Forestar Group Inc.
Form 10-Q
November 05, 2009

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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 September 30, 2009

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. Yes þ No o

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 o No o

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). Yes o No þ

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 November 2, 2009
Common Stock, par value $1.00 per share	35,916,406

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

FORESTAR GROUP INC.
Consolidated Balance Sheets

	(Unaudited) September 30, 2009	December 31, 2008
	(In thousands)	
ASSETS		
Cash and cash equivalents	$ 43,542	$ 8,127
Real estate	549,458	610,586
Assets held for sale	31,592	
Investment in unconsolidated ventures	110,386	117,554
Timber	20,686	50,989
Receivables, net	3,967	4,262
Prepaid expense	2,117	2,425
Property and equipment, net	5,890	6,211
Deferred tax asset	37,999	17,184
Other assets	11,232	17,238
TOTAL ASSETS	$ 816,869	$ 834,576
LIABILITIES AND SHAREHOLDERS EQUITY		
Accounts payable	$ 3,881	$ 7,438
Accrued employee compensation and benefits	3,431	3,389
Accrued property taxes	8,838	6,808
Accrued interest	612	1,199
Income taxes payable	23,389	
Other accrued expenses	6,249	11,448
Other liabilities	21,299	12,940
Debt	224,966	337,402
TOTAL LIABILITIES	292,665	380,624
COMMITMENTS AND CONTINGENCIES		
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, 36,002,020 issued at September 30, 2009 and 35,839,390 issued at December 31, 2008	36,002	35,839
Additional paid-in capital	381,004	377,810
Retained earnings	103,270	36,769
Accumulated other comprehensive loss	(631)	(1,260)

Treasury stock, at cost, 95,898 shares at September 30, 2009 and 90,819 at December 31, 2008	(1,912)	(1,866)
Total Forestar Group Inc. shareholders equity	517,733	447,292
Noncontrolling interests	6,471	6,660
TOTAL EQUITY	524,204	453,952
TOTAL LIABILITIES AND EQUITY	$ 816,869	$ 834,576

Please read the notes to the consolidated financial statements.

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FORESTAR GROUP INC.
Consolidated Statements of Income
(Unaudited)

	Third Quarter		First Nine Months	
	2009	2008	2009	2008
	(In thousands, except per share amounts)			
REVENUES				
Real estate sales	$ 18,259	$ 14,532	$ 55,387	$ 54,383
Commercial operating properties and other	4,662	6,398	14,768	19,108
Real estate	22,921	20,930	70,155	73,491
Mineral resources	18,828	9,539	31,767	40,193
Fiber resources and other	3,558	3,474	12,928	9,079
	45,307	33,943	114,850	122,763
COSTS AND EXPENSES				
Cost of real estate sales	(8,356)	(6,933)	(20,934)	(28,919)
Cost of commercial operating properties and other	(4,007)	(4,087)	(11,814)	(12,516)
Cost of mineral resources	(221)	(608)	(499)	(1,286)
Cost of fiber resources	(880)	(947)	(2,816)	(2,418)
Other operating	(9,923)	(10,530)	(29,717)	(31,986)
General and administrative	(8,000)	(5,237)	(22,758)	(18,021)
Gain on sale of assets	24,833		104,047	
	(6,554)	(28,342)	15,509	(95,146)
OPERATING INCOME	38,753	5,601	130,359	27,617
Equity in (loss) earnings of unconsolidated ventures	(2,443)	1,436	(7,063)	4,988
Interest expense	(5,440)	(5,079)	(15,653)	(15,747)
Other non-operating income	287	79	382	233
INCOME BEFORE TAXES	31,157	2,037	108,025	17,091
Income tax expense	(10,956)	(320)	(39,761)	(4,986)
CONSOLIDATED NET INCOME	20,201	1,717	68,264	12,105
Less: Net income attributable to noncontrolling interests	(725)	(845)	(1,763)	(1,875)
NET INCOME ATTRIBUTABLE TO FORESTAR GROUP INC.	$ 19,476	$ 872	$ 66,501	$ 10,230
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING				
Basic	35,817	35,518	35,769	35,433
Diluted	36,173	35,828	35,975	35,935
NET INCOME PER COMMON SHARE				
Basic	$ 0.54	$ 0.02	$ 1.86	$ 0.29

Diluted	$ 0.54	$ 0.02	$ 1.85	$ 0.28

Please read the notes to the consolidated financial statements.

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

	First Nine Months 2009	2008
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Consolidated net income	$ 68,264	$ 12,105
Adjustments:		
Depreciation and amortization	7,390	5,258
Deferred income taxes	(21,153)	(7,285)
Tax benefits not recognized for book purposes	6,066	
Equity in loss (earnings) of unconsolidated ventures	7,063	(4,988)
Distributions of earnings of unconsolidated ventures	259	883
Distributions of earnings to noncontrolling interests	(1,992)	(3,557)
Share-based compensation	7,717	4,658
Non-cash real estate cost of sales	19,040	27,610
Non-cash cost of assets sold	49,804	
Real estate development and acquisition expenditures	(30,731)	(76,387)
Reimbursements from utility and improvement districts	22,299	374
Other changes in real estate	384	(521)
Gain on termination of timber lease	(195)	(1,495)
Cost of timber cut	2,577	2,046
Deferred income	(944)	2,010
Asset impairments	5,044	
Other	90	(450)
Changes in:		
Receivables	(783)	17
Prepaid and other	1,385	(105)
Accounts payable and other accrued liabilities	(8,864)	6,090
Income taxes payable (receivable)	23,389	(2,632)
Net cash provided by (used in) operating activities	156,109	(36,369)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property, equipment, software and reforestation	(6,317)	(2,044)
Investment in unconsolidated ventures	(1,916)	(14,962)
Return of investment in unconsolidated ventures	2,671	6,168
Proceeds from sale of assets		202
Net cash used in investing activities	(5,562)	(10,636)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments of debt	(155,948)	(51,649)
Additions to debt	43,512	100,220
Deferred financing fees	(3,127)	(1,238)
Return of investment to noncontrolling interests	(171)	
Exercise of stock options	576	896

Payroll taxes on restricted stock and stock options	(44)	(1,840)
Tax benefit from share-based compensation		81
Other	70	269
Net cash (used in) provided by financing activities	(115,132)	46,739
Net increase (decrease) in cash and cash equivalents	35,415	(266)
Cash and cash equivalents at beginning of period	8,127	7,520
Cash and cash equivalents at end of period	$ 43,542	$ 7,254

Please read the notes to the consolidated financial statements.

FORESTAR GROUP INC.
Notes to the Consolidated Financial Statements
(Unaudited)

Note 1 Background

Prior to December 28, 2007, we were a wholly-owned subsidiary of Temple-Inland Inc. On December 28, 2007, Temple-Inland distributed all of the issued and outstanding shares of our common stock to its shareholders in a transaction commonly referred to as a spin-off.

Note 2 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 distribution 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 2008 Annual Report on Form 10-K.

Certain prior year items have been reclassified to conform to the current year s presentation.

Note 3 New Accounting Pronouncements

In first quarter 2009, we adopted the following new accounting pronouncements:

FASB Staff Position (FSP) Financial Accounting Standards (FAS) 157-2, *Effective Date of FASB Statement 157* (Codified within Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*) This FSP delayed the effective date of Statement of Financial Accounting Standard (SFAS) No. 157, *Fair Value Measurements*, for certain nonfinancial assets and nonfinancial liabilities. Adoption of this FSP did not significantly affect how we determine fair value but has resulted in certain additional disclosures. Please read Note 9 Fair Value.

FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities* (Codified within ASC 260, *Earnings Per Share*) This staff position specifies that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and should be included in the computation of earnings per share pursuant to the two-class method. Adoption of this FSP did not have a significant effect on our earnings per share.

SFAS No. 141(R), *Business Combinations* (Codified within ASC 805, *Business Combinations*) This standard requires most identifiable assets, liabilities, noncontrolling interests and goodwill acquired in a business combination to be recorded at full fair value. The standard also changes the approach to determining the purchase price, the accounting for acquisition cost and several acquisition related accounting practices. Adoption of this pronouncement did not have a significant effect on our earnings or financial position.

SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (Codified within ASC 810, *Consolidation*) This standard specifies that noncontrolling interests be reported as a part of equity, not as a liability or other item outside of equity. Upon adoption, we reclassified $6,660,000 of noncontrolling interests to shareholders equity at year-end 2008 and we reclassified $1,875,000 of minority interest expense to net income attributable to noncontrolling interests for first nine months 2008. A reconciliation of the changes in shareholders equity in first nine months 2009 follows:

	Forestar Group Inc.	Noncontrolling Interests	Total
		(In thousands)	
Balance as of December 31, 2008	$ 447,292	$ 6,660	$ 453,952
Net income	66,501	1,763	68,264
Unrealized gain	629		629
Distributions to noncontrolling interests		(2,163)	(2,163)
Contributions from noncontrolling interests		211	211
Other (primarily share-based compensation)	3,311		3,311
Balance as of September 30, 2009	$ 517,733	$ 6,471	$ 524,204

SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133* (Codified within ASC 815, *Derivatives and Hedging*) This standard requires enhanced disclosures about derivative instruments including how and why they are used; how they are accounted for; and how they affect an entity s financial position, financial performance and cash flows. Adoption of this pronouncement did not have a significant effect on our earnings or financial position.

In second quarter 2009, we adopted the following new accounting pronouncements:

FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (Codified within ASC 820, *Fair Value Measurements and Disclosures*) This FSP provides guidance for estimating fair value when the volume and level of activity for an asset or liability have significantly decreased. Adoption of this FSP affects how we consider Level 2 and Level 3 inputs in determining fair values but did not have a significant effect on our earnings or financial position.

FSP FAS 107-1 and Accounting Principles Board (APB) Opinion 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (Codified within ASC 825, *Financial Instruments*) This FSP requires an entity to provide disclosures about fair value of financial instruments at interim reporting periods. Adoption of this FSP did not significantly affect how we determine fair value but has resulted in certain additional disclosures. Please read Note 9 Fair Value.

SFAS No. 165, *Subsequent Events* (Codified within ASC 855, *Subsequent Events*) This Statement establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued, introduces the concept of financial statements being available to be issued and requires disclosures regarding the date through which subsequent events were evaluated. Adoption of this standard did not have a significant effect on our earnings or financial position but does affect our disclosures regarding subsequent events.

SEC SAB 112 This bulletin amends or rescinds guidance included in the SAB Series to make it consistent with recent FASB pronouncements, namely, SFAS No. 141 (revised 2007), *Business Combinations*, and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. Adoption did not have a significant effect on our earnings or financial position.

In third quarter 2009, we adopted the following new accounting pronouncement:

SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (Codified within ASC 105, *Generally Accepted Accounting Principles*) This Statement establishes the FASB Accounting Standards Codification as the single source of authoritative accounting principles to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. Adoption did not have an impact on our earnings or financial position but did revise our disclosures regarding accounting guidance references.

In addition, the following pending pronouncements have not yet been adopted, and we are currently evaluating the effect, if any, on our earnings or financial position:

Accounting Standards Update (ASU) 2009-05, *Measuring Liabilities at Fair Value* This ASU amends ASC 820, *Fair Value Measurements and Disclosures,* to provide additional guidance on how to measure the fair value of a liability and is effective fourth quarter 2009.

SFAS No. 166, *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140* (Not yet included in Codification) This standard removes the concept of a qualifying special-purpose entity from FIN 46(R) and requires additional disclosures and is effective first quarter 2010.

SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (Not yet included in Codification) This standard amends certain requirements of FIN 46(R) to improve financial reporting related to consolidation of and disclosures about variable interest entities and is effective first quarter 2010.

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Note 4 Strategic Initiatives and Assets Held for Sale

In first quarter 2009, we announced our near-term strategic initiatives to enhance shareholder value by generating significant cash flow, principally from the sale of about 175,000 acres of higher and better use (HBU) timberland. As a result, we classified to assets held for sale about 171,000 acres of undeveloped land located in Alabama, Georgia and Texas with a carrying value of $51,390,000 and related timber with a carrying value of $24,749,000.

In second quarter 2009, we sold about 75,000 acres of timber and timberland in Georgia and Alabama for $119,702,000 to Hancock Timber Resource Group, which acquired the assets on behalf of its investor clients. The transaction generated net proceeds of $116,116,000, which were principally used to reduce debt, and resulted in a gain on sale of $79,214,000. In third quarter 2009, we sold about 20,000 acres of timber and timberland in Georgia for $38,901,000 to St. Regis Paper Company, LLC, affiliate of Holland M. Ware. The transaction generated net proceeds of $37,735,000, which were principally used to reduce our debt and fund our third quarter estimated income tax payment, and resulted in a gain on sale of $24,833,000.

At third quarter-end 2009, assets held for sale includes about 74,000 acres of undeveloped land with a carrying value of $18,137,000 and related timber with a carrying value of $10,357,000. These assets are actively being marketed. Also included is our undivided 15 percent interest in corporate aircraft contributed to us by Temple-Inland at spin-off with a carrying value of $3,098,000. Our interest is being disposed of pursuant to the terms of an aircraft joint ownership agreement, which expires December 28, 2009.

Note 5 Real Estate

Real estate consists of:

	September 30, 2009	December 31, 2008
	(In thousands)	
Entitled, developed and under development projects	$ 435,862	$ 445,394
Undeveloped land	89,187	143,749
Commercial operating properties	48,320	43,987
	573,369	633,130
Accumulated depreciation	(23,911)	(22,544)
	$ 549,458	$ 610,586

Included in entitled, developed and under development projects are the estimated costs of assets we expect to convey to utility and improvement districts of $55,239,000 at third quarter-end 2009 and $76,173,000 at year-end 2008, including $29,259,000 at third quarter-end 2009 and $49,529,000 at year-end 2008 related to our Cibolo Canyons project near San Antonio, Texas. These costs relate to water, sewer and other infrastructure assets for which the utility or improvement districts have agreed to reimburse us. We billed these districts $3,109,000 in first nine months 2009 and $18,058,000 in first nine months 2008. We collected $22,299,000 from these districts in first nine months 2009, of which $20,270,000 related to our Cibolo Canyons project and was accounted for as a reduction of our investment in the mixed-use development. We collected $374,000 from these districts in first nine months 2008. We expect to collect the remaining amounts billed when these districts achieve adequate tax bases to support payment.

We recognized asset impairment charges of $3,050,000 in first nine months 2009 related to a condominium project in Texas. We did not recognize any asset impairment charges in first nine months 2008 on our owned or consolidated real estate projects. Asset impairment charges are included in cost of real estate sales.

Depreciation expense primarily related to commercial operating properties was $1,367,000 in first nine months 2009 and $1,303,000 in first nine months 2008 and is included in other operating expense.

Note 6 Timber

We have about 231,000 acres of timber, primarily in Georgia. The cost of timber cut was $2,577,000 in first nine months 2009 and $2,046,000 in first nine months 2008.

Note 7 Investment in Unconsolidated Ventures

At third quarter-end 2009, 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 third quarter-end 2009 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

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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 third quarter-end 2009, the venture had 15 residential and mixed-use communities, of which 10 are in Texas, 3 are in Florida and 2 are in Georgia, representing about 7,500 remaining residential lots and 560 commercial acres.

Temco Associates, LLC was formed in 1991 for the purpose of acquiring and developing residential real estate sites in Georgia. At third quarter-end 2009, the venture had 5 residential and mixed-use communities, representing about 1,560 remaining residential lots, all of which are located in Paulding County, Georgia. The venture also owns approximately 5,500 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. Construction of the project was completed in fourth quarter 2008 and is approximately 68% leased at third quarter-end 2009. Our remaining commitment for investment in this venture as of third quarter-end 2009 is $2,573,000. 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.

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

	September 30, 2009					December 31, 2008				
	CL Realty	Temco	Palisades West	Other Ventures	Total	CL Realty	Temco	Palisades West	Other Ventures	Total
	(In thousands)									
Real estate	$ 114,782	$ 60,179	$ 123,466	$ 91,151	$ 389,578	$ 124,417	$ 60,791	$ 120,953	$ 94,094	$ 400,255
Total assets	116,160	60,799	123,895	99,159	400,013	126,726	61,832	123,290	102,930	414,778
Borrowings, principally non-recourse (a)	3,700	3,139		77,638	84,477	4,901	3,198		75,638	83,737
Total liabilities	6,292	4,170	50,780(b)	87,916	149,158	8,683	3,570	50,548(b)	89,580	152,381
Equity	109,868	56,629	73,115	11,243	250,855	118,043	58,262	72,742	13,350	262,397
Our investment in real estate ventures:										
Our share of their equity (c)	54,934	28,315	18,277	16,829	118,355	59,022	29,131	18,779	18,295	125,227
Unrecognized deferred gain (d)	(7,059)			(910)	(7,969)	(7,059)			(614)	(7,673)
Investment in real estate ventures	$ 47,875	$ 28,315	$ 18,277	$ 15,919	$ 110,386	$ 51,963	$ 29,131	$ 18,779	$ 17,681	$ 117,554

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