

Forestar Group Inc.
Form 10-Q
August 05, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
^x 1934

For the quarterly period ended June 30, 2016

or

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

For the transition period from _____ to _____

Commission File Number: 001-33662

FORESTAR GROUP INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware 26-1336998
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)
6300 Bee Cave Road, Building Two, Suite 500, Austin, Texas 78746
(Address of Principal Executive Offices, Including Zip Code)
(512) 433-5200
(Registrant's Telephone Number, Including Area Code)

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 ☐ No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☒ Yes ☐ No

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 ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ☐ Yes ☒ No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Title of Each Class	Number of Shares Outstanding as of August 3, 2016
Common Stock, par value \$1.00 per share	33,624,026

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

FORESTAR GROUP INC.

Consolidated Balance Sheets

(Unaudited)

	Second Quarter-End 2016	Year-End 2015
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents	\$ 107,421	\$ 96,442
Real estate, net	419,060	586,715
Assets of discontinued operations	1,845	104,967
Investment in unconsolidated ventures	79,730	82,453
Timber	7,183	7,683
Receivables, net	3,473	19,025
Income taxes receivable	3,228	12,056
Prepaid expenses	2,070	3,116
Property and equipment, net	10,003	10,732
Goodwill and other intangible assets	43,455	43,455
Other assets	4,365	5,602
TOTAL ASSETS	\$ 681,833	\$ 972,246
LIABILITIES AND EQUITY		
Accounts payable	\$ 7,208	\$ 11,617
Accrued employee compensation and benefits	2,918	5,547
Accrued property taxes	3,406	4,529
Accrued interest	1,585	3,267
Deferred tax liability, net	992	1,037
Earnest money deposits	8,266	10,214
Other accrued expenses	10,980	14,556
Liabilities of discontinued operations	3,116	11,192
Other liabilities	22,147	24,657
Debt, net	114,185	381,515
TOTAL LIABILITIES	174,803	468,131
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Forestar Group Inc. shareholders' equity:		
Common stock, par value \$1.00 per share, 200,000,000 authorized shares, 36,946,603 issued at second quarter-end 2016 and year-end 2015	36,947	36,947
Additional paid-in capital	560,641	561,850
Accumulated deficit	(40,808)	(46,046)
Treasury stock, at cost, 3,322,577 shares at second quarter-end 2016 and 3,203,768 shares at year-end 2015	(51,877)	(51,151)
Total Forestar Group Inc. shareholders' equity	504,903	501,600
Noncontrolling interests	2,127	2,515
TOTAL EQUITY	507,030	504,115
TOTAL LIABILITIES AND EQUITY	\$ 681,833	\$ 972,246

Please read the notes to consolidated financial statements.

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FORESTAR GROUP INC.

Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)

(Unaudited)

	Second Quarter		First Six Months	
	2016	2015	2016	2015
	(In thousands, except per share amounts)			
REVENUES				
Real estate sales and other	\$43,018	\$28,300	\$69,426	\$50,261
Commercial and income producing properties	3,363	11,109	13,053	21,978
Real estate	46,381	39,409	82,479	72,239
Mineral resources	1,337	2,360	2,419	5,114
Other	274	1,856	712	3,646
	47,992	43,625	85,610	80,999
COSTS AND EXPENSES				
Cost of real estate sales and other	(66,877)	(13,890)	(80,139)	(24,252)
Cost of commercial and income producing properties	(5,789)	(7,548)	(10,951)	(15,240)
Cost of mineral resources	(160)	(267)	(390)	(655)
Cost of other	(119)	(860)	(504)	(1,780)
Other operating expenses	(8,317)	(11,400)	(20,408)	(24,694)
General and administrative	(4,852)	(4,901)	(11,331)	(13,043)
	(86,114)	(38,866)	(123,723)	(79,664)
GAIN ON SALE OF ASSETS	107,650	1,160	121,231	1,160
OPERATING INCOME	69,528	5,919	83,118	2,495
Equity in earnings of unconsolidated ventures	188	5,584	235	8,629
Interest expense	(6,918)	(8,715)	(14,557)	(17,536)
Loss on extinguishment of debt, net	(35,766)	—	(35,864)	—
Other non-operating income	199	783	371	1,700
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE TAXES	27,231	3,571	33,303	(4,712)
Income tax benefit (expense)	(14,929)	(897)	(17,081)	1,869
NET INCOME (LOSS) FROM CONTINUING OPERATIONS	12,302	2,674	16,222	(2,843)
LOSS FROM DISCONTINUED OPERATIONS, NET OF TAXES	(2,048)	(36,992)	(10,264)	(39,712)
CONSOLIDATED NET INCOME (LOSS)	10,254	(34,318)	5,958	(42,555)
Less: Net income attributable to noncontrolling interests	(640)	(189)	(720)	(110)
NET INCOME (LOSS) ATTRIBUTABLE TO FORESTAR GROUP INC.	\$9,614	\$(34,507)	\$5,238	\$(42,665)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING				
Basic	34,302	34,278	34,302	34,223
Diluted	42,423	42,328	42,372	34,223
NET INCOME (LOSS) PER BASIC SHARE				
Continuing operations	\$0.28	\$0.07	\$0.37	\$(0.09)
Discontinued operations	(0.05)	(1.08)	(0.24)	(1.16)
NET INCOME (LOSS) PER BASIC SHARE	\$0.23	\$(1.01)	\$0.13	\$(1.25)
NET INCOME (LOSS) PER DILUTED SHARE				
Continuing operations	0.28	0.06	0.37	(0.09)
Discontinued operations	(0.05)	(0.87)	(0.24)	(1.16)
NET INCOME (LOSS) PER DILUTED SHARE	0.23	(0.81)	0.13	(1.25)
TOTAL COMPREHENSIVE INCOME (LOSS)	\$9,614	\$(34,507)	\$5,238	\$(42,665)

Please read the notes to consolidated financial statements.

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FORESTAR GROUP INC.

Consolidated Statements of Cash Flows
(Unaudited)

	First Six Months	
	2016	2015
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Consolidated net income (loss)	\$5,958	\$(42,555)
Adjustments:		
Depreciation, depletion and amortization	7,268	23,360
Change in deferred income taxes	(45)	(25,103)
Equity in earnings of unconsolidated ventures	(235)	(8,629)
Distributions of earnings of unconsolidated ventures	2,067	5,089
Share-based compensation	1,716	3,327
Real estate cost of sales	33,836	24,151
Dry hole and unproved leasehold impairment charges	—	30,663
Real estate development and acquisition expenditures, net	(33,066)	(57,353)
Reimbursements from utility and improvement districts	306	7,154
Asset impairments	49,438	25,764
Loss on debt extinguishment, net	35,864	—
Gain on sale of assets	(106,658)	(2,014)
Other	3,402	2,333
Changes in:		
Notes and accounts receivable	18,849	8,144
Prepaid expenses and other	1,080	2,502
Accounts payable and other accrued liabilities	(16,069)	(17,919)
Income taxes	8,828	3,573
Net cash provided by (used for) operating activities	12,539	(17,513)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property, equipment, software, reforestation and other	(5,639)	(6,971)
Oil and gas properties and equipment	(567)	(40,286)
Investment in unconsolidated ventures	(4,658)	(10,136)
Proceeds from sales of assets	318,480	2,984
Return of investment in unconsolidated ventures	1,914	1,960
Net cash provided by (used for) investing activities	309,530	(52,449)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments of debt	(307,491)	(4,925)
Additions to debt	1,462	5,016
Deferred financing fees	—	(100)
Distributions to noncontrolling interests, net	(1,108)	(687)
Repurchases of common stock	(3,537)	—
Payroll taxes on issuance of stock-based awards	(205)	(723)
Other	(211)	15
Net cash used for financing activities	(311,090)	(1,404)
Net increase (decrease) in cash and cash equivalents	10,979	(71,366)
Cash and cash equivalents at beginning of period	96,442	170,127
Cash and cash equivalents at end of period	\$107,421	\$98,761
Please read the notes to consolidated financial statements.		

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FORESTAR GROUP INC.

Notes to Consolidated Financial Statements
(Unaudited)

Note 1—Basis of Presentation

Our consolidated financial statements include the accounts of Forestar Group Inc., all subsidiaries, ventures and other entities in which we have a controlling interest. We account for our investment in other entities in which we have significant influence over operations and financial policies using the equity method. We eliminate all material intercompany accounts and transactions. Noncontrolling interests in consolidated pass-through entities are recognized before income taxes.

We prepare our unaudited interim financial statements in accordance with U.S. generally accepted accounting principles and Securities and Exchange Commission requirements for interim financial statements. As a result, they do not include all the information and disclosures required for complete financial statements. However, in our opinion, all adjustments considered necessary for a fair presentation have been included. Such adjustments consist only of normal recurring items unless otherwise noted. We make estimates and assumptions about future events. Actual results can, and probably will, differ from those we currently estimate including those principally related to allocating costs to real estate, measuring long-lived assets for impairment, oil and gas revenue accruals, capital expenditure and lease operating expense accruals associated with our oil and gas production activities, oil and gas reserves and depletion of our oil and gas properties. These interim operating results are not necessarily indicative of the results that may be expected for the entire year. For further information, please read the financial statements included in our 2015 Annual Report on Form 10-K.

At second quarter-end 2016, we have exited substantially all of our oil and gas working interest properties with the sale of the remaining Bakken/Three Forks properties in North Dakota which closed in second quarter 2016. As a result of this significant change in our operations, we have reported the results of operations and financial position of these assets as discontinued operations within the consolidated statements of income (loss) and comprehensive income (loss) and consolidated balance sheets for all periods presented. In addition, in second quarter 2016, we changed the name of the oil and gas segment to mineral resources to reflect the strategic shift from oil and gas working interest investments to owned mineral interests. We also changed the name of the other natural resources segment to other.

Note 2—New and Pending Accounting Pronouncements

Adoption of New Accounting Standards

In April 2015, the FASB issued ASU 2015-03, Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, as part of its initiative to reduce complexity in accounting standards. To simplify presentation of debt issuance costs, the amendments in this update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. In August 2015, the FASB issued ASU 2015-15, Interest-Imputation of Interest (Subtopic 835-30), Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements - Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting (SEC Update), which allows an entity to defer and present debt issuance costs as an asset and subsequently amortize the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The updated standards are effective for financial statements issued for annual and interim periods beginning after December 15, 2015. We adopted ASU 2015-03 in first quarter 2016 and prior period amounts have been reclassified to conform to the current period presentation. As of December 31, 2015, \$8,267,000 of debt issuance costs were reclassified in the consolidated balance sheet from other assets to debt. The adoption did not impact our consolidated financial position, results of operations or cash flows. As permitted under this guidance, we will continue to present debt issuance costs associated with revolving-debt agreements as other assets.

In February 2015, the FASB issued ASU 2015-02, Consolidation: Amendments to the Consolidation Analysis (Topic 810), requiring entities to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The revised consolidation model: (1) modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities,

(2) eliminates the presumption that a general partner should consolidate a limited partnership, (3) affects the consolidation analysis of reporting entities that are involved with VIEs, and (4) provides a scope exception from consolidation guidance for reporting entities with interests in certain legal entities. The updated standard is effective for financial statements issued for annual and interim periods beginning after December 15, 2015. The adoption of this guidance, which was applied retrospectively, had no impact to the consolidated financial statements.

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Pending Accounting Standards

In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606), requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. Early adoption is not permitted. The updated standard becomes effective for annual and interim periods beginning after December 15, 2016. In July 2015, the FASB decided to defer the effective date of the new standard by one year, to December 15, 2017. We have not yet selected a transition method and we are currently evaluating the effect that the updated standard will have on our earnings, financial position and disclosures. In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), in order to provide increased transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The updated standard is effective for financial statements issued for annual periods beginning after December 15, 2019 and interim periods within fiscal years beginning after December 31, 2020 with early adoption permitted. We are currently evaluating the effect that the updated standard will have on our earnings, financial position and disclosures.

In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, as part of its Simplification Initiative. The areas for simplification in this update involve several aspects of the accounting for share-based payment transactions, including income tax consequences, classification of awards as either equity or liabilities, and the classification on the statement of cash flows. The updated standard becomes effective for annual and interim periods beginning after December 31, 2016. We are currently evaluating the effect that the updated standard will have on our earnings, financial position and disclosures.

Note 3—Real Estate

Real estate consists of:

	Second Quarter-End 2016			Year-End 2015		
	Carrying Value	Accumulated Depreciation	Net Carrying Value	Carrying Value	Accumulated Depreciation	Net Carrying Value
	(In thousands)					
Entitled, developed and under development projects	\$312,749	\$ —	—\$312,749	\$352,141	\$ —	\$352,141
Timberland and undeveloped land (includes land in entitlement)	87,885	—	87,885	98,181	—	98,181
Commercial						
Radisson Hotel & Suites ^(a)	—	—	—	62,889	(29,268)	33,621
Income producing properties						
Eleven ^(a)	—	—	—	53,896	(2,861)	51,035
Dillon ^(a)	—	—	—	19,987	—	19,987
Music Row ^(a)	—	—	—	9,947	—	9,947
Downtown Edge multifamily site	12,988	—	12,988	12,706	—	12,706
West Austin multifamily site	5,438	—	5,438	9,097	—	9,097
	\$419,060	\$ —	—\$419,060	\$618,844	\$ (32,129)	\$586,715

^(a) Sold in 2016.

In second quarter 2016, we sold the Radisson Hotel & Suites, a 413 room hotel in Austin, for \$130,000,000, generating \$128,764,000 in net proceeds before paying in full the associated debt of \$15,400,000 and recognized a gain on sale of \$95,336,000. We also sold Eleven, a wholly-owned 257-unit multifamily property in Austin, for \$60,150,000, generating \$59,719,000 in net proceeds before paying in full the associated debt of \$23,936,000 and recognized a gain on sale of \$9,116,000. In addition, we sold Dillon, a planned 379-unit multifamily property that was

under construction in Charlotte, for \$25,979,000, generating \$25,433,000 in net proceeds and recognized a gain on sale of \$1,229,000.

In first quarter 2016, we sold Music Row, a planned 230-unit multifamily property that was under construction in Nashville, for \$15,025,000, generating \$14,703,000 in net proceeds and recognized a gain on sale of \$3,968,000.

In second quarter 2016, we recognized non-cash impairment charges of \$48,826,000 related to five non-core community development projects and one multifamily site. These impairments were a result of our key initiative to review our entire

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portfolio of assets which resulted in business plan changes, inclusive of cash tax savings considerations, to market these properties for sale, which resulted in adjustment of the carrying value to fair value.

Our estimated costs of assets for which we expect to be reimbursed by utility and improvement districts were \$69,675,000 at second quarter-end 2016 and \$67,554,000 at year-end 2015, including \$23,062,000 at second quarter-end 2016 and \$22,302,000 at year-end 2015 related to our Cibolo Canyons project near San Antonio, Texas. In first six months 2016, we have collected \$306,000 in reimbursements that were previously submitted to these districts. At second quarter-end 2016, our inception-to-date submitted and approved reimbursements for the Cibolo Canyons project were \$54,376,000 of which we have collected \$34,703,000. These costs are principally for water, sewer and other infrastructure assets that we have incurred and submitted or will submit to utility or improvement districts for approval and reimbursement. We expect to be reimbursed by utility and improvement districts when these districts achieve adequate tax basis or otherwise have funds available to support payment.

Note 4—Discontinued Operations

At second quarter-end 2016, we have exited substantially all of our oil and gas working interest properties with the sale of the remaining Bakken/Three Forks properties which closed in second quarter 2016. As a result of this significant change in our operations, we have reported the results of operations and financial position of these assets as discontinued operations within the consolidated statements of income (loss) and comprehensive income (loss) and consolidated balance sheets for all periods presented. In addition, in second quarter 2016, we changed the name of the oil and gas segment to mineral resources to reflect the strategic shift from oil and gas working interest investments to owned mineral interests.

Summarized results from discontinued operations were as follows:

	Second Quarter		First Six Months	
	2016	2015	2016	2015
	(In thousands)			
Revenues	\$1,377	\$13,805	\$5,647	\$24,236
Cost of sales	(1,521)	(69,874)	(6,485)	(81,028)
Other operating expenses	(1,066)	(2,242)	(2,389)	(7,008)
Loss from discontinued operations before income taxes	\$(1,210)	\$(58,311)	\$(3,227)	\$(63,800)
Gain (loss) on disposal before income taxes	(3,596)	(322)	(14,573)	854
Income tax benefit (expense)	2,758	21,641	7,536	23,234
Loss from discontinued operations, net of taxes	\$(2,048)	\$(36,992)	\$(10,264)	\$(39,712)

In first quarter 2016, we recorded a net loss of \$10,977,000 on the sale of 190,960 net mineral acres leased from others and 185 gross (66 net) producing oil and gas working interest wells in Nebraska, Kansas, Oklahoma and North Dakota for total proceeds of \$32,227,000, which includes \$3,269,000 in reimbursement of capital costs incurred on in-progress wells that were assumed by the buyer.

In second quarter 2016, we recorded a net loss of \$3,596,000 on the sale of nearly 8,100 net mineral acres leased from others and 175 gross (16 net) producing oil and gas working interest wells principally in North Dakota for total sales proceeds of \$46,986,000.

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The major classes of assets and liabilities of discontinued operations held for sale at second quarter-end 2016 and year-end 2015 are as follows:

	Second Quarter-End 2016	End-End 2015
	(In thousands)	
Assets of Discontinued Operations:		
Receivables, net of allowance for bad debt	\$1,276	\$4,632
Oil and gas properties and equipment, net	438	79,733
Goodwill and other intangible assets	—	19,673
Prepaid expenses	31	96
Other assets	100	833
	\$1,845	\$104,967
Liabilities of Discontinued Operations:		
Accounts payable	\$751	\$342
Accrued property taxes	—	259
Other accrued expenses	1,979	8,924
Other liabilities	386	1,667
	\$3,116	\$11,192

Significant operating activities and investing activities of discontinued operations are as follows:

First
Six
Months