg.)	13.4	11.9

Income/Employee	137,194	85,559
Revenue/Employee	2 Mil	879,740
Receivable Turnover	20.2	32.4
Inventory Turnover	1.2	3
Asset Turnover	1.3	1

Trends Over 10 Years

Granite

Date	Avg P/E	Price/ Sales	Price/ Book	Net Profit Margin (%)		
5-Dec	15	0.56	2.41	3.1		
4-Dec	16.2	0.51	2.01	2.7		
3-Dec	12.5	0.52	1.93	3.3		
2-Dec	16.8	0.36	1.41	2.8		
Dec-06	19.6	0.63	2.36	3.3		
Dec-00	12.1	0.58	2.09	4.1		
Dec-99	12.7	0.37	1.52	4		
Dec-98	13.7	0.75	3.08	3.8		
Dec-97	13.6	0.4	1.63	2.7		
Dec-96	13.3	0.36	1.47	2.9		
	Book Value/ Share	Debt/ Equity	ROE	ROA	Int. Covrg	
	\$14.91	0.24	13.4	5.6	19.5	
	\$13.23	0.3	10.4	4.5	11.6	
	\$12.16	0.27	12	5.7	9.2	
	\$11.03	0.31	10.8	5	8.8	
	\$10.19	0.33	12.1	5.4	8.3	
	\$9.24	0.17	14.8	7.8	9.8	
	\$8.09	0.22	16.1	7.8	10.1	
	\$7.26	0.27	15.4	7.4	7.4	
	\$6.26	0.28	10.8	5	5.4	
	\$5.73	0.23	11.7	5.8	9.7	

KB Home

Date	Avg P/E	Price/ Sales	Price/ Book	Net Profit Margin (%)
5-Dec	9.1	0.65	2	8.9
4-Dec	12.7	0.53	1.68	6.8
3-Dec	12.4	0.5	1.69	6.3
2-Dec	12.7	0.39	1.41	6.2
Dec-06	11	0.29	1.3	4.7
Dec-00	8.5	0.32	1.64	5.3
Dec-99	15.4	0.28	1.45	3.8
Dec-98	22.9	0.42	2.12	3.9
Dec-97	23	0.46	2.21	3.1
Dec-96	-16.7	0.26	1.47	-3.4

Book Value/ Share	Debt/ Equity	ROE	ROA	Int. Covrg
\$34.83	0.86	29.5	10.9	56.8
\$26.15	NA	23.4	8.2	34.8
\$20.41	0.87	23.3	8.8	20
\$15.90	1.31	24.7	7.8	11.8
\$12.93	1.54	19.6	5.8	6.8
\$9.58	2.1	32.1	7.4	6.5
\$7.63	1.76	21.8	5.5	6.9
\$5.93	1.62	20.1	5.1	4.8
\$4.91	1.82	15.2	4.1	3
\$4.38	1.7	-18	-4.9	-0.9

Horizon Offshore

Date	Avg P/E	Price/ Sales	Price/ Book	Net Profit Margin (%)
5-Dec		NA	NA	-21.9
4-Dec		NA	NA	-25
3-Dec		NA	NA	-26.8
2-Dec		NA	NA	-2
Dec-06		NA	NA	3.9
Dec-00		NA	NA	3.1
Dec-99		NA	NA	1.9
Dec-98		NA	NA	10.4
Dec-97		NA	NA	6.3
Dec-96		NA	NA	-68

Book Value/ Share	Debt/ Equity	ROE	ROA	Int. Covrg
\$6.04	0.71	-38.7	-17.6	NA
\$72.45	2.28	-68.2	-16.1	-1.4
\$131.99	1.23	-51.9	-17.7	-7.4
\$200.61	0.46	-2.6	-1.3	-0.3
\$199.49	0.64	5.8	2.7	3.8
\$137.86	0.87	4.8	2.1	1.9
\$129.12	0.82	1.7	0.8	1.4
\$126.48	0.74	13.2	6.4	6.6
\$35.62	1.99	11.3	3.1	1.9
(\$11.63)	-5.97	146.3	-24.1	-5.8

KB Home CEO Karatz leaving after errors found in stock option accounting

Mon Nov 13, 6:41 PM

By Jeremiah Marquez

LOS ANGELES (AP) - One of the highest-paid executives in the United States has left his job after becoming ensnared in a stock options scandal that already has forced dozens of companies across the country to wipe out billions in combined profits.

Bruce Karatz, chairman and CEO of KB Homes ([KBH](#)), agreed to retire Sunday and repay the Los Angeles-based company US\$13 million after an internal report concluded the home construction company incorrectly reported stock option grants.

Jeffrey Mezger, KB's executive vice-president and chief operating officer since 1999, will succeed Karatz, the company announced.

The company also announced the firing of Gary Ray, head of human resources, and the resignation of Richard Hirst, executive vice-president and chief legal officer.

The board concluded Karatz and Ray "selected grant dates under the company's stock option plans," the company said. Additionally, the review found that other senior executives "had no role in establishing incorrect grant dates."

KB Home shares rose 96 cents, or 2.19 per cent, to close at \$44.78 on the New York Stock Exchange.

Karatz, 61, is the latest corner-office victim of so-called backdating of employee stock options without properly accounting for the manoeuvre. So far, at least 30 executives and directors, including William McGuire of UnitedHealth Group Inc., have lost their jobs. McGuire resigned as chairman last month and UnitedHealth said he will step down as CEO by Dec. 1. More than 160 companies U.S.-wide have disclosed their stock option practices are under internal review or being investigated by the government.

Backdating isn't necessarily illegal as long as backdated stock options are properly recorded on the company books. If the accounting for the rewards is bungled, it can exaggerate corporate profits and improperly lower taxes.

The company's review didn't reach any conclusion about whether there was intentional wrongdoing on Karatz's part.

The KB review found the company used incorrect measurement dates for financial reporting purposes for yearly stock option grants from 1998 to 2005, the company said in a statement. As a result of the errors, KB expects a non-cash compensation expense of no more than \$50 million. It said the errors may also require an increased tax provision.

KB was still determining whether to restate previously filed financial statements. It said it was cooperating with a Securities and Exchange Commission inquiry.

Karatz was one of the highest-paid executives in 2005, making \$155.9 million, mostly from exercising options, according to the Wall Street Journal. He had served as KB's CEO since 1986.

"I am extremely proud of everything that the entire KB team and I have accomplished over the past 20-plus years," Karatz said in a statement.

KB Homes, one of the largest home construction companies and land developers in the country, said in September that revenue increased six per cent during its fiscal third quarter but noted that net home orders fell 43 per cent during the period, in part due to cancellations.

Last year, KB built more than 37,000 homes in the U.S. and France and posted nearly \$10 billion in sales. It has 6,700 employees.