Exhibit A

BT KB HOME Earnings Teleconference KBH US
Jan 7 2011 13:08:10

Event Date: 01/07/2011
Company Name: KB HOME
Event Description:Q4 2010 Earnings Call
Source: KB HOME
For more event information and transcripts,
visit EVTS

Q4 2010 Earnings Call

MANAGEMENT DISCUSSION SECTION

Operator:
Well, good day, everyone, and welcome to the KB Home 2010 Fourth Quarter and Year End Earnings Conference Call. Today's conference is being recorded and webcast on KB Home's website at kbhome.com. The recording will be available via telephone replay until Midnight on January 16 by calling 719-457-0820 or 888-203-1112 and using the replay passcode of 4152590. A replay will also be available through KB Home's website for 30 days.
KB Home's discussion today may include certain predictions and other forward-looking statements that reflect management's current expectations or forecasts of market and economic conditions and of the company's business activities, prospects, strategies and financial and operational results. These statements are not guarantees of future performance and due to a number of risks, uncertainties and other factors outside of its control, KB Home's actual results could be materially different from those expressed or implied by the forward-looking statements. Many of these risk factors are identified in KB Home's filings with the SEC, which the company urges you to read with care.
The discussion today may also include references to non-GAAP financial measures as defined in Regulation G. The reconciliation of these non-GAAP financial measures to their most directly comparable GAAP financial measures and other Regulation G required information is provided in the company's earnings release, which is posted on the Investor Relations page of the company's website under recent releases and through the Financial Information News Release link on the right-hand side of the page.
And now I would like to turn the conference over to Mr. Jeff Mezger. Please go ahead, sir.

Jeffrey T. Mezger, President and Chief Executive Officer:
Thanks, Kelsey. Happy New Year, everyone. Thank you for joining us today for a discussion of our fourth quarter and full year 2010 results. With me this morning are Jeff Kaminski, our Executive Vice President and Chief Financial Officer; and Bill Hollinger, our Senior Vice President and Chief Accounting Officer.
This morning I will provide some color on our operational and financial results and also discuss how our disciplined approach to executing on our strategic goals continues to generate steady improvement on many fronts despite the historic market conditions in which we are operating.
Next, Jeff Kaminski will offer details on our financials, and then I will conclude our prepared remarks by summarizing our outlook for KB Home as we begin the New Year. As always, we will then open the call to your questions.
One of our key message points today is that our fourth quarter results reinforce the fact that our strategy to return our company to profitability is working. The primary components of this strategy, which we have consistently shared with you over the last couple of years, have remained the same.
These actions include continuing to execute on our disciplined KBnxt Built to Order business model, improving and refining our successful Open Series product offerings, right-sizing our overhead for current market conditions while retaining our growth platform, maintaining a liquid balance sheet that

Copyright (c) 2011

allows us to be nimble and opportunistic and reinvesting in highly desirable sub-markets at attractive lot costs. As we continue to follow this successful road map, we are very pleased with how we have transformed and repositioned our company as we head into 2011.

We are also very pleased to report a profit for the fourth quarter of 2010 based on our solid financial performance in a number of areas of our business. We generated net income for the quarter of $17.4 million or $0.23 per diluted share with these earnings driven by improvements in our core home building operations. These favorable results demonstrate that we now have the capability to generate earnings on lower revenue levels based in large part on our tremendous progress in improving our gross margin and lowering our SG&A expenses.

Our reinvestment in top performing sub-markets in 2010 will create immediate opportunities for us in 2011. For the long term, we continue to operate in 28 of the best-positioned growth markets in the U.S. where we have experience delivering significantly higher volumes than our current levels. In essence we have reset our cost to operate and breakeven volume needs and have a great opportunity to leverage our business platform as housing markets recover.

As we shared with you early in 2010, our goal was to achieve profitability at some point in the latter part of the year. In fact, on a cumulative basis, we actually achieved positive net income for the entire second half of the year in spite of the volatility created by the home buyer tax credits and the stronger than expected economic headwinds we experienced.

While recent data suggests that the economy has started to recover, this improvement has not yet resulted in sustained job growth or higher consumer confidence, the two necessary components of any housing recovery. We recognize that without these two drivers, the combination of soft demand and excess supply will continue to be a challenge and the overall housing recovery will be a slow one.

Having said that, there are some encouraging signs. In many markets, the most desirable sub-markets that are close to employment centers are stabilizing. These areas are demonstrating price stability, fewer foreclosures, and supply and demand that are in balance. This dynamic is a result of incredible levels of affordability that are attracting buyers to these areas where they want to live, but previously could not afford to. This trend will, in the course of a typical recovery, continue to gradually expand over time to locations that are a little farther out. At KB Home, we have been investing in these more desirable sub-markets that will be the first to significantly benefit once the eventual recovery in housing takes hold.

Turning back to our results, we were pleased with our overall financial performance in the fourth quarter, especially in light of the fact that we missed on our delivery projections. We delivered 1,918 homes in the fourth quarter as our backlog conversion averaged a highly efficient rate of nearly 90%. However, deliveries were impacted by an unexpected increase in our cancellation rate particularly during the month of November, primarily due to a more cautious mortgage-underwriting environment.

In many cases, buyers who received loan approval at the start of construction were subsequently declined as their homes neared completion. Underscoring this issue is the fact that the average FICO score of our buyers in the fourth quarter was 723, the highest level it has been in at least five years, reflecting the more stringent lending standards.

Net orders during the quarter totaled 1,085, a 25% decrease from the fourth quarter of 2009, in part due to the increased cancellation rate and new stricter underwriting guidelines I just referred to. In contrast, our gross orders were down just 17%. While our orders were disappointing, we did continue our sequential year-over-year improvement that has been occurring since the tax credit expired. We are hopeful this trend continues as we enter 2011.

During the quarter we remained disciplined in our pricing strategy as we emphasized profit over volume. We will continue to evaluate the tradeoff of sales pace versus margin depending on demand as we enter the selling season.

Copyright (c) 2011

On a positive note, for the first time in nearly five years, we saw an increase in year-over-year traffic levels in the fourth quarter of 2010. While encouraging, it is also our experience that today's consumer is both patient and diligent and is not buying a home on their first, second or even their third visit. Because of this lengthened buying process, driving increased traffic to our communities is an absolute priority. We are constantly developing new ways to bring potential buyers in, from offering free holiday family portraits at our communities in December, to re-launching our How to buy a Home events this month, which were such a great success last year.

In particular, we have an expanded emphasis on the advantages of our Built to Order approach. Our company has a history of creative marketing efforts and we have a lot planned for 2011. When you couple higher traffic levels with increased marketing outreach, the spring selling season, and our plans to grand open 70 new communities in the first half of the year, it is our expectation that order rates will improve.

We have also been prudently planning for the future growth of our business by investing approximately 560 million in land and land development in 2010. Our strong and liquid balance sheet has allowed us to opportunistically reinvest in highly desirable sub-markets at lower prices, the kind of investments that cannot only perform in today's market but have the potential for even greater margins or higher absorption rates as the market improves over time.

Our focus remains on finished lots or fully entitled land that can quickly go from land closing to housing revenue as we continue to transition KB Home into a more land-light home-building company. While our average community count in 2010 was down year-over-year, we do expect, for the first time in many years, that we will increase our average community count in 2011. With sales per community that continue to be among the best in the industry, we are confident that our growing community count will bode well for our business going forward.

Now I'll turn it over to Jeff Kaminski, who will provide a review of our financials.

Jeff Kaminski, Executive Vice President and Chief Financial Officer:

Thank you, Jeff. As previously mentioned we substantially improved our operating performance for the 11th consecutive quarter. After reporting positive home-building operating income for the first time in nearly four years last quarter, we repeated that encouraging result again in the fourth quarter of 2010, generating home building operating income of $29.1 million, compared to a loss of $81.5 million in the prior year's quarter.

On a pre-tax basis, we reported income of $15.4 million, compared to the prior year's fourth quarter pre-tax loss of $91 million. And it was especially satisfying to report net income of $17.4 million or $0.23 per share in the quarter.

These results included non-cash charges of just $3.2 million for inventory impairments and abandonments in the fourth quarter 2010, versus $77.2 million of charges in the fourth quarter of 2009, relating to inventory and joint-venture impairments and the abandonment of land option contracts. On a full-year basis, impairments and abandonments totaled $19.9 million in fiscal 2010, with the majority of those occurring in the first quarter compared to $206.7 million incurred in fiscal 2009.

Despite the fact that we had anticipated some pricing pressures and product mix impact reflecting in part the sale of more spec homes, our margins actually improved in the fourth quarter. Our housing gross margin excluding impairments increased to 19.7% in the quarter, versus 19% in the prior year and was also up 150 basis points sequentially over the third quarter of 2010. Factors contributing to this performance included continued pricing discipline as we emphasized profits over volume, an increased proportion of deliveries coming out of higher priced communities in California, improved operating efficiencies and product mix. In addition, the trend of increased deliveries coming from new communities continued during the quarter. 37% of

Copyright (c) 2011

our deliveries in the fourth quarter related to previously impaired communities, compared to 79% during the same period of 2009 and 47% in the third quarter 2010.

We delivered 1,918 homes in Q4 at an average selling price of $232,500 generating $446 million in housing revenues. This higher average selling price was primarily due to regional and product mix, rather than pure price appreciation. Our backlog at November 30, 2010 stood at 1,336 homes representing potential future housing revenues of approximately $263.8 million. This lower year-over-year number reflects our high backlog conversion rate, increased cancellations and softer sales in the fourth quarter.

Our SG&A expense ratio narrowed steadily throughout 2010 representing 12.5% of housing revenues in the fourth quarter. Our continued actions to reduce overhead produced our third consecutive quarter of improvement and a notable change from where we started out in the first quarter 2010 at 27.5%. This figure also compared favorably to the 13.8% reported in the fourth quarter 2009. On a full-year basis, we achieved an SG&A expense ratio of 18.4% in 2010, in line with our guidance at the beginning of the year.

We ended our fiscal year with over $1 billion in total cash, maintaining our strong and flexible balance sheet even as we made considerable investments in land and land development totaling approximately $560 million in fiscal 2010.

Now I'll turn the call back over to Jeff Mezger for closing remarks.

Jeffrey T. Mezger, President and Chief Executive Officer:

Thanks, Jeff. As we've shared today, we are making strong progress on our financial results while maintaining a sharp focus on the disciplines of our KBnxt Built to Order business model and diligently expanding our growth platform. We are also constantly looking for ways to differentiate KB Home in the marketplace, recognizing that re-sales remain our biggest competitor. One of the most impactful ways we are standing out against other new homes and in particular resale homes is through our sustainability initiatives. KB Home is receiving a lot of media and other third-party recognition for our sustainability programs and consumers are responding favorably as well. We have developed ways to include features that provide significant benefits to our customers without materially affecting the price of their homes. In fact, our EPA ENERGY STAR qualified homes dramatically reduce our buyers' ongoing cost of homeownership. In an industry that does not have many game changers, this is definitely one of them and KB Home has clearly established itself as the front-runner in this area.

We are recently named the number one green homebuilder based on a study conducted by Calvert Investments, a leading voice on corporate sustainability performance across all industries. Our overall score was almost double that of the next best performing homebuilder and over 10 times the average score of the remaining eight builders in the study. These results firmly establish KB Home as the leader of the industry when it comes to sustainability.

Our spirit of leadership and innovation in the area of earth friendly home building will in many ways be embodied in our GreenHouse Idea Home created with Martha Stewart, which will be unveiled at the International Builders Show in Orlando next week. This beautiful and highly functional home is our first net-zero energy home, which means it produces more energy than it consumes over the course of a year, a maximized energy-efficient home according to the Department of Energy that results in an annual energy credit rather than a cost for the homeowner.

This is an actual KB Home floor plan that we will offer in Orlando that has been inspired by Martha Stewart and equipped with state-of-the-art features we believe could one day be standard in all new production homes. The KB Home GreenHouse has served as a laboratory for us to explore technologies that are new to KB Home and we look forward to showcasing how a volume homebuilder can apply these technologies that are good for the environment and a real benefit for our customers. We will also leverage the showcase event to promote a new Martha Stewart Community nearby that will feature this floor plan and open

Copyright (c) 2011

for sales in the spring.
Our sustainability initiatives are not only ingrained in our culture, these accomplishments are cementing the KB Home brand as the number one environmental choice for homebuyers.
In addition to sustainability, we have also differentiated KB Home through our brand and marketing efforts, our Open Series product innovation and the many benefits of our Built to Order business model. From the value and choice consumers appreciate as they go through the studio process to the risk adverse attributes of our pre-sold delivery cycle, land light positioning and mortgage venture with Bank of America. We also believe our business is concentrated in the right markets for when housing recovers.
In closing, let me summarize our 2010 accomplishments. We continuously improved our operating performance including reducing costs and growing margins culminated in a fourth quarter and second-half profit. We refined our popular Open Series product lines, lowered our cost to build and accelerated our earth-friendly home building initiatives to meet the demands of today's homebuyers. We achieved record high customer satisfaction levels based on both the recent JD Power and Associates surveys and our own internal customer satisfaction scores. And we invested in well-positioned sub-markets that set us up for future growth while maintaining over 1 billion in cash.
As gratifying as it is for our company to reach profitability in the fourth quarter and second half of 2010, we recognize that there are many challenges still facing the housing market that will likely persist until the improving economy translates into job growth and higher consumer confidence. It was the transformation of our company over the past few years, with a constant focus on operating efficiencies, that allowed us to report a fourth quarter profit and set up the capability to achieve profitability at lower revenue levels. At the same time, we have retained the strategic leverage of our growth platform, which will provide significant opportunities as the markets recover.
As we look forward to 2011, the essential elements of our strategy as a company include: adhering to the pure execution of our KBnxt Built to Order business model; working diligently to expand our top line by growing our community count and increasing traffic and sales conversion levels; continuing to opportunistically invest in targeted, desirable sub-markets; taking out additional efficiencies and driving down our costs; maintaining our strong balance sheet; remaining nimble and proactive in response to the market conditions; and achieving world class customer satisfaction levels.
As I have said many times, we cannot control the market but we can control how we operate within it and these strategic actions are all within our control. We do believe the economy is starting to improve, however, it will be some time before housing markets fully recover. In the meantime, KB Home will continue to execute our integrated strategy that allows us to successfully compete in today's environment, as we remain committed to the goal of running a profitable business at whatever scale the market will sustain.
I'd like to recognize and congratulate the KB Home employees for their continued efforts and accomplishments. I know our company would not be this well positioned without the commitment, pride and enthusiasm that the KB Home team brings to work each day. As we begin the New Year, we are confident that our business strategy and results have positioned us to be profitable. If the market gains strength, we're poised to generate upside. If the market does not strengthen, then we will react accordingly and make adjustments. We are both optimistic and cautious but above all, we are prepared for whatever the future holds.
With that, Jeff, Bill and I will now take your questions.

Q&A

Operator:
We'll go first to Jonathan Ellis with Bank of America Merrill Lynch.

Copyright (c) 2011

<Q - Jonathan Ellis>: Thanks, and good morning, guys.

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Good morning.

<Q - Jonathan Ellis>: First I wanted to talk about just the cost structure, gross margins and SG&A. On gross margins, given the strength in orders in your California market, would you expect gross margins through the first half of 2011 to remain around current levels? Or perhaps because of product mix shifts there may be some gross margin compression? And then on SG&A, any reason to think that the current level of SG&A and obviously putting aside how sales commissions may affect that number, but just the G&A portion, any reason to think that would deviate from where we are right now going into 2011?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Jonathan, let me make a couple of comments. I'll refer it to Jeff K., to differentiate us today, to give you those specific numbers.
Relative to gross margin and mix, based on where we've invested in 2010, we do expect over the year for California and Texas to become a larger part of our mix, California in particular being the driver. And it's difficult to peg and say margins will be higher in that even within California there's a big difference in margin between a home that we deliver in Redwood Shores, and a home we deliver in Sacramento within the same division. So in any given month with our revenue levels, you can influence margin a lot by a handful of communities within the mix.
And again, I'll let Jeff speak to the specifics, but as to SG&A, I can share that the improvements in SG&A have not necessarily been tied to the variable sales cost. I believe that our selling cost, whether it's commissions or closing costs, have remained fairly static and the improvement is more in the other costs within that bucket. Any color for him, Jeff?

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: Yeah, I'll add a little bit of color on the SG&A side especially. The volume impact we are running at about 6% variable. That stayed pretty much consistent quarter-over-quarter, as Jeff said, as well as last year same quarter. That brought us about $10 million of savings for the third quarter due to top line volume levels. We had some pretty significant savings in categories such as salaries, rent, incentive compensation and insurance of about $12 million.
We did have some legal recoveries during the quarter, which is good news for us. As everyone is aware, we had some unusually high legal expenses in the first part of the year, and we're going through some tremendous efforts right now to gain recoveries, whether it be through insurance or through any other means possible as we go forward. So we had about $3 million of recoveries in the quarter and plan to continue to push for that as we go into 2011. Then professional fees and outside services were also down $3 million in dollar terms.
So the way I'd characterize it actually both on the margin side and on the SG&A side, is we had, as always, a number of things going both ways, but the predominance of the activity this quarter during the closing process were on the positive side. So we had just about everything going the right way for us. It was a very satisfying quarter both from an expense control point of view as well as from a margin point of view, and we were pleased with that result.

<Q - Jonathan Ellis>: Okay, great. My second question is just looking into community count, I appreciate the guidance in terms of 70 new community openings. I think you had previously given a target of 25% growth in 2011. Maybe if you can just help us out with where community count ended this year so we have a sense of what the starting point is? And then to the extent do

Copyright (c) 2011

you still feel that your community count will grow for the full year around 25%?

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: Yes. So we had - we ended the year at about 132 communities, which gave us an average for the year of 130 under our calculation methodology. As we had mentioned, we are planning to open about 70 communities in the first six months. I think importantly, the regions where we're planning to open those communities are heavily weighted towards California and our Central region with about 50 communities opening in those two markets overall. And we are still expecting a 25% increase in that average. So it's pretty much as planned as we've been talking about for the past couple quarters.

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: It's actually a very nice mix, as we've shared. We're positioned now where we're incurring the cost. We're starting to incur the cost of these openings as they come online in the next five months at the same time, having lowered our overhead structure. So you have a nice revenue opportunity at a lower cost level.

Operator:
Our next question will come from Ivy Zelman with Zelman & Associates.

<Q - Ivy Zelman>: Good morning, guys. With respect to your impressive profitability, I think everyone's kind of looking at the sustainability of that, and you said that you were challenged with underwriting that's more stringent, which resulted in a pretty nice increase in cancellations. So I guess whether we ask it slightly different than the prior question, your sustainability going into 2011 even on your backlog being as low as it is, you feel pretty comfortable with that? And that the revenues, although likely to be down because of backlog and continued struggles or challenges in the market, should not be mitigating the profitability and enabling you to remain profitable in the first and second quarter?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Ivy, I'll talk to the backlog and the market situation. And then Jeff can go at any guidance on where we're headed. As we mentioned in our prepared comments, we were surprised by the cancellations we incurred, which were primarily on homes under construction not dirt.
As you know in our business model, normally your can rate is higher on homes you haven't started as you filter through it before you start the home. We're trying to get our arms around whether it's changes in documentation; the cautious approach that lenders are taking. I'd say the industry, not just our venture partner, has required us to reset expectations on what you have to provide the lenders in the process and upfront so we don't have any surprises at the 11th hour. I don't think that that's a sustained can rate. I think it's a short-term spike because we'll reset and we'll figure it out and we'll go right back to work.
Relative to backlog, obviously we'd like more backlog at any time because it is a crystal ball for us since we're going to stay disciplined as a Built to Order company. We've shortened our cycle times where we can take backlog and convert it into deliveries and revenue much faster than in the past. And heading into the year we have some work to do. Our backlog's down - well, you can look at the percentage. I want to say it's 400 or 500 in units, something like that.
So it's not a big number to catch up and pass and we'll wait and see what happens as we open these communities and as we see how the spring selling season evolves. We elected not to chase sales in early November, at that time in the year by getting very aggressive on pricing because there's not that many buyers that are going to show up and close in three weeks during the Thanksgiving season or certainly into December. So we elected - let's turn the corner into 2011 and see what type of market we're facing.

Copyright (c) 2011

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: Yeah, okay. Yeah, and on the guidance side, I - given the current uncertainty around the markets and the lower order rates that we've recently experienced, we're really not planning to give detailed guidance during this call as far as how 2011 will shape up. Instead, we'd like to make a few more directional comments. And I guess first of all, starting with the first quarter, given the backlog levels and what we expect volume and top line to be, it's not likely to be a profitable quarter for us. And while we'd certainly like to push for that, it's probably not in the cards for us in the first quarter. Despite that however, subject to the selling season again, and the strengthening of the top line, we do believe we are well positioned to have a profitable 2011 in total as we go through the year. So that's pretty much where we're at right now. As far as specifics, as far as percentages, we're basically going to stay away from that during the call.

<Q - Ivy Zelman>: Well, for - I appreciate that. My second question with the media having recently discussed the joint venture you're involved in with the largest - I guess builder at 48% of Inspirada, can you give us as much information to mitigate uncertainty around the potential risk associated with this joint venture with J.P. Morgan trying to push you guys into involuntary bankruptcy and the risks associated with the debt and taking down lots priced at $500,000 as the original value in '04?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Sure. I'm glad you asked that question, Ivy, because I know that that issue has gotten some media coverage recently. And before Jeff gives you the financial details, I'd like to make a few comments about the actual Inspirada community itself, which is a development that's underlying the South Edge joint venture. To date we've delivered 534 homes at Inspirada since it opened in 2007 and it continues to be one of our best-selling communities in Las Vegas due to its highly desirable location in one of the top performing sub-markets in Vegas today. We're currently open for sale within the development, and we'll actually be introducing an additional product line this spring.
During the fourth quarter, we delivered 40 homes in the various Inspirada communities where there's amenities in place including pools; there's clubhouses, there's parks, there's an amphitheater. It's really a nice community where we're selling the homes today. And I say that because we have a real stake in the success of this community where we have our employees and also our customers that matter greatly to us.
Now I'll talk briefly about the recent news regarding Inspirada and then Jeff can give you the financial detail, all of which is intended to question - to address the questions that the people on the call may have.
As you've seen and heard, on December 9, J.P. Morgan and two of the other lenders filed an involuntary Chapter 11 Bankruptcy petition against the South Edge joint venture. It's another step in what's been a several year litigation process. Yesterday, the South Edge JV filed papers asking the Bankruptcy Court to dismiss the involuntary bankruptcy petition. We agreed with the South Edge filing. The bankruptcy judge is scheduled to decide by early February whether the case would proceed or whether it will be dismissed. Jeff, recognizing it's in litigation, can provide the details that we can share?

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: Yes, I'd be happy to, Jeff. Much of this we have shared in past public filings but I think it will be helpful to go over a few things again. First of all, we have accounted for this entity as an unconsolidated joint venture. A subsidiary of KB Home, KB Home Nevada Inc, owns 48.5% of the entity and at year-end for us we had $45 million of investment balance and the unconsolidated joint venture had bank debt of approximately $328 million in outstanding principal. The original capacity of the bank facility was about

Copyright (c) 2011

$585 million.
As you can read in the third quarter 10-Q, the company has also provided to the lenders a limited several guaranty of certain of the JV's obligations, which may be triggered by an involuntary bankruptcy of the venture that is not dismissed within 60 days. At November 30, 2010, if the guaranty were then in force, the company's maximum potential responsibility under the guaranty could have been about $180 million in principal. In addition, there may be claims by the banks for fees and for accrued and unpaid interest, our share of which could run into the tens of millions of dollars if the banks are successful. However, none of these figures take into account any offsets or defenses that could be available us to.
Also disclosed in our third quarter 10-Q, on July 6, 2010, a decision was issued in an arbitration proceeding regarding the South Edge joint venture in order to address one member's claims for specific performance of lot take down contracts, and in the alternative damages. In its decision, the arbitration panel denied the specific performance claim that would have forced the purchase of the land and instead the panel awarded damages to one of the venture members in the amount of $36.8 million, which we thought was erroneously high, and which we are seeking to reduce on appeal. KB Home Nevada, Inc. will be responsible for a share of the final award.
Now let me take a minute to return the involuntary bankruptcy filing that we discussed earlier. You may have read that the lenders are seeking the appointment of a trustee for the venture who would then, according to the press report, attempt to force the builders, including our subsidiary, KB Home Nevada, Inc., to buy land from South Edge. For a number of reasons we do not believe that this should occur. As Jeff said we believe that the involuntary bankruptcy petition should be dismissed. If that happens, litigation between the builders and the lenders will continue in the federal court. The lenders have asserted claims under other guaranties as well as other claims, all of which are disputed.
In connection with our period-end closing procedures and in accordance with U.S. GAAP, we assess the carrying value of joint venture investments and we assess our potential liabilities resulting from pending litigation. In prior periods we recorded and at year-end we carried significant provisions on our balance sheet for potential contingencies relating to this issue. There's a wide range of possible outcomes in the South Edge litigation from good to bad as in any complex litigation and the ultimate result could be materially different than our assessments.
As Jeff said, we are proud of the Inspirada community and we want it to continue to succeed. We remain hopeful that we can reach a mutually satisfactory resolution with the lenders. Due to the outstanding litigation we really can't comment much beyond the above. Please also reference our 2010 Form 10-K that will be filed prior to the end of January for disclosure relating to our unconsolidated joint ventures including this one.
So like I said, that's pretty much what we're prepared to say today on the JV and hopefully that provides some additional level of detail to the folks on the phone and helps clarify some of the uncertainty around the issue.

Operator:
Moving on to Michael Smith with JMP Securities.

<Q - Michael Smith>: Hey, guys. How you doing?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Morning, Michael.

<Q - Michael Smith>: Just a couple quick questions. One is could you just give some color on what's happening out there on the land market? I know we heard early in 2009 it really got heated and then it slowed down quite a bit. I'm wondering in anticipation of maybe a little bit better 2011 especially in the spring, if you've seen it start to heat up again and what effect that's

Copyright (c) 2011

having on pricing in the places where you guys are looking?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Okay. Well, you're absolutely correct that back in the spring of '10 there was some frenzy out there as people started feeling better about things, whether it was builders or some of the speculators that are out there playing in the land market and that frenzy quickly went away by late summer and into early fall. The public builders in particular continue to be very disciplined. And we're not seeing a lot of pressure right now on land prices moving up. I think it has calmed down again.
We remain very disciplined on underwriting to our hurdles and very selective in where we're going to invest. So if the things that hit the media like the portfolio auction with 50 bidders and the high gloss brochure, we're not even participating in those kind of things. And most of our acquisitions continue to be created through our network, our relations - with our long-term relationships with developers and land sellers. And frankly in many cases the parcel doesn't even go to market when we've tied it up. So I think if the market improves, you'll see more pressure on land pricing, but we're not seeing it at this point in time.

<Q - Michael Smith>: Okay. Thanks, guys. Another question, just to kind of follow up, you were speaking earlier, Jeff, about not lowering your prices in November as a way of kind of bringing out buyers, because you understood they wouldn't have much time to close. I'm wondering if that's a way of saying that you might be more open to some price cuts or some added incentives in the spring if the demand doesn't materialize? Are you guys still kind of, of the opinion that finance is pretty inelastic at this point and buyers are going to come, and the buyers are going to come, and there's not a whole lot of pricing options that you have there?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Sure. Well, I can make a few comments, Michael. It's kind of a numbers game, and the more traffic and the more demand and more buyers, the less you have to do to sell homes, a pretty fundamental theory. And in November your traffic levels are lower than they are in February or March, so you'll have more people and more interests naturally. And we just elected not to even test hey, if we lower prices by x%, how many more could we sell in November? Because I just don't think it would have had that much of an impact.
As we enter the year, and we've always shown flexibility to do what it takes to run our business, we will continue to manage each asset. It's not a company strategy. It's a community strategy, where we'll try to balance the sales pace to the price, to the margin, to the cash flow. What's the return? What's the best way to manage in that subdivision? And if in a sub-market in that subdivision we're not getting close to the sales we need, we'll do something to make that a more attractive value proposition to the consumer. Having said that, we don't fall in the trap of throwing more incentives out there. Our business model is based on value to the customer. You won't see us playing let's make a deal. We'll offer the best value. If we're out of the market and it's not selling and we got the get out of the asset, it would probably come in adjustments to price.
We're hopeful here, between the mix of community openings, the traffic uptick that we saw, which tells us there's momentum building in consumer demand, that we can fall into what I'll call a muted, typical, spring selling season. If we get that, I think we'll be fine. If it doesn't show up, we'll take whatever steps we need to to keep selling at a level that covers our overhead.

Operator:
We'll now hear from Michael Rehaut with JP Morgan.

<Q - Michael Rehaut>: Thanks. Good morning, everyone.

Copyright (c) 2011

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Morning, Michael.

<Q - Michael Rehaut>: First question, if I could just circle back to the order trends during the quarter, and I was wondering if, just to peel back the onion a little bit more, you had mentioned that the can rate difficulties were centered - kind of popped up in November. Did they come back down in December? I was wondering if you could also just walk us through how the can rate trended throughout the quarter? And also order trends in general, if you saw a softer sales pace or absorption rate as you got through the quarter as well?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Michael, I mentioned the can rate spiked in particular in November. It was higher in October than it had been. September was fairly typical. And the can rate normally is a sign of how stable or instable the market is. And for a five-quarter period, our can rate had been pretty consistent. When I say can rate, we look at it both as a percent of backlog or a percent of gross. As a percent of backlog even, it had been pretty consistent for five quarters. All of the sudden it spiked here in October and November. I don't think it was a spike because of a big shift in consumer sentiment or people that don't want to buy a home.
Normally when people have made the decision to buy with us, been through the studio process, have been advised that their loan is either approved or very approvable, they're now relieved and they wait for us to get their home completed. And what happened here in the fall, again, particularly in November, as homes were getting completed, new conditions came up, more requirements came up and people that were once approved now can't qualify for the homes. So it was an odd dynamic that we're trying to get our arms around. As we said in our prepared comments, the traffic trends in November are very, very encouraging because they were up - not just November, the whole quarter, but November our traffic held very well. So we can say it's a softer holiday season, but traffic levels were high. Traffic was up about 11%. And in December we can share, and we don't like to do a lot within the current quarter, and you certainly don't like to gauge December as a reflection on what the overall market's going to do because of the influence of all the activities in the holidays. But even in December, our traffic levels continued to be up year-over-year. So it's very encouraging as we head into 2011. And we'll see what it means.

<Q - Michael Rehaut>: Okay. Appreciate that. And just a second question. First off, just following up on the first question, if there's any way just to comment on if can rates kind of receded as you said you expect it to be - it's a spike, you expect it to come back down. I'm just curious if you can comment on December. But aside from that, my follow up - my second question is on the comments from last quarter regarding spec that you thought you might increase spec as a percent of your product offering. Historically, I think with the KBnxt Built to Order, it's in the single digits perhaps of closings. I was under the impression that you were thinking maybe pushing it up to 20%-ish type range, which is still below I think a lot of other builders but higher for you guys.
With the volatility in the can rates, does that give you pause to maybe go back to historically how you approach spec in the lower single digits? Or are you going to stick with maybe a higher level of spec as we go into the - higher level of spec for you guys as we go into the spring?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Michael, you just exceeded two questions, by the way so - but we'll answer it since you successfully blended it together and tied it to the same thing. We don't - I don't have and Bill's telling me, we don't have with us right now what the

Copyright (c) 2011

can rate is in December. And again, we're early in the quarter. My hunch is it'll settle down and whatever it is, we'll manage to that issue.
But relative to the spec strategy and our Built to Order model and where we're going ahead of time, or not ahead of time, but into '11, it's been my experience over the years that it's not unusual to resell a spec two or three times. It's not a predictable business model. So the last thing I would want to do is throw more specs in the ground, to lower a can rate or to have more of a predictable revenue stream. And Jeff can talk to the spec and the backlog ratios in a minute.
We, as a company, have always had the goal of a 90/10 ratio. 90% sold under construction, 10% unsold. It's been elevated a little bit over the last few years depending on what level of stability there is in the marketplace. So it's probably been 80/20, 85/15. It broke my heart to decide to go into that spec strategy going into the second half of '10. When you take a look back at the 10 or 12 years I personally sweated and bled in order to get us to this business model, you risk giving it away as you are dealing with today's business environment.
Nevertheless, we did. And I think along the way it created some confusion for our sales team, for our brand, for our customer, and we have an intense focus on getting back to our core business model, are not starting much if any inventory today. Maybe that odd lot that is left on a cul-de-sac, and we're pure on our business model from a selling effort point of view. The spec strategy was successful relative to helping us cover revenue and achieve the deliveries that we did in the fourth quarter, but it's not something we're sustaining going forward. We're - the flag is in the ground; we're committed to being a Built to Order company.

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: Mike, I'll give you a little more detail on the numbers more specifically. As you know, when we ended the third quarter we had a higher amount of unsold inventory than is usual for KB, and we had about 400 units of finished and about 600 under construction, or a little over 1,000 units total. The spec sales during the fourth quarter helped cover part of our unexpected spike in backlog that we experienced. So we were...

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Can spike.

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: Right. I'm sorry, yeah; can spike. So we're happy with that. The strategy worked well. We sold through a fair amount of the inventory during the quarter, and we ended Q4 reducing the total unsold inventory by about 300 units. So we were down about 30%, from 1,000 units down to about 700 units at the end of the fourth quarter. Of the 700, and I think it is important to note that of the 700, about 175 of those units relates to the two Southern California condo projects that we've discussed in the past. And that's a pretty significant number. If you pull those out, you're at about 500 specs at the end of the quarter both finished and under construction and a much more reasonable number for the business.
In summary, a few things; during the quarter, again, we did think the strategy worked well. It helped cover some of the cans that we had. As Jeff said, most of the additional specs if any that started during the quarter were actually as a result of cancellations. So we're really back to the business model as we've operated in the past and as we'll continue to operate it. We'll continue to work through those unsold units through the system and we expect to work through those in the first half of 2011, as we get to a much more normalized level for the business and for the strategy. We really don't see it as a problem or an issue, and we're really not totally out of a line as we're entering 2011. We believe it will be an issue that we'll address, and we'll continue to stay on our strategy of Built to Order.

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: The other

Copyright (c) 2011

thing that I could add is in our experience in the fourth quarter deliveries, the margins on the inventory we did sell was lower than our Built to Order deliveries, so while it got us the top line and helps cover the overhead, it does mute your gross margin, because your margins don't run as high. I like being predictable with higher margins, and that's our goal.

Operator:
Buck Horne with Raymond James has the next question.

<Q - Buck Horne>: Hi. Thanks, gentlemen. I guess just talking a little bit about buyer preferences right now, for those that are qualifying for the mortgages and aren't having to get cancelled, have you noticed any shifts in buyer preferences? As the economy started to improve here, are buyers still very value focused? Or are they starting to look at larger floor plans or more upgrades and options? Is there any change in the consumer? Are they loosening up the purse strings any?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: It's a great question, Buck. One of the things I would like to add to your question, when we talk about some signs that maybe things are normalizing, certainly in the more highly desirable sub-markets, but prior to the frenzy in the middle of the decade, about 50% of our buyers would go to the studio, identify what options and features they wanted in their home, and then go buy the house. And that had been in place for seven or eight years prior to that. And that would have suggested at the time that a buyer intended to live in the home longer and wanted exactly their features and benefits in the home.
In the frenzy, when people started buying to flip, or buying as an investment, or not expecting to live there very long, that process really was muted. And most of the people bought the home and then went to the studio. Over the last 90 to 120 days we have seen the trend re-emerge where a lot of the buyers, I don't know that it's half but it's a big number, are once again visiting the studios before they buy their home. So it tells me we're back to a buyer that's value conscious and wants to put in the home what they want for features and benefits, because they intend to live there.
Having said that, I don't know that we've seen any material shifts over the last six to nine months relative to the selections that they're putting in the home. For most of last year, the buyer was very much value conscious. My quote is always the Jacuzzis and granite are gone, and they'd rather have an extra bedroom or a second bathroom or functions in the home, or a little bit larger cabinet combination in the kitchen, things like that. Very value conscious, and a buyer that intends to live there.

<Q - Buck Horne>: Great, thank you. My follow up is kind of a shift here, but I just wanted to drill down really on the Florida markets and just wondering what your current thoughts are on the state of Florida in terms of the housing situation right now? Would you plan to possibly shrink your presence here until we start to work through some of these foreclosure and excess vacancy issues?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Buck, I don't know if you saw any of the comments from Bernanke this morning, but he and I seem to be on the same page because he observed that while the economy is definitely headed in the right track, there hasn't been a lot of traction on jobs. And you need the jobs to help housing. And he went from there right to housing and that housing still has issues. I think those two combinations are most appropriate for Florida where a lot of the markets were driven by second home buyers or pure speculators instead of people wanting to live in the home because they were occurring in markets that didn't have a lot of jobs in the first place. I think it'll be some time before those peripheral areas get any kind of traction in housing, up around Punta Gorda and north of Fort Myers or the stretch between Palm Beach and Daytona Beach.

Copyright (c) 2011

Having said that, we're very bullish in the long run on the core markets that we're in of Jacksonville, Orlando and Central Florida and then Tampa and the West Coast. I smiled when you asked if we're reducing our presence in that we already have by default. We're a much smaller business than we once were. I do believe we're the largest builder in Orlando, the last number I saw, and if not the largest, one of the top builders. And I'd say the same in Jacks and to a lesser intent, Tampa. So our intent is to manage our assets, keep our position, keep our network, keep our brand, be as lean as you can on overhead, and when things show the stability that we're seeing in Texas or in California, we'll go right back in and have a spring coiled. So, we like the state. We just think it's going be one of the slower recoveries.

Operator:
And our next question will come from Joshua Pollard with Goldman Sachs.

<Q - Joshua Pollard>: Hey, thanks for taking my question. The first is you talked about having higher traffic levels in the fourth quarter, and I think even into December. I'm looking at the comp and the fact that - and the fact that the first version of the homebuyer tax credit expired right around this time last year. When you guys look out to the second half, or excuse me the first half of 2011, would you anticipate that traffic levels would continue to be higher than they were versus the previous year comp?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Yeah, let me make an observation for you, Josh, and then I'll give you my thoughts. We stopped promoting that first tax credit in July and August because we are a Built to Order company and you had to sell it in order to build it and still qualify for the credit. So our promotions tied to the credit actually ended mid-year.
In '10, about this time last year, we saw an uptick in traffic. We saw an uptick in interest. My sense is the tax credit didn't start be a real driver until March and April when you approached the deadline and there was this urgency created because of the deadline.
It's normal this time of year for traffic to pick up. I find it very interesting that in the November, December period, traffic picked up when in theory it's everything else going on and people aren't out looking for houses. So it's encouraging. And I would expect traffic levels overall will be up in the next few months because of the time of year we're in. Unclear whether it's going be up greater than it was with the tax credit influence. But we'll see. It's an encouraging sign.

<Q - Joshua Pollard>: Got it. The other question I have - and I'll make it a two-part question in Mike Rehaut fashion, but I won't tie them together. The first is, on your balance sheet. With your debt levels, I think you guys are net debt-to-cap roughly 55%. Are you guys comfortable there? Or in the cautiousness of your outlook, do you guys think that it starts to make more sense to start paying down debt with your cash and I'd love to sort of understand what you guys think is more than just a long-term capital structure, but where you think your capital structure should be over the next 12 to 18 months.
The other question I had, because I want to try and sneak it in, is if you look at your spec as a percentage of your backlog it was under 40% at the beginning of this fourth quarter. As you guys head into the first quarter, it's over 50%. And that's just a quick calculation of what your spec count is relative to your backlog. I'm trying to understand how that supports stable to higher margins? Thanks for taking those questions, guys.

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Okay. Josh, I'll speak high level, and then Jeff can share his thoughts on our balance sheet. First off, in normal times our range of a comfortable ratio is, as we've been for years, is 45% to 55%. We're net debt 55 today, but you're

Copyright (c) 2011

excluding the value of the DTA. As we can restore profitability if that DTA were to reverse, you've got a ratio significantly below that. I think it's even under 30%. Obviously nobody knows when that will be reversed and what impact it would be, but I wanted to remind people there is another element to this that's influencing our ratio relative to historical.
On the spec level, again, keep in mind of those numbers you just rattled off, 170 of them are tied to two condo projects, one of which we just started reporting in those numbers in the fourth quarter. So you have to look at each community on its own, and these condo buildings you don't open for sale until they're completed. So it's going to look like we have more inventory. If you back those two out, where it's not backlog and you've got this inventory, I think your ratio is much better. And we demonstrated in the fourth quarter we got rid of some inventory. It did hurt margin. Yet our overall margin was favorable. And as I shared on this call, we'll deal with each community on its own and meet the balance of sales pace on margins. Any thoughts on capital structure?

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: Yeah, I'll talk about the balance sheet for a minute. First of all, Josh, yes, we are comfortable with our debt levels right now from the point of view of being able to, obviously, to service to debt and also to refinance the company as we have maturities. I think you're aware that we do have 100 million maturing in August of this year, which we obviously intend to take down and at this point not replace, so we'll get some lower leverage out of that. We also have some project debt that we're looking at taking down. Actually, it's early in the first quarter. With the combination of the two, we'll obviously have some leverage improvement.
There are some opportunities beyond that. There's opportunities that we are exploring to reduce the negative carry, as you know, with $1 billion in cash and the debt levels we have, and with the current interest rate environment, we are experiencing some negative carry, a very obvious statement on the outlook or on the profile right now. We are exploring those opportunities to reduce that.

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: I can share also that we recognize the cash - it's an interesting observation when you say the cash is a debt asset. It's relative to it's not generating any return or it could be used to lower your cost through debt restructuring. Having said that, it's also our opportunity for growth and our assurance that we can then be able to manage through an extended downturn. I continue to look at the economic environment, and if things were to worsen again, I think the cash will come in handy. There isn't a day that goes by that Jeff and the team aren't talking about what to do with this, or I'm in there talking about what to do with this. It's definitely on our radar. And as Jeff said, we're exploring alternatives but there's nothing we're ready to say we want to do right now.

Operator:
David Goldberg with UBS. Please go ahead.

<Q - David Goldberg>: The first question I had, I was wondering if there was a way to tie the increase in traffic, maybe not coming through in orders at this point, to something with the underwriting standards? In other words, do you think the people that are coming to the community can qualify under tighter underwriting standards? Do you think that's an issue for people that are out there shopping now, but maybe not moving forward with the decision?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Obviously tighter underwriting standards are going to reduce the number of potential buyers, but some of the anecdotes I was sharing, David, these buyers that we were managing through in Q4, it wasn't always income or credit. It was other

Copyright (c) 2011

issues, other conditions, other documents, other requirements that came into play that may not have been as big an issue in the past. Whether it's FHA and VA, or conforming conventional, the money's still available. We've been selling homes at the prerequisite FICO scores on FHA for some time now.
So it absolutely reduces your pool, but there's still a pool out there for us that is more than ample to service our business needs. I think it gets down to people may or may not feel good about the economy, may or may not feel good about their jobs, definitely see the attraction to the affordability levels that are out there today and the appeal of our proposition, the product that we have to offer. They're just taking their time.
And the days of a floor pop are gone, as I used to call it, and I think because of that, our strategy is let's go invest and be more aggressive to generate more traffic. And it's numbers game. The more traffic you get, the more sales you get and depending on your conversion of traffic to sales, you'll target a traffic goal that will eventually turn into a sales goal. I don't - I wouldn't tie it to the qualifying. I'd just say people are cautious and concerned.

<Q - David Goldberg>: Got it. And then, Jeff Kaminski, just to make sure I understand, with the change in SG&A that you outlined in the comments, my understanding was about if we look sequentially at the number was about $23 million reduction in the SG&A, and I think you said $10 million came of that from variable cost reduction and just lower volumes generally and the remainder was from fixed costs, if I understood you correctly. Within the fixed costs it seems like it was $6 million delta from legal costs, of which half of that was recoveries and the other half was not incurring the additional legal costs that were out there. Is that correct how I heard that?

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: Well, yes. It's correct in some respects and maybe incorrect in others. First of all the comp in the numbers I went through were year-over-year. It wasn't third quarter to fourth. It was fourth to fourth. And I thought that was a fair comparison and a way to depict it due to some seasonality that you always get in the fourth quarter. So with the $173-odd million reduction in volume, that had about a 6% expense savings associated with it because that's about our variable cost ratio so that's where we started the other comp numbers were compared to that prior year period.
You are correct in your assessment on the legal side. We did have $3 million of recoveries and we had $3 million of improvements of reduced basically professional and not just legal but overall professional and other outside service costs during the quarter.

Operator:
Our next question will come from Dan Oppenheim with Credit Suisse.

<Q - Daniel Oppenheim>: Thanks very much. I was wondering if you can talk a little bit more about the specs. I guess, with last quarter you talked about 850 specs. Now you're saying that number was really 1,000 but that either way it came down to 700. But you said that the cancellation rate went up in October, November, closer to the end of the quarter and that you weren't pushing the volume. Was it that your spec levels came down significantly in September at the start of the quarter? Just trying to understand what happened and if you expect - if the cancellation is at the end of the quarter, typically that means more specs, not fewer?

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: Yeah, Dan, just to clarify on the numbers. At the end of last quarter, the 1,000 specs, that was total. That was the gross. There was 850 or roughly 850 net of the condo units, so just a quick clarification on that. And we have been separating that as we talked about before because the nature of condo buildings where you're putting up the building, you're building the units and

Copyright (c) 2011

by definition if you choose to open the building all at once, you have all those spec units either under construction or final. So that's the situation with the numbers.

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: The other thing I could add, Dan, you've tracked us for a long time, but typically we've had the benefit of a backlog that's stable and delivers when the home is completed and it got disrupted earlier a few years ago when things got a little more fragile and it has settled down for five quarters in a row. The can rate, we didn't break it out between inventory we sold in the quarter and pre-sold homes that came to completion and then the buyer couldn't qualify or didn't perform. But there was a lot of cans that occurred on homes that were sold and in construction at the start of the fourth quarter. So if you look at it, we're covering some of the inventory and we've shared that, that did help with the revenue. We had some cans on some of those that were started that we then would have covered but overall, we dropped our - if you eliminate the noise of these condos that are not a large part of our business, we dropped our inventories - Jeff, 300 units was your number?

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: 300 units.

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: About 300 units in the quarter.

<Q - Daniel Oppenheim>: Okay. I guess on gross margins and there's a significant sequential increase there in contrast to what we're seeing from most others in the industry. You're selling more specs in the quarter, which typically isn't good for gross margins. The ASP on closings was significantly higher than the ASP in backlog. It seems that there's some things going on there. How would you describe sort of what's underlying trends there? And as you think about that into the start of 2011?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: I shared, Dan, we know the margins were lower on the inventory deliveries, the spec sales that delivered. We also shared that we're seeing more business come out of our new communities as we open them. So you have this lift going on of the "good bank". And I put spec in the bad bank. But we - you had offsets going both ways on margin that blended together had a very nice outcome. And at our revenue size, your margin can move around a lot depending on the mix. And if we deliver 50 homes out of San Jose or Redwood Shores, at $100,000 a copy in margin versus a suburban Houston home at $15,000 a copy in margin, it's a big difference. So we don't have the straight line we once had when we had a lot more scale. I don't know if you want to give more thoughts on...

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: Yeah I think that...

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: On margin or expectation...

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: You summed it up. The drivers that we talked about during the first part were the main drivers on the margins; the pricing discipline, the specs were less of an impact than we had thought coming into it. Our mix shifted a bit during the quarter versus what we'd anticipated and it is significant that we did decrease the level of deliveries coming from previously impaired communities by another 10 percentage points during the quarter. It was like I said earlier on the SG&A and the margin virtually any of the factors, almost all the factors were positive this quarter, which is a little bit unusual. Usually you get more offsets going both ways. And we had a very fortunate

Copyright (c) 2011

quarter and it was a very good quarter of management by the team here at KB Home to generate that result.

Operator:
We'll now hear from Carl Reichardt with Wells Fargo Securities.

<Q - Carl Reichardt>: Hi, guys. Just one - two on my end. First, do you have the owned and option lot count at the end of the quarter, Bill?

<A - William Hollinger>: Yeah. Carl...

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: I have it right here, Bill.

<A - William Hollinger>: Okay.

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: We had 9,300 lots optioned at the end of the quarter. We had 39,500 in total.

<Q - Carl Reichardt>: Okay. And then can you talk a little bit about, to the extent you have it, the projected land spend for 2011 and land and development spend? And, also, do you think there'll be a point over '11 or into' 12, a tipping point where your qualifying inventory balance will start to allow you to cut back your interest expense and capitalize more?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Carl, I can make a few comments. We haven't pegged a number yet for '11 on land spend, whether acquisition or development. And frankly our sales experience over the next three or four months will drive that. But we continue to be opportunistic in these preferred sub-markets that I'm talking about. And we continue to underwrite at today's price, which gives you an automatic governor on how much money you're going to spend and to our hurdle. So you have these governors in place where we're opportunistic, but it needs to make sense and it needs to be aligned with our strategy. And for the year in '10, as I recall, we ended up growing our lots owned and controlled by about 2,000 through the year.
Heading into '11, we've now demonstrated, and you know we have $1 billion on the books, we can be as aggressive as we're comfortable with and we can be as prudent as we need to be depending on where the market takes us. It was - I don't think anybody's asked the question yet, but our investment is heavily, heavily weighted to highly desirable sub-markets in California right now. And I say that because in a lot of the other markets, it's an easy term option and you can buy a lot when you sell a home. But those also are places where the market's not as robust. So we're spending the dollars in the right places. But we're not really going to give a guidance. You know we have the capacity and the ability, but we want to see how the year unfolds.

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: Yes, and just to add to that a little bit. As Jeff said, the underwriting process continues to be very disciplined at the company. We'll continue that as we go into 2011 and it'll - it won't waiver as we go forward. On the capitalized interest question, my view on that and maybe coming from outside the industry is a little bit different than you hear it from others, but interest is interest to me. And whether you're going put it up into inventory and defer the expensing of it into a future period or take it up front, I'm less sensitive on it. I tend to look more at the cap side and the cash impact on the business. KB Home has a relatively conservative capitalization policy here within the company. As a result, we probably cap less than you might see out of some of the peers. But I do know at the bottom line it really doesn't make a difference over time on that policy. It's just a deferral of expense. Whether we hit an inflection point during 2011 as you said, to be seen, I

Copyright (c) 2011

guess, depending on the land spend. We like our land-light position. We definitely like the underwriting that we're going through and the new communities that we have coming online, and depending on the spend, pretty much, I would say it's going to depend more on the spend the second half of the year, whether we actually hit that inflection point or not.

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: I can also add the observation, our inventory was up year-over-year for the first time in many years, and to me that's a good thing, because it's inventory coming in the door in desirable sub markets as we continue to clean out and whittle away some of our holdings that weren't performing so well. So it's not tied to house inventory. It's investment in our future. So you'd love to see our inventory grow more right now, but it will only be if the investments make sense.

Operator:
Megan McGrath with Barclays Capital has the next question.

<Q - Megan McGrath>: Hi. Thanks. Most of my questions have been answered but I just wanted to see if you could give us more detail on the sub-markets that you talked about or the two areas that you're really focusing on for the first half of '11 being California and Texas and why your decision to go very aggressively there? Is that where you've found the best deals on land, so you're seeing the returns? Or are you seeing incrementally better traffic patterns in those two areas of the country? Or both?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Sure. Good questions Megan. You'll never find the best deals where your strategy is targeted, because everyone knows that's where the better opportunities are. It requires a lot of digging and hard work to uncover and negotiate and tie up the assets that are in a more preferred market, because they're typically more land constrained, and that's what creates a better supply-and-demand balance.
When we walk through our investment dashboard in every city, we will balance how resale inventory is performing, what level is it at, what's pricing doing, is it stable or not? And to us, a market is in balance when prices are stable, or up, and there's a six-month or less supply of re-sales. And through pretty much all of 2010, the more coastal oriented markets of California were demonstrating all the statistics that would suggest it's a good place to invest. The Bay Area in particular has held very well, frankly, through this whole cycle, and Southern Cal had a bump. The prices dropped much more, but where they dropped was 60 to 100 miles from the coast, not in Orange County or closer to the coast in L.A. County or around Chino and Corona, and those more close-in sub-markets near jobs.
So we have a strategy in every city. Those metrics will drive it. If you go over to Texas, Austin and San Antonio in particular, are seeing good job growth right now. They're easier places to play in the market and find opportunities that align with your strategy. But whether it's the military that's stimulating things there, or just the overall Texas economy, they're performing better. Compare that and contrast it with a Phoenix, where there's a lot of inventory still and prices are still under a lot of pressure, you wouldn't strategically say let's go grow our Phoenix business. We like every city we're in. We just will use our dashboard and our underwriting requirements to keep control of where we spend.

<Q - Megan McGrath>: Thanks and California, no concern there that you had a doubly positive impact in 2010 because they had their own tax credit? Or have they really - they've maintained that same momentum throughout the year?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Yeah, the first tax credit in California, Megan, absolutely was favorable. It was

Copyright (c) 2011

favorable because it was only on new homes. It was $10,000, and you could literally monetize it at closing. Between the federal and the tax credit and the state tax credit, you therefore had $18,000 in tax credit, definitely a motivator that helped us in the spring and summer of '09. The tax credit for '10 did not have nearly that kind of impact. For starters, the refund was spread over three years, and you needed a calculus degree to understand what your refund would be. It was a very complex formula tied to specific tax situations for each customer. So it didn't have the impact that the previous one did.

Operator:
Ladies and gentlemen, unfortunately we only have time for one more question, which will come from Nishu Sood with Deutsche Bank.

<Q - Nishu Sood>: Thanks. The trend from your third quarter EPS to your fourth quarter EPS, if I look at the last few years, the last three years, there's been a dramatic, dramatic upswing in your margin performance from the third to fourth quarter. Now obviously there's seasonality for every builder related to the fourth quarter but it's been a lot more dramatic for you folks, both on the gross and the SG&A margin line. So I was wondering if you could help us to understand that? Maybe it has to do with your fiscal year end? Maybe the November versus the calendar quarters for the other builders? Maybe it was just a function of the downturn since it was just the last three years and that should go away? I was just wondering if you could maybe help us wrap our heads around that?

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: Nishu, I'll make a couple comments again and then Jeff can give you his thoughts. It's very interesting, in the years I've been in public home building which are now too many for me to even share anymore because I'm starting to feel old, every company depending on when their fiscal year end is, has a great fourth quarter. And we always say it's a seasonal business but whether it was a spring fiscal, a fall fiscal, or December, you seem to have a great quarter in results typically in your fourth quarter.
One of the interesting things for us that does influence the margins is that these communities that we're getting into are not several year investments. They're typically 60 lots, 100 lots, 140 lots. We work hard to get them open in January, February, March and then a lot of them close out in your fourth quarter. So many of the smaller, more desirable area communities that we open will open and close in the same year. And they typically have a delivery spike in Q4. So that's one of the influences. And I also know that volume can influence these ratios as well to a degree and if you look at this year, our Q3 and Q4 had a lot higher delivery volume than the first half. But, any other thoughts for you, Jeff?

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: No.

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: No? Nothing.

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>: I think that covers it.

<A - Jeffrey T. Mezger, President and Chief Executive Officer>: All right.

<Q - Nishu Sood>: And second question if I could. In the first question, I'm not sure, maybe I didn't ask it correctly. I was asking why the seasonality would have been more pronounced in the last couple of years as opposed to - normally I understand the fourth quarter is obviously strongest but I don't know if you have any particular thoughts on that. But my second question was, just you had mentioned the percentage of your closings that were from

Copyright (c) 2011

communities that are not impaired. Should I take the inverse of that to be the percentage of closings that are in new communities? I was just wondering if you could give us a sense of what that number is and how that's trended and what you expect it to be going forward?

<A - Jeff Kaminski, Executive Vice President and Chief Financial Officer>:
Yes, I'd say generally you can look at the inverse of that as being newer communities. It's not 100% across the board because we do have obviously have some "older communities" that were not impaired. But generally you can look at that as meaning newer land, newer land purchases and newer acquisitions that we're working through.

Operator:
Ladies and gentlemen, once again, that was all the time we have for questions. Mr. Mezger, I'll turn it back to you for closing or additional remarks

Jeffrey T. Mezger, President and Chief Executive Officer:
Thanks again, Kelsey. When you combine the power of a more efficiently run homebuilding company with an expanded community count, and an even more compelling value proposition for consumers, plus the reduced competitive landscape, the incredible opportunity ahead of us really begins to come into view and we're excited as we enter 2011. I'd like to thank everyone for attending. Have a great day and we look forward to talking to you again soon.

Operator:
Thank you, Mr. Mezger. Again, ladies and gentlemen, that concludes our conference for today. We thank you all for your participation.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP

Copyright (c) 2011