Forestar Group Inc.
Form 10-Q
August 08, 2011

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 June 30, 2011

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 Number: 001-33662

FORESTAR GROUP INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**26-1336998**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer 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. þ Yes o 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). þ Yes o 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.

Large accelerated filer o	Accelerated filer þ	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). o Yes þ 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 1, 2011
Common Stock, par value $1.00 per share	35,492,686

FORESTAR GROUP INC.
TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

FORESTAR GROUP INC.
Consolidated Balance Sheets

	(Unaudited) Second Quarter-End 2011	Year-End 2010
	(In thousands)	
ASSETS		
Cash and cash equivalents	$ 5,715	$ 5,366
Real estate	568,139	562,192
Assets held for sale	25,588	21,122
Investment in unconsolidated ventures	98,909	101,166
Timber	15,998	17,959
Receivables, net	23,382	2,875
Prepaid expenses	2,824	2,034
Income taxes receivable	790	
Property and equipment, net	5,423	5,577
Oil and gas properties and equipment, net	2,413	322
Deferred tax asset	54,141	47,141
Goodwill and other intangible assets	5,989	6,527
Other assets	15,844	17,043
TOTAL ASSETS	$ 825,155	$ 789,324
LIABILITIES AND SHAREHOLDERS EQUITY		
Accounts payable	$ 4,281	$ 4,214
Accrued employee compensation and benefits	463	994
Accrued property taxes	5,112	3,662
Accrued interest	1,293	1,061
Income taxes payable		3,293
Other accrued expenses	9,176	8,168
Other liabilities	35,054	32,064
Debt	260,825	221,589
TOTAL LIABILITIES	316,204	275,045
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS EQUITY		
Forestar Group Inc. shareholders equity:		
Preferred stock, par value $0.01 per share, 25,000,000 authorized shares, none issued		
Common stock, par value $1.00 per share, 200,000,000 authorized shares, 36,773,370 issued at June 30, 2011 and 36,667,210 issued at December 31, 2010	36,773	36,667
Additional paid-in capital	395,573	391,352

Retained earnings	94,607	101,001
Treasury stock, at cost, 1,281,084 shares at June 30, 2011 and 1,216,647 shares at December 31, 2010	(20,672)	(19,456)
Total Forestar Group Inc. shareholders equity	506,281	509,564
Noncontrolling interests	2,670	4,715
TOTAL SHAREHOLDERS EQUITY	508,951	514,279
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 825,155	$ 789,324

Please read the Notes to Consolidated Financial Statements.

3

Table of Contents

FORESTAR GROUP INC.
Consolidated Statements of Income
(Unaudited)

	Second Quarter 2011	Second Quarter 2010	First Six Months 2011	First Six Months 2010
	(In thousands, except per share amounts)			
REVENUES				
Real estate sales	$ 12,576	$ 16,145	$ 26,533	$ 26,895
Income producing properties and other	7,039	5,404	14,221	11,902
Real estate	19,615	21,549	40,754	38,797
Mineral resources	4,580	4,606	11,913	11,733
Fiber resources and other	1,290	1,982	2,658	3,965
	25,485	28,137	55,325	54,495
COSTS AND EXPENSES				
Cost of real estate sales	(5,991)	(7,462)	(11,636)	(13,129)
Cost of income producing properties and other	(4,366)	(3,945)	(8,891)	(8,749)
Cost of mineral resources	(438)	(307)	(1,232)	(629)
Cost of fiber resources and other	(285)	(391)	(532)	(742)
Other operating	(10,483)	(9,228)	(22,157)	(19,437)
General and administrative	(6,849)	(6,120)	(12,820)	(11,696)
	(28,412)	(27,453)	(57,268)	(54,382)
OPERATING INCOME (LOSS)	(2,927)	684	(1,943)	113
Equity in earnings (loss) of unconsolidated ventures	402	287	984	658
Interest expense	(4,653)	(4,103)	(8,662)	(8,649)
Other non-operating income	24	246	51	444
INCOME (LOSS) BEFORE TAXES	(7,154)	(2,886)	(9,570)	(7,434)
Income tax benefit (expense)	2,828	(162)	3,540	1,353
CONSOLIDATED NET INCOME (LOSS)	(4,326)	(3,048)	(6,030)	(6,081)
Less: Net (income) loss attributable to noncontrolling interests	405	(225)	(364)	(164)
NET INCOME (LOSS) ATTRIBUTABLE TO FORESTAR GROUP INC.	$ (3,921)	$ (3,273)	$ (6,394)	$ (6,245)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING BASIC	35,448	36,155	35,389	36,117
NET INCOME (LOSS) PER COMMON SHARE BASIC	$ (0.11)	$ (0.09)	$ (0.18)	$ (0.17)

Please read the Notes to Consolidated Financial Statements.

Table of Contents

FORESTAR GROUP INC.
Consolidated Statements of Cash Flows
(Unaudited)

	First Six Months	
	2011	2010
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Consolidated net income (loss)	$ (6,030)	$ (6,081)
Adjustments:		
Depreciation and amortization	4,864	5,293
Deferred income taxes	(7,000)	(6,950)
Tax benefits not recognized for book purposes	95	64
Equity in (earnings) loss of unconsolidated ventures	(984)	(658)
Distributions of earnings of unconsolidated ventures	4,102	99
Distributions of earnings to noncontrolling interests	(2,491)	(238)
Share-based compensation	3,952	5,553
Non-cash real estate cost of sales	10,525	11,470
Real estate development and acquisition expenditures	(23,529)	(7,020)
Acquisition of non-performing loan	(21,137)	
Reimbursements from utility and improvement districts	1,790	183
Other changes in real estate	(5)	28
Gain on termination of timber lease	(181)	(497)
Cost of timber cut	524	692
Deferred income	947	1,421
Asset impairments	450	900
Loss on sale of assets held for sale		277
Other	74	(113)
Changes in:		
Notes and accounts receivable	530	(9,771)
Prepaid expenses and other	(239)	147
Accounts payable and other accrued liabilities	3,896	(8,154)
Income taxes	(4,083)	(5,518)
Net cash (used for) provided by operating activities	(33,930)	(18,873)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property, equipment, software and reforestation	(899)	(1,392)
Oil and gas properties and equipment	(2,112)	
Investment in unconsolidated ventures	(1,135)	(1,039)
Return of investment in unconsolidated ventures	252	4,784
Proceeds from sale of assets held for sale		2,602
Proceeds from termination of timber lease	290	
Proceeds from sale of property	103	
Net cash (used for) provided by investing activities	(3,501)	4,955
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments of debt	(37,043)	(19,750)
Additions to debt	76,279	18,527
Deferred financing fees	(1,379)	

Return of investment to noncontrolling interest	(1)	(598)
Exercise of stock options	1,167	872
Payroll taxes on restricted stock and stock options	(1,216)	(49)
Tax benefit from share-based compensation	(110)	121
Other	83	103
Net cash provided by (used for) financing activities	37,780	(774)
Net increase (decrease) in cash and cash equivalents	349	(14,692)
Cash and cash equivalents at beginning of period	5,366	21,051
Cash and cash equivalents at end of period	$ 5,715	$ 6,359

Please read the Notes to Consolidated Financial Statements.

Table of Contents

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 and variable interest entities of which we are the primary beneficiary. We eliminate all material intercompany accounts and transactions. Noncontrolling interests in consolidated pass-through entities are recognized before income taxes. We account for our investment in other entities in which we have significant influence over operations and financial policies using the equity method (we recognize our share of the entities income or loss and any preferential returns and treat distributions as a reduction of our investment). We account for our investment in other entities in which we do not have significant influence over operations and financial policies using the cost method (we recognize as income distributions of accumulated earnings).

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 related to allocating cost of sales to real estate, minerals and fiber and measuring assets for impairment. 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 2010 Annual Report on Form 10-K.

In 2011, we reclassified $199,000 and $397,000 from cost of income producing properties to operating expenses in second quarter and first six months 2010 to conform to the current year s presentation.

Note 2 New and Pending Accounting Pronouncements

Accounting Standards Adopted in 2011

In first quarter 2011, we adopted Accounting Standards Update (ASU) 2010-28 *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts* and ASU 2010-29 *Disclosure of Supplementary Pro Forma Information for Business Combinations*. Adoption of these pronouncements did not affect our earnings or financial position.

Pending Accounting Standards

Pending ASU 2011-04 *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* and ASU 2011-05 *Comprehensive Income: Presentation of Comprehensive Income* will be effective first quarter 2012. Adoption is not anticipated to have a significant effect on our earnings or financial position but will likely result in certain additional disclosures.

Note 3 Strategic Initiatives and Assets Held for Sale

In 2009, we announced our near-term strategic initiatives to enhance shareholder value by generating significant cash flow, principally from the sale of 175,000 acres of higher and better use timberland; reducing debt by $150,000,000; and repurchasing up to 20 percent of our common stock.

Since announcing these initiatives, we have sold 119,000 acres of timber and timberland in Georgia, Alabama and Texas for $197,381,000 generating combined net proceeds of $191,891,000, which were principally used to reduce debt, pay taxes, reinvest in qualifying real estate and repurchase our common stock. These transactions resulted in a combined gain on sale of assets of $132,654,000. In 2010, we repurchased 1,000,987 shares of our common stock at a cost of $15,178,000. The repurchased shares are classified as treasury stock.

At second quarter-end 2011, assets held for sale includes 65,000 acres of undeveloped land with a carrying value of $18,024,000 and related timber with a carrying value of $7,564,000. We continue to actively market this land. Please read Note 19 for information regarding a sale of 50,000 acres of timberland subsequent to second quarter-end 2011.

Table of Contents

Note 4 Real Estate

Real estate consists of:

	Second Quarter-End 2011	Year-End 2010
	(In thousands)	
Entitled, developed and under development projects	$ 400,287	$ 403,059
Undeveloped land	90,067	86,608
Income producing properties	102,983	95,963
	593,337	585,630
Accumulated depreciation	(25,198)	(23,438)
	$ 568,139	$ 562,192

Included in entitled, developed and under development projects are the estimated costs of assets we expect to convey to utility and improvement districts of $62,030,000 at second quarter-end 2011 and $59,079,000 at year-end 2010, including $36,552,000 included in both second quarter-end 2011 and year-end 2010 related to our Cibolo Canyons project near San Antonio, Texas. These costs relate to water, sewer and other infrastructure assets we have submitted to utility or improvement districts for approval and reimbursement. We submitted for reimbursement to these districts $2,336,000 in first six months 2011 and $1,827,000 in first six months 2010. We collected $187,000 from these districts in first six months 2011 and $183,000 in first six months 2010. We expect to collect the remaining amounts billed when these districts achieve adequate tax bases to support payment.

Also included in entitled, developed and under development projects is our investment in the resort development owned by third parties at our Cibolo Canyons project. In second quarter 2011, we received $1,603,000 from the Special Improvement District (SID) related to hotel occupancy revenues and other revenues from resort sales collected as taxes by the SID. We currently account for these collections as a reduction of our investment. At second-quarter-end 2011, we have $40,399,000 invested in the resort development.

Income producing properties principally represents our investment in a 401 unit multifamily property in Houston, Texas and a 413 room hotel in Austin, Texas. In addition, in second quarter 2011, we reclassified $4,555,000 in land from entitled, developed and under development projects to income producing properties as result of commencing construction on a 289 unit multifamily project in Austin, Texas. At second-quarter end 2011, our investment in this project, including land and construction in progress is $5,961,000, with an estimated additional cost to complete construction of $24,579,000.

We recognized asset impairment charges in second quarter 2011 of $450,000 related to a residential real estate project located near Dallas, Texas and $900,000 in second quarter 2010 related to a residential real estate project located near Salt Lake City, Utah.

Depreciation expense, primarily related to income producing properties, was $1,760,000 in first six months 2011 and $1,465,000 in first six months 2010 and is included in other operating expenses.

Note 5 Timber

We own directly or through ventures approximately 201,000 acres of timber, primarily in Georgia. The cost of timber cut and sold was $524,000 in first six months 2011 and $692,000 in first six months 2010.

Note 6 Shareholders Equity

A reconciliation of changes in shareholders equity at second quarter-end 2011 follows:

	Forestar Group Inc.	Noncontrolling Interests	Total

		(In thousands)	
Balance at year-end 2010	$ 509,564	$ 4,715	$ 514,279
Net income (loss)	(6,394)	364	(6,030)
Distributions to noncontrolling interests		(2,492)	(2,492)
Contributions from noncontrolling interests		83	83
Other (primarily share-based compensation)	3,111		3,111
Balance at second quarter-end 2011	$ 506,281	$ 2,670	$ 508,951

In first six months 2011, we issued 106,160 shares of our common stock as a result of stock option exercises and vesting of equity-settled restricted stock units.

Table of Contents

Note 7 Investment in Unconsolidated Ventures

At second quarter-end 2011, we had ownership interests ranging from 25 to 50 percent in 10 ventures that we account for using the equity method. We have no real estate ventures that are accounted for using the cost method. Our three largest ventures at second quarter-end 2011 are CL Realty, Temco and Palisades West. We own a 50 percent interest in both CL Realty and Temco, and Cousins Real Estate Corporation owns the other 50 percent interest. We own a 25 percent interest in Palisades West, Cousins Properties Incorporated owns a 50 percent interest and Dimensional Fund Advisors LP owns the remaining 25 percent interest. Information regarding these ventures follows:

CL Realty, L.L.C. was formed in 2002 for the purpose of developing residential and mixed-use communities in Texas and across the southeastern United States. At second quarter-end 2011, the venture has 14 residential and mixed-use communities, of which 10 are in Texas, 3 are in Florida and 1 is in Georgia, representing approximately 5,200 planned residential lots and 290 commercial acres.

Temco Associates, LLC was formed in 1991 for the purpose of acquiring and developing residential real estate sites in Georgia. At second quarter-end 2011, the venture has 4 residential and mixed-use communities, representing approximately 1,550 planned residential lots, all of which are located in Paulding County, Georgia. The venture also owns 5,712 acres of undeveloped land in Paulding County, Georgia.

Palisades West LLC was formed in 2006 for the purpose of constructing a commercial office park in Austin, Texas. The project includes two office buildings totaling approximately 375,000 square feet and an accompanying parking garage. At second quarter-end 2011, the buildings are approximately 97 percent leased. Our remaining commitment for investment in this venture as of second quarter-end 2011 is $1,532,000. Effective fourth quarter 2008, we entered into a 10-year operating lease for approximately 32,000 square feet that we occupy as our corporate headquarters. In second quarter and first six months 2011, rents paid under this operating lease were $256,000 and $560,000 and are included in general and administrative and other operating expenses.

Combined summarized balance sheet information for our ventures accounted for using the equity method follows:

	Second Quarter-End 2011					Year-End 2010				
	CL Realty	Temco	Palisades West	Other Ventures	Total	CL Realty	Temco	Palisades West	Other Ventures	Total
					(In thousands)					
Real estate	$ 81,898	$ 59,567	$ 121,754	$ 66,942	$ 330,161	$ 85,436	$ 60,454	$ 124,696	$ 69,612	$ 340,198
Total assets	82,838	60,232	125,907	76,782	345,759	86,657	60,609	129,378	78,060	354,704
Borrowings (a)	1,727	2,859		74,080	78,666	2,664	2,929		74,605	80,198
Total liabilities	3,478	3,270	45,227(b)	88,150	140,125	4,124	3,133	48,612(b)	87,145	143,014
Equity	79,360	56,962	80,680	(11,368)	205,634	82,533	57,476	80,766	(9,085)	211,690
Our investment in real estate ventures:										
Our share of their equity (c)	39,680	28,481	20,170	13,726	102,057	41,267	28,738	20,191	14,075	104,271
Unrecognized deferred gain (d)	(2,190)			(958)	(3,148)	(2,190)			(915)	(3,105)

Investment in real estate ventures	$ 37,490	$ 28,481	$ 20,170	$ 12,768	$ 98,909	$ 39,077	$ 28,738	$ 20,191	$ 13,160	$ 101,166

Table of Contents

Combined summarized income statement information for our ventures accounted for using the equity method follows:

	Second Quarter		First Six Months	
	2011	2010	2011	2010
	(In thousands)			
Revenues:				
CL Realty	$ 1,649	$ 2,485	$ 3,518	$ 4,212
Temco	288	89	346	1,877
Palisades West	4,084	3,416	8,114	6,731
Other ventures	4,116	6,355	5,665	8,220
Total	$ 10,137	$ 12,345	$ 17,643	$ 21,040
Earnings (Loss):				
CL Realty	$ 734	$ 1,364	$ 1,390	$ 1,22