

# NET REALIZABLE VALUE

© 2011 All rights reserved

Vol. 14, Iss. 6 (September 2011)

PUBLISHED BY LARK RESEARCH, INC.

## 2011 Second Quarter Homebuilder Comparables

It was a very tough summer for the homebuilders.

The season got off to a rocky stock, with stock prices falling along with the broader market.

Then, second quarter earnings reports were terrible. The industry faced tough comparisons against last year's sales pop from the federal housing tax credit. With the especially disappointing 2011 first quarter results, anyone who pays attention to the industry knew that this was going to be a rough quarter. Thus, earnings reports, with only a few exceptions, were in line with expectations, but the market punished the stocks anyway.

Finally, Homebuilder stocks plunged 28.8% from July 29 to August 19, due to fears of an economic slowdown, as the broader market fell 11.7%.

As noted, second quarter results for the builders were awful. Revenues for the 12 builders included in this comparables analysis fell 26.9% on average.

Unit closings were down 28%, while average prices rose 1.8%.

The drop in revenues put more pressure on operating margins. The average builder reported a second quarter operating margin of -6.4%, compared with -2.7% last year.

An especially poor showing by Hovnanian skewed the average operating margin in the 2010 second quarter. Without HOV, average builder operating margins for last year's second quarter were positive at 0.6%.

Gross margins, before amortized interest, declined by 40 basis points to 16.8%. Amortized interest, as a percent of sales, was 5.1%, up from 4.6% last year. So gross margins after amortized interest declined by 90 bp to 11.7%.

By my estimates, impairments reduced gross margins by 231 basis points in the 2011 second quarter, compared with 221 bp last year. I assume that most builders do not include write-offs of option costs in cost of sales;



but for comparison purposes, these write-offs amounted to 40 bp (of revenues) vs. only 5 bp last year.

The average SG&A expense ratio increased by 2.5 percentage points to 16.5%, primarily because of low sales volume.

Other items, such as joint venture gains and losses and interest expensed directly (i.e. not capitalized into inventories) reduced operating margins by 1.4 percentage points, up from 1.1 last year.

With the drop in sales and operating margins, the average builder reported a loss of \$9.1 million, compared with a profit of \$12.2 million.

Similarly, average EBITDA levels, adjusted for impairments charges and write-offs, on a rolling 12 month basis, declined from \$123.6 million to \$82.8 million. Impairments and write-offs, used in this calculation, averaged \$202 million in the 2010 second quarter, compared with \$107.5 million in the 2011 second quarter. Given that it has been nearly five years since the peak of the market and impairment charges have been low for about 18

### Performance Metrics

Common stock and valuation	2
Net income, EPS and sustainable growth	3
Revenues and margins	4
Debt levels and alternative leverage measures	5
EBITDA and capitalized interest	6
Asset efficiency and cash flow	7
Closings and net new orders	8
Backlogs and percentage of backlog delivered	9
Financial services	10

(Continued on page 11)

COMMON EQUITY									
	Latest Quarter	Ticker	Total Common Equity	Number of Shares Outstand.	Book Value per Share	Latest Share Price	Price to Book Value	Latest 12 Months EPS	PE Multiple
D.R. Horton, Inc.	6/30/11	DHI	2,591,200	315,818	\$8.20	\$9.58	1.17	\$0.09	NM
Hovnanian Enterprises	7/31/11	HOV	(539,456)	94,454	(\$5.71)	\$1.49	NM	(\$3.66)	NM
KB Home	5/31/11	KBH	443,452	77,005	\$5.76	\$5.67	0.98	(\$2.17)	NM
Lennar Corporation	5/31/11	LEN	2,651,845	186,956	\$14.18	\$13.48	0.95	\$0.54	25
MDC Holdings, Inc.	6/30/11	MDC	926,978	47,474	\$19.53	\$17.61	0.90	(\$1.93)	NM
M/I Homes	6/30/11	MHO	183,703	18,712	\$9.82	\$6.85	0.70	(\$2.11)	NM
Meritage Corp.	6/30/11	MTH	498,797	32,410	\$15.39	\$16.56	1.08	(\$0.18)	NM
NVR, Inc.	6/30/11	NVR	1,650,796	5,579	\$295.89	\$614.00	2.08	\$26.27	23
Pulte Corporation	6/30/11	PHM	2,049,727	382,819	\$5.35	\$4.30	0.80	(\$3.52)	NM
Ryland Group, Inc.	6/30/11	RYL	470,808	44,409	\$10.60	\$10.01	0.94	(\$1.82)	NM
Standard Pacific Corp.	6/30/11	SPF	156,440	196,642	\$0.80	\$2.45	3.08	(\$0.11)	NM
Toll Brothers, Inc.	7/31/11	TOL	2,611,400	168,600	\$15.49	\$15.68	1.01	\$0.45	35
AVERAGES			1,141,308	130,906	\$32.94	\$59.81	1.24	\$0.99	28
MEDIANS			712,888	85,730	\$10.21	\$9.80	0.98	(\$1.00)	25

Homebuilder stocks suffered mightily throughout the summer; but there have been some tentative signs that their stock prices have started to stabilize, which could set the stage for a rebound. From the mid-June to early September, the Lark Research Homebuilder Stock Index fell 27.9%, worse than the losses of 9.2% and 13.8% on the S&P 500 and Russell 2000. From August 19 to September 9, however, the Index gained 5.9%, better than the gains of 1.2% on the S&P and 1.7% on the Russell.

The average price-to-book value ratio, adjusted for the liquidation values of preferred shares outstanding and excluding HOV, which has negative common equity, is now 1.24 times. This is down from 1.69 times in my previous report. This is about the middle of the historical range, which spans from below 1.00 at the trough of the cycle to around 2.5 times at the peak of the cycle..

The average price-to-tangible book ratio for those companies reporting goodwill and intangibles is now 1.35 times. The number of companies still carrying goodwill and intangibles on their balance sheet has declined to four from ten nearly three years ago. Six builders have written off goodwill entirely. As a result of goodwill write-offs, the difference between gross and tangible book value ratios is now small for most builders.

Excluding those builders with reported losses, the average trailing 12 month P/E multiple is 28 times. Consensus estimates anticipate that four of the twelve builders will report a profit in 2011 and nine will be profitable in 2011.

Total common equity excludes accumulated other comprehensive income of \$0.3 million for D.R. Horton, \$6.2 million for MDC and \$1.5 million for Ryland, but includes accumulated other comprehensive losses of \$22.7 million for KB Home, \$1.5 million for Pulte, \$11.9 million for Standard Pacific and \$0.2 million for Toll Brothers.

EPS (and EBITDA) include gains on debt retirement (and estimated EPS impact) for KBH (\$3.6 million, \$0.03) and LEN (\$5.8 million, \$0.02), \$0.07) and charges for debt retirement costs for DHI (\$8.9 million, \$0.02), HOV (\$3.0 million, \$0.02), MHO (\$8.4 million, \$0.29), PHM (\$42.5 million, \$0.07), RYL (\$0.9 million, \$0.01), SPF (\$24.8 million, \$0.08) and TOL (\$3.9 million, \$0.02). EPS impact of debt extinguishment is estimated by applying a 35% tax rate to pre-tax gains or losses.

	Goodwill And Other Intangibles	Tangible Equity		
		Book Value	Book Val. Per Share	Price-to-Book Mult.
DHI	15,900	2,575,600	\$8.16	1.17
MTH	1,807	496,990	\$15.33	1.08
NVR	48,927	1,601,869	\$287.13	2.14
PHM	409,439	1,640,288	\$4.28	1.00

Results here are not adjusted for inventory impairments and land deposit write-offs.

Figures in the tables on this page and throughout most of this report are based on stock prices as of September 9, 2011.

## NET INCOME AND EPS GROWTH

	Latest Quarter Date	Quarterly				Latest 12 Months			
		Net Income	Percent Change	EPS	Percent Change	Net Income	Percent Change	LTM EPS	Percent Change
		D.R. Horton, Inc.	6/30/11	28,600	-43.4%	\$0.09	-43.3%	27,300	23.5%
Hovnanian Ent.	7/31/11	(50,930)	-30.1%	(\$0.47)	-48.9%	(319,852)	175.6%	(\$3.66)	140.5%
KB Home	5/31/11	(68,304)	122.4%	(\$0.89)	122.5%	(166,785)	228.7%	(\$2.17)	226.2%
Lennar Corporation	5/31/11	13,785	-65.3%	\$0.07	-66.7%	103,256	-200.4%	\$0.54	-189.3%
MDC Holdings, Inc.	6/30/11	(27,980)	659.5%	(\$0.60)	650.0%	(88,072)	-224.8%	(\$1.93)	-232.5%
M/I Homes	6/30/11	(9,144)	90.2%	(\$0.49)	88.5%	(39,310)	44.4%	(\$2.11)	66.4%
Meritage Corp.	6/30/11	562	-86.5%	\$0.02	-86.7%	(5,773)	-117.9%	(\$0.18)	-117.2%
NVR, Inc.	6/30/11	38,445	-46.1%	\$6.48	-41.8%	156,261	-33.8%	\$26.27	-29.6%
Pulte Corporation	6/30/11	(55,385)	-172.6%	(\$0.15)	-175.0%	(1,255,455)	202.9%	(\$3.52)	157.4%
Ryland Group, Inc.	6/30/11	(10,713)	-50.8%	(\$0.24)	-51.0%	(79,328)	60.2%	(\$1.82)	59.6%
Standard Pacific Corp.	6/30/11	(10,519)	-198.7%	(\$0.03)	-175.0%	(42,630)	-166.2%	(\$0.11)	-234.6%
Toll Brothers, Inc.	7/31/11	42,108	54.2%	\$0.25	56.3%	75,231	-145.5%	\$0.45	-144.6%
AVERAGES		(9,123)	19.4%	\$0.34	19.1%	(136,263)	-12.8%	\$0.99	-1.9%
MEDIANS		(9,832)	-44.7%	(\$0.09)	-46.1%	(40,970)	-5.1%	(\$1.00)	15.0%

The average builder reported a first quarter net loss of \$9.1 million and an average EPS of 0.34. (The difference is due to the stronger EPS impact of NVR, which has very few shares outstanding. Comparable figures for last year were an average net profit of \$12.2 million and EPS of \$0.82. Excluding NVR, the average net loss per share was \$0.22 compared with a loss of \$0.12 last year. On a rolling 12 month basis, the average loss was \$136.2 million, compared with a loss of \$41.7 million last year. The figures suggest that performance deteriorated markedly in the 2011 second quarter.

The average builder has reported a 12-month return on sales of -7.4% and return on assets of -4.0%. Return on equity was also -4.2%. Over the past 12 months, the average ratio of sales-to-assets has slipped from 0.67 to 0.58 times. The average ratio of assets-to-equity, excluding HOV, increased from 2.93 to 3.00 times. Only five builders - DHI, KBH, LEN, MDC and RYL - currently pay a dividend. Return on equity figures are distorted both by ongoing reported net losses and, in the case of a few builders, equity book values that are near or below zero.

## SUSTAINABLE GROWTH

	Return on Sales (LTM)	Return on Equity (LTM)	Return on Assets (LTM)	Sales/Assets (LTM)	Assets/Equity	Net Inc./Sales (LTM)	Dividend Payout Ratio	Sustainable Growth Rate
D.R. Horton, Inc.	0.8%	1.1%	0.5%	0.62	2.12	0.80%	175.1%	-0.8%
Hovnanian Ent.	-27.9%	80.1%	-18.8%	0.68	(4.25)	-27.90%	0.0%	80.1%
KB Home	-11.7%	-37.6%	-5.8%	0.50	6.45	-11.74%	-11.5%	-41.9%
Lennar Corporation	3.4%	3.9%	1.2%	0.35	3.28	3.43%	28.8%	2.8%
MDC Holdings, Inc.	-10.1%	-9.4%	-3.6%	0.36	2.59	-10.12%	-53.7%	-14.5%
M/I Homes	-7.2%	-14.0%	-6.0%	0.84	2.33	-7.17%	0.0%	-14.0%
Meritage Corp.	-0.7%	-1.2%	-0.5%	0.69	2.46	-0.68%	0.0%	-1.2%
NVR, Inc.	5.8%	9.5%	7.2%	1.24	1.32	5.78%	0.0%	9.5%
Pulte Corporation	-31.5%	-61.2%	-16.9%	0.54	3.62	-31.52%	0.0%	-61.2%
Ryland Group, Inc.	-9.4%	-16.8%	-5.0%	0.53	3.34	-9.44%	-6.8%	-18.0%
Standard Pacific Corp.	-5.7%	-7.0%	-2.0%	0.35	3.55	-5.71%	0.0%	-7.0%
Toll Brothers, Inc.	5.2%	2.9%	1.5%	0.29	1.94	5.19%	0.0%	2.9%
AVERAGES	-7.4%	-4.2%	-4.0%	0.58	2.40	-7.42%	11.0%	-5.3%
MEDIANS	-6.4%	-4.1%	-2.8%	0.54	2.53	-6.44%	0.0%	-4.1%

REVENUE GROWTH										
	Latest Quarter End	Sales or Revs.	Housing revenues (latest qtr.)	Revenue growth (latest qtr.)	Housing revenues (2 prior qtr)	Revenue growth (2 prior qtr)	Housing revenues (3 prior qtr)	Revenue growth (3 prior qtr)	Housing revenues (4 prior qtr)	Revenue growth (4 prior qtr)
D.R. Horton, Inc.	6/30/11	(HL)	975,400	-29.2%	733,100	-18.3%	767,000	-30.8%	925,700	-8.7%
Hovnanian Enterprise	7/31/11	(R)	277,767	-25.3%	249,793	-19.8%	245,473	-21.3%	344,457	19.5%
KB Home	5/31/11	(R)	269,983	-27.5%	195,301	-25.6%	447,917	-33.3%	498,821	9.3%
Lennar Corporation	5/31/11	(HL)	662,476	-6.1%	466,709	-10.4%	761,386	-11.1%	718,149	11.6%
MDC Holdings, Inc.	6/30/11	(R)	208,728	-34.2%	163,587	16.1%	251,567	-20.0%	217,405	10.8%
M/I Homes	6/30/11	(R)	134,149	-30.5%	107,370	-7.2%	161,538	-19.7%	132,003	-11.2%
Meritage Corp.	6/30/11	(R)	220,131	-24.5%	177,589	-12.0%	214,644	-24.9%	233,803	0.9%
NVR, Inc.	6/30/11	(HL)	682,663	-27.9%	502,744	-12.9%	794,470	8.8%	661,935	16.5%
Pulte Corporation	6/30/11	(R)	904,831	-28.7%	783,767	-20.8%	1,157,345	-31.4%	1,030,755	-2.5%
Ryland Group, Inc.	6/30/11	(R)	217,906	-39.9%	168,585	-30.3%	221,088	-45.5%	206,453	-34.6%
Standard Pacific	6/30/11	(HL)	204,345	-35.6%	143,699	-18.1%	212,424	-37.5%	207,466	-36.6%
Toll Brothers, Inc.	7/31/11	(HL)	394,305	-13.2%	319,675	2.7%	334,116	2.3%	402,600	-17.3%
AVERAGES			429,390	-26.9%	334,327	-13.0%	464,081	-22.0%	464,962	-9.5%
MEDIANS			273,875	-28.3%	222,547	-15.5%	292,842	-23.1%	373,529	-10.0%

The average builder reported a 26.9% decline in second quarter revenues vs. a 33.3% increase in the 2010 second quarter. First quarter revenues had declined by 13.0%. The drop in 2011 second quarter revenues was due to a tough prior year comparison, which was aided by the expiration of the federal housing tax credit. Given the recent decline in the stock market, it is unlikely that we will begin to see positive revenue comparisons until the fourth quarter of 2011 at the earliest and more likely in 2012, but any improvement is predicated upon a continuation of the economic recovery.

MARGINS									
	Latest Quarter End	Latest Quarter				Last 12 Months			
		Gross Mgn. (w/o cap int)	Gross Mgn. (w/cap int)	SG&A/ Sales	Oper. Prof. Margin	Gross Mgn. (w/o cap int)	Gross Mgn. (w/cap int)	SG&A/ Sales	Oper. Prof. Margin
D.R. Horton, Inc.	6/30/11	18.1%	15.5%	11.7%	2.3%	17.3%	14.6%	14.1%	-2.9%
Hovnanian Ent.	7/31/11	6.4%	-7.8%	16.8%	-24.5%	0.0%	-15.0%	19.6%	-34.6%
KB Home	5/31/11	14.5%	7.3%	23.2%	-26.1%	21.3%	15.3%	17.5%	-12.9%
Lennar Corporation	5/31/11	25.7%	16.0%	14.6%	1.4%	25.6%	16.8%	14.2%	2.6%
MDC Holdings, Inc.	6/30/11	11.6%	9.0%	23.6%	-14.6%	15.4%	12.8%	24.5%	-11.7%
M/I Homes	6/30/11	10.9%	8.3%	16.3%	-7.8%	11.6%	9.2%	16.3%	-6.9%
Meritage Corp.	6/30/11	19.1%	18.0%	15.4%	-0.8%	18.5%	18.1%	15.4%	-1.9%
NVR, Inc.	6/30/11	18.2%	18.2%	10.0%	8.4%	17.8%	17.8%	9.9%	8.1%
Pulte Corporation	6/30/11	16.9%	12.3%	15.6%	-4.0%	12.8%	7.8%	23.0%	-33.6%
Ryland Group, Inc.	6/30/11	16.3%	12.6%	15.4%	-6.1%	13.7%	10.0%	17.4%	-4.9%
Standard Pacific	6/30/11	24.9%	17.0%	18.8%	-5.1%	27.8%	20.8%	18.9%	-5.6%
Toll Brothers, Inc.	7/31/11	19.1%	13.8%	16.4%	0.5%	18.1%	12.4%	18.1%	-5.1%
AVERAGES		16.8%	11.7%	16.5%	-6.4%	16.7%	11.7%	17.4%	-9.1%
MEDIANS		17.5%	13.2%	15.9%	-4.5%	17.5%	13.7%	17.4%	-5.3%

Average operating margins were -6.4%, compared with -2.7% last year. This quarter's margins were heavily influenced again by Hovnanian and KB Home, which both took more charges for impairments and other factors. Four out of 12 builders reported positive operating margins in the quarter. Gross margins before amortized interest were 16.8%, a decline of 0.4 percentage points from last year. Amortized interest equaled 5.1% of revenues, up from 4.6% last year. So net gross margins declined by 0.9 percentage points to 11.7%. The average SG&A expense ratio rose from 14.0% to 16.5%, while other expenses reduced margins by 140 bp this quarter, compared with 110 bp last year. Lower sales volume explains most of the decline in operating profit margins.

**DEBT LEVELS**

	Latest Quarter End	Total Cash and Mkt. Sec.	Debt	Preferred Stock	Common Equity Book Val.	Total Capitalization	Debt-to Total Capital	Debt-to Sales	Debt-to Inventory
D.R. Horton, Inc.	6/30/11	1,138,100	1,880,400	0	2,591,200	4,355,300	43.2%	55.5%	53.7%
Hovnanian Enterprises	7/31/11	282,385	1,713,583	140,000	(539,456)	1,314,127	130.4%	153.3%	167.2%
KB Home	5/31/11	627,196	1,691,659	0	443,452	2,135,111	79.2%	119.8%	89.3%
Lennar Corporation	5/31/11	1,131,454	3,856,619	0	2,651,845	6,508,464	47.7%	119.0%	89.7%
MDC Holdings, Inc.	6/30/11	1,402,730	1,252,261	0	926,978	2,179,239	57.5%	148.9%	145.5%
M/I Schottenstein	6/30/11	44,900	276,747	96,325	183,703	556,775	49.7%	51.7%	59.8%
Meritage Corp.	6/30/11	366,783	606,095	0	498,797	1,104,892	54.9%	71.6%	76.9%
NVR, Inc.	6/30/11	929,445	1,696	0	1,650,796	1,652,492	0.1%	0.1%	0.2%
Pulte Corporation	6/30/11	1,075,223	3,332,263	0	2,049,727	5,381,990	61.9%	86.0%	66.2%
Ryland Group, Inc.	6/30/11	541,354	852,501	0	470,808	1,323,309	64.4%	104.7%	101.5%
Standard Pacific Corp.	6/30/11	483,675	1,357,437	450,829	156,440	1,964,706	69.1%	176.8%	98.2%
Toll Brothers, Inc.	7/31/11	1,184,353	1,644,911	0	2,611,400	4,256,311	38.6%	113.4%	48.0%
AVERAGES		767,300	1,538,848	57,263	1,141,308	2,727,726	58.1%	100.1%	83.0%
MEDIANS		778,321	1,501,174	0	712,888	2,049,909	56.2%	109.1%	83.1%

The average ratio of debt-to-total capitalization increased from 56.1% last year to 58.1%. (For purposes of this calculation, preferred stock is not included as debt.) Average cash balances declined 32.6% to \$767 million. (I exclude restricted cash from cash balances.) Average debt levels declined 2.3%. Equity book values, excluding preferred stock, decreased to \$1.14 billion from \$1.27 billion a year ago. At the same time, housing and land sales, on a rolling 12 month basis, fell 19.0% to \$1.69 billion and inventories rose 5.7% to \$2.02 billion. The increase in inventories reflect efforts by builders to increase their community counts in anticipation of higher sales. The concern at this time, however, is that with slowing sales, inventory increases could lead to another modest round of losses and inventory write-downs. Questions remain as to the extent of off-balance sheet liabilities from joint ventures and other similar arrangements, although they are certainly down from levels at the 2007 market peak. Excluding financial services debt, the average debt-to-capital ratio was 58.5%, up from 55.6% last year. Average financial services debt decreased 24.8% to \$46.1 million. The average debt-to-cap ratio with financial services debt was 59.5%, up from 56.8% last year.

**ALTERNATIVE LEVERAGE CALCULATIONS**

	Latest Quarter Date	Excl. Fin. Serv. Debt			Incl. Fin. Services Debt			
		HB	Total	Debt-to-	Fin. Serv.	Total	Total	Debt-to-
		Debt	Capital	Capital	Debt	Debt	Capital	Capital
D.R. Horton, Inc.	6/30/11	1,764,100	4,355,300	40.5%	116,300	1,880,400	4,471,600	42.1%
Hovnanian Enterprises	7/31/11	1,671,924	1,272,468	131.4%	41,659	1,713,583	1,314,127	130.4%
KB Home	5/31/11	1,691,659	2,135,111	79.2%	0	1,691,659	2,135,111	79.2%
Lennar Corporation	5/31/11	3,856,619	6,508,464	59.3%	189,502	4,046,121	6,697,966	60.4%
MDC Holdings, Inc.	6/30/11	1,243,273	2,170,251	57.3%	8,988	1,252,261	2,179,239	57.5%
M/I Homes	6/30/11	244,614	524,642	46.6%	32,133	276,747	556,775	49.7%
Meritage Corp.	6/30/11	606,095	1,104,892	54.9%	0	606,095	1,104,892	54.9%
NVR, Inc.	6/30/11	1,696	1,652,492	0.1%	89,649	91,345	1,742,141	5.2%
Pulte Corporation	6/30/11	3,332,263	5,381,990	61.9%	0	3,332,263	5,381,990	61.9%
Ryland Group, Inc.	6/30/11	852,501	1,323,309	64.4%	0	852,501	1,323,309	64.4%
Standard Pacific Corp.	6/30/11	1,322,564	1,929,833	68.5%	34,873	1,357,437	1,964,706	69.1%
Toll Brothers, Inc.	7/31/11	1,605,006	4,216,406	38.1%	39,905	1,644,911	4,256,311	38.6%
AVERAGES		1,516,026	2,714,597	58.5%	46,084	1,562,110	2,760,681	59.5%
MEDIANS		1,463,785	2,032,472	58.3%	33,503	1,501,174	2,049,909	58.9%

Adjusted EBITDA Multiples and Ratios									
	Latest Quarter End	Adjusted EBITDA LTM	Book Value of Debt	Market Value of Equity	Market Value of Capitalization	Market Cap/ Adj. EBITDA	Total Debt/ Adj. EBITDA	Adjusted EBITDA Margin	Adj. EBITDA/ Int. Incur.
D.R. Horton, Inc.	6/30/11	223,000	1,880,400	3,025,537	4,905,937	22.0	8.4	6.6%	1.6
Hovnanian Enterprises	7/31/11	(18,633)	1,713,583	140,737	1,854,320	NM	NM	-1.7%	(0.1)
KB Home	5/31/11	(1,272)	1,691,659	436,619	2,128,278	NM	NM	-0.1%	(0.0)
Lennar Corporation	5/31/11	434,731	3,856,619	2,413,106	6,269,725	14.4	8.9	17.2%	2.6
MDC Holdings, Inc.	6/30/11	833	1,252,261	836,017	2,088,278	NM	NM	0.1%	0.0
M/I Homes	6/30/11	10,129	276,747	165,779	442,526	43.7	27.3	1.9%	0.5
Meritage Corp.	6/30/11	52,645	606,095	536,703	1,142,798	21.7	11.5	6.2%	1.2
NVR, Inc.	6/30/11	321,004	1,696	3,425,502	3,427,198	10.7	0.0	12.2%	238.8
Pulte Corporation	6/30/11	(209,624)	3,332,263	1,646,122	4,978,385	NM	NM	-5.4%	(0.9)
Ryland Group, Inc.	6/30/11	6,421	852,501	444,530	1,297,031	NM	NM	0.8%	0.2
Standard Pacific Corp.	6/30/11	69,356	1,357,437	225,415	1,582,852	22.8	19.6	9.0%	0.5
Toll Brothers, Inc.	7/31/11	105,225	1,644,911	2,643,648	4,288,559	40.8	15.6	7.3%	0.9
AVERAGES		82,818	1,538,848	1,328,310	2,867,157	25.2	13.0	4.5%	20.5
MEDIANS		31,387	1,501,174	686,360	2,108,278	22.0	11.5	4.1%	0.5

The average trailing 12 month EBITDA level for the second quarter, adjusted for impairments and gains/losses on debt retirement, was \$82.8 million, compared with \$123.6 million last year. The average market capitalization was down 8.8% to \$2.87 billion. Thus, the market value of equity (including preferred stock) was down 15.3% to \$1.33 billion. Dividing the average market cap by the average adjusted EBITDA yields a multiple of 34.6 times. The average total debt-to-EBITDA ratio was 18.6, calculated in a similar way. Adjusted EBITDA margins deteriorated to 4.5% from 6.0% last year. The average EBITDA/interest incurred ratio, excluding NVR, was 0.7 times.

Capitalized interest as a percent of inventories declined from 8.3% to 7.9%. Some builders do not allocate impairments to capitalized interest, which renders this measure less useful.

Builders expensed 92% of interest incurred, compared with 120% last year. For the latest 12 months, builders expensed 96% of interest incurred, down from 118% last year.

INTEREST CAPITALIZED AND EXPENSED										
	Latest Quarter End	Total Inventory	Cap. Int. incl. in Inventory	Cap. Int. as % of Inventory	Latest Quarter			Last 12 Months		
					Interest Incurred	Int Exp & Amort	Int Exp/ Int Incur	Interest Incurred	Int Exp & Amort	Int Exp/ Int Incur
D.R. Horton, Inc.	6/30/11	3,500,800	84,400	2.4%	31,400	35,300	112.4%	136,800	150,200	109.8%
Hovnanian Ent.	7/31/11	1,025,030	136,178	13.3%	40,051	39,429	98.4%	155,631	167,831	107.8%
KB Home	5/31/11	1,894,981	249,792	13.2%	29,462	32,710	111.0%	115,723	141,336	122.1%
Lennar Corporation	5/31/11	4,301,565	NA	NA	50,181	63,910	127.4%	166,917	229,749	137.6%
MDC Holdings, Inc.	6/30/11	860,748	49,058	5.7%	18,084	10,908	60.3%	73,257	44,130	60.2%
M/I Homes	6/30/11	462,796	19,758	4.3%	6,143	6,284	102.3%	22,294	24,006	107.7%
Meritage Corp.	6/30/11	788,038	13,205	1.7%	10,848	9,952	91.7%	43,394	42,626	98.2%
NVR, Inc.	6/30/11	687,403	NA	NA	287	287	100.0%	1,344	1,344	100.0%
Pulte Corporation	6/30/11	5,033,282	358,806	7.3%	56,263	42,211	75.0%	242,781	194,597	80.2%
Ryland Group, Inc.	6/30/11	839,946	85,091	10.1%	9,924	8,099	81.6%	36,869	30,723	83.3%
Standard Pacific	6/30/11	1,382,744	169,705	12.3%	35,353	23,590	66.7%	126,605	89,424	70.6%
Toll Brothers, Inc.	7/31/11	3,423,617	295,406	8.6%	28,386	21,488	75.7%	114,055	89,903	78.8%
AVERAGES		2,016,746	146,140	7.9%	26,365	24,514	91.9%	102,973	100,489	96.4%
MEDIANS		1,203,887	110,635	8.0%	28,924	22,539	95.1%	114,889	89,664	99.1%

ASSET EFFICIENCY									
	Latest Quarter End	Total Inventory	Housing Cost of Sls (last 12 mo.)	Inventory Turnover	Consol. Inventory Not Owned	Adjusted Total Inventory	Adjusted Inventory Turnover	Days Receivable	Days Payable & Accr.
D.R. Horton, Inc.	6/30/11	3,500,800	2,907,200	0.8	0	3,500,800	0.8	NA	109
Hovnanian Ent.	7/31/11	1,025,030	1,285,164	1.3	2,619	1,022,411	1.3	16	80
KB Home	5/31/11	1,894,981	1,196,082	0.6	0	1,894,981	0.6	18	191
Lennar Corporation	5/31/11	4,301,565	2,170,612	0.5	425,770	3,875,795	0.6	10	126
MDC Holdings, Inc.	6/30/11	860,748	733,715	0.9	0	860,748	0.9	3	92
M/I Homes	6/30/11	462,796	485,802	1.0	4,668	458,128	1.1	24	54
Meritage Corp.	6/30/11	788,038	699,647	0.9	1,398	786,640	0.9	7	49
NVR, Inc.	6/30/11	687,403	2,172,269	3.2	23,022	664,381	3.3	1	49
Pulte Corporation	6/30/11	5,033,282	3,573,253	0.7	30,037	5,003,245	0.7	NA	138
Ryland Group, Inc.	6/30/11	839,946	732,854	0.9	58,582	781,364	0.9	NA	88
Standard Pacific Corp.	6/30/11	1,382,744	608,036	0.4	61,586	1,321,158	0.5	28	99
Toll Brothers, Inc.	7/31/11	3,423,617	1,271,085	0.4	43,554	3,380,063	0.4	11	153
AVERAGES		2,016,746	1,486,310	0.964	54,270	1,962,476	0.987	13	102
MEDIAN		1,203,887	1,233,584	0.8	13,845	1,171,785	0.8	11	96

Inventory turnover declined from 1.40 times to 0.96 times. Excluding FIN 46 inventories, average turnover decreased from 1.46 times to 0.99 times. Average inventories increased 5.7% to \$2.02 billion. Average trailing 12 month cost of sales declined 22.2% to \$1.49 billion. Inventory impairments declined from \$136.7 million to \$80.1 million in total. Average trailing 12 month housing sales decreased 18.9% to \$1.68 billion. Days receivable declined from 17 days to 13 days, while days payable rose from 93 days to 102 days.

CASH FLOW									
	Latest Quarter	Latest Quarter				Last 12 Months			
		Operating Activities	Investing Activities	Financing Activities	Net Chg. in Cash	Operating Activities	Investing Activities	Financing Activities	Net Chg. in Cash
D.R. Horton, Inc.	6/30/11	(54,200)	(16,800)	(169,100)	(240,100)	47,000	(13,900)	(584,600)	(551,500)
Hovnanian Enterprises	7/31/11	(83,282)	1,282	10,655	(71,345)	(238,695)	15	110,829	(127,851)
KB Home	5/31/11	(106,425)	(1,342)	(7,535)	(115,302)	(292,684)	64,694	(134,191)	(362,181)
Lennar Corporation	5/31/11	(5,066)	(93,428)	23,362	(75,132)	4,163	(325,741)	195,967	(125,611)
MDC Holdings, Inc.	6/30/11	(11,556)	187,918	(9,570)	166,792	(99,404)	266,640	(103,533)	63,703
M/I Homes	6/30/11	(11,146)	(30,038)	5,723	(35,461)	(27,783)	(35,397)	26,478	(36,702)
Meritage Corp.	6/30/11	(8,172)	71,952	280	64,060	(59,029)	67,675	2,253	10,899
NVR, Inc.	6/30/11	(16,190)	(64,966)	(208,743)	(289,899)	96,471	111,133	(368,090)	(160,486)
Pulte Corporation	6/30/11	(61,180)	(100,040)	(56,506)	(217,726)	(490,004)	(99,787)	(1,081,598)	(1,671,389)
Ryland Group, Inc.	6/30/11	(41,809)	46,923	(24,989)	(19,875)	(230,918)	114,097	(33,438)	(150,259)
Standard Pacific Corp.	6/30/11	(121,963)	(5,475)	12,938	(114,500)	(351,990)	(40,520)	172,001	(220,509)
Toll Brothers, Inc.	7/31/11	(51,177)	9,029	(17,681)	(59,829)	(37,290)	(120,596)	(386,682)	(544,568)
AVERAGES		(47,681)	418	(36,764)	(84,026)	(140,014)	(974)	(182,050)	(323,038)
MEDIANS		(46,493)	(3,409)	(8,553)	(73,239)	(79,217)	(6,943)	(68,486)	(155,373)

The average builder used \$47.7 million in cash from operating activities, compared with \$36 million of cash generated last year. For the latest 12 months, the average builder used \$140 million from operating activities, compared cash generated of \$256 million last year. Cash flow from operations was used to cover operating costs and increase inventories, as many builders have begun increasing their active selling communities. Cash was also used to reduce debt.

UNIT SALES DATA - CLOSINGS									
	Latest Quarter End	Latest Quarter				Last 12 Months			
		Unit Closings	% Change	Avg Sales Price	% Change	Unit Closings	% Change	Avg Sales Price	% Change
D.R. Horton, Inc.	6/30/11	4,555	-33.1%	214	5.6%	15,989	-25.3%	212	3.3%
Hovnanian Enterprises	7/31/11	993	-24.5%	278	-0.5%	3,941	-20.7%	279	-1.2%
KB Home	5/31/11	1,265	-29.0%	213	2.7%	6,452	-23.1%	218	7.4%
Lennar Corporation	5/31/11	2,652	-8.6%	245	2.3%	10,620	-4.3%	244	-0.5%
MDC Holdings, Inc.	6/30/11	709	-37.5%	291	6.0%	2,850	-16.8%	294	7.6%
M/I Homes	6/30/11	590	-25.3%	227	-7.0%	2,194	-21.4%	243	3.0%
Meritage Corp.	6/30/11	856	-29.1%	257	6.5%	3,219	-23.9%	263	10.9%
NVR, Inc.	6/30/11	2,207	-34.0%	309	9.2%	8,607	-17.9%	307	5.7%
Pulte Corporation	6/30/11	3,633	-27.8%	248	-1.4%	15,044	-21.6%	257	0.7%
Ryland Group, Inc.	6/30/11	884	-41.3%	245	3.1%	3,328	-39.2%	244	2.1%
Standard Pacific Corp.	6/30/11	610	-31.5%	335	-5.7%	2,267	-30.5%	337	3.7%
Toll Brothers, Inc.	7/31/11	693	-13.7%	569	0.6%	2,554	-9.0%	568	0.6%
AVERAGES		1,637	-28.0%	286	1.8%	6,422	-21.2%	289	3.6%
MEDIANS		939	-29.0%	252	2.5%	3,635	-21.5%	260	3.2%

2011 second quarter unit closings declined 28.0%, while average prices rose 1.8%. Average unit closings rose 1.9% in 2010 Q1 and 34.6% in 2010 Q2 before falling 13.3% in 2010 Q3, 24.2% in 2010 Q4 and 13.4% in 2011 Q1. Net new unit orders rose 3.7% on the 2011 second quarter, compared to a drop of 16.3% in the 2010 second quarter. The sequence of orders is as follows: a gain of 17.5% in 2010 Q1, and then declines of 16.3% in 2010 Q2, 23.8% in 2010 Q3, 10.6% in 2010 Q4 and 15.8% in the 2011 first quarter. The average gain in the dollar value of new orders was 6.1% in the 2011 second quarter. Assuming that the economic recovery continues, order comparisons should be less unfavorable going forward, especially with the increase in average community counts. 2011 third quarter orders may be relatively flat, given the recent turmoil in the financial markets which has kept buyers on the sidelines.

UNIT SALES DATA - NET NEW ORDERS									
	Latest Quarter End	Latest Quarter				Last 12 Months			
		New Orders in units	% Change	New Orders in \$000s	% Change	New Orders in units	% Change	New Orders in \$000s	% Change
D.R. Horton, Inc.	6/30/11	4,874	-1.0%	1,067,400	4.1%	17,159	-15.9%	3,617,500	-14.3%
Hovnanian Enterprises	7/31/11	1,169	29.6%	332,306	34.2%	4,085	-6.4%	1,133,291	-5.9%
KB Home	5/31/11	1,998	-11.0%	417,901	-15.6%	5,699	-26.6%	1,261,394	-19.0%
Lennar Corporation	5/31/11	3,167	-0.4%	823,751	9.0%	10,567	-8.0%	2,616,634	-6.9%
MDC Holdings, Inc.	6/30/11	1,064	4.8%	328,982	17.2%	3,084	-14.3%	914,982	-7.9%
M/I Homes	6/30/11	635	5.5%	160,063	9.7%	2,238	-8.1%	546,816	-10.0%
Meritage Corp.	6/30/11	910	1.1%	236,014	3.2%	3,169	-14.0%	814,218	-10.9%
NVR, Inc.	6/30/11	2,468	-3.6%	711,934	-5.7%	8,787	-9.9%	2,637,504	-7.5%
Pulte Corporation	6/30/11	4,222	0.1%	1,115,123	-2.9%	15,177	-7.1%	3,869,213	-10.0%
Ryland Group, Inc.	6/30/11	1,065	11.2%	265,537	15.0%	3,606	-17.4%	885,251	-15.2%
Standard Pacific Corp.	6/30/11	764	6.3%	286,373	3.7%	2,399	-17.8%	820,971	-17.2%
Toll Brothers, Inc.	7/31/11	713	1.7%	406,700	1.6%	2,698	-4.1%	1,530,100	-3.6%
AVERAGES		1,921	3.7%	512,674	6.1%	6,556	-12.5%	1,720,656	-10.7%
MEDIANS		1,117	1.4%	369,503	3.9%	3,846	-11.9%	1,197,343	-10.0%

<b>BACKLOG DATA</b>									
	Latest Quarter End	Backlog in units (latest qtr)	% Change (prior qtr.)	% Change (prior yr.)	Backlog in \$000s (latest qtr)	% Change (prior qtr.)	% Change (prior yr.)	Avg. Price in Backlog (latest qtr)	Backlog as % of LTM Clos.
D.R. Horton, Inc.	6/30/11	5,600	6.0%	26.4%	1,182,200	8.5%	23.9%	211	35.0%
Hovnanian Enterprises	7/31/11	1,469	13.6%	6.8%	467,571	15.4%	11.5%	318	37.3%
KB Home	5/31/11	2,422	43.4%	-23.7%	501,544	41.8%	-22.6%	207	37.5%
Lennar Corporation	5/31/11	2,461	26.6%	-0.4%	628,291	27.5%	-1.7%	255	23.2%
MDC Holdings, Inc.	6/30/11	1,424	43.4%	27.8%	433,000	38.8%	23.4%	304	50.0%
M/I Homes	6/30/11	833	11.5%	11.4%	214,019	13.8%	7.0%	257	38.0%
Meritage Corp.	6/30/11	994	5.7%	-4.8%	260,822	6.5%	-10.9%	262	30.9%
NVR, Inc.	6/30/11	3,946	7.1%	4.8%	1,233,125	5.7%	3.8%	313	45.8%
Pulte Corporation	6/30/11	5,777	11.4%	2.4%	1,583,452	15.7%	0.4%	274	38.4%
Ryland Group, Inc.	6/30/11	1,646	12.4%	20.3%	416,000	13.4%	21.3%	253	49.5%
Standard Pacific Corp.	6/30/11	781	24.6%	20.3%	293,804	38.7%	23.6%	376	34.5%
Toll Brothers, Inc.	7/31/11	1,780	1.1%	8.8%	1,018,900	1.2%	8.5%	572	69.7%
<b>AVERAGES</b>		2,428	17.2%	8.3%	686,061	18.9%	7.3%	300	40.8%
<b>MEDIANS</b>		1,713	11.9%	7.8%	484,558	14.6%	7.7%	268	37.8%

With the increase in orders, average backlogs rose 8.3% in units and 7.3% in dollar value, both against prior year levels. Many builders are beginning to boost community counts, which should make the decline in backlogs less unfavorable against prior year comparisons over time.

Builders on average delivered 77.5% of their opening backlogs during the 2011 second quarter, compared with 85.3% in the 2010 second quarter.

<b>PERCENTAGE OF BACKLOG DELIVERED</b>							
	Latest Quarter Date	Latest Quarter	One Quarter Ago	Two Quarters Ago	Three Quarters Ago	Four Quarters Ago	Average Latest 4 Quarters
D.R. Horton, Inc.	6/30/11	86.3%	91.2%	88.1%	96.6%	107.8%	90.6%
Hovnanian Enterprises	7/31/11	64.0%	66.5%	60.6%	78.1%	67.0%	67.3%
KB Home	5/31/11	74.9%	71.0%	88.4%	73.1%	65.7%	76.9%
Lennar Corporation	5/31/11	136.4%	118.6%	145.8%	117.8%	131.8%	129.7%
MDC Holdings, Inc.	6/30/11	71.4%	65.8%	72.8%	64.8%	92.0%	68.7%
M/I Homes	6/30/11	79.0%	82.5%	90.0%	68.9%	84.4%	80.1%
Meritage Corp.	6/30/11	91.1%	87.1%	92.8%	81.2%	89.3%	88.1%
NVR, Inc.	6/30/11	59.9%	56.0%	69.6%	56.5%	73.5%	60.5%
Pulte Corporation	6/30/11	70.0%	78.8%	82.4%	68.5%	77.9%	74.9%
Ryland Group, Inc.	6/30/11	60.3%	58.0%	68.9%	61.9%	78.6%	62.3%
Standard Pacific Corp.	6/30/11	97.3%	106.0%	102.3%	92.3%	108.5%	99.5%
Toll Brothers, Inc.	7/31/11	39.4%	40.1%	38.2%	42.8%	46.2%	40.1%
<b>AVERAGES</b>		77.5%	76.8%	83.3%	75.2%	85.2%	78.2%
<b>MEDIANS</b>		73.1%	74.9%	85.3%	71.0%	81.5%	75.9%

FINANCIAL SERVICES SEGMENT							
	Latest Quarter End	Total Assets	Total Capital Invested	Total Revenues (last 12 mo.)	Operating Income (last 12 mo.)	Op. Inc./ Tot. Revs.	Pretax Return on Capital
D.R. Horton, Inc.	6/30/11	352,300	199,300	85,800	17,400	20.3%	8.7%
Hovnanian Enterprises	7/31/11	68,686	12,951	28,804	6,730	23.4%	52.0%
KB Home	5/31/11	25,060	21,784	8,622	8,327	96.6%	38.2%
Lennar Corporation	5/31/11	543,690	141,336	265,020	22,210	8.4%	15.7%
MDC Holdings, Inc.	6/30/11	112,113	103,125	28,144	9,233	32.8%	9.0%
M/I Homes	6/30/11	NA	NA	13,538	5,376	39.7%	NA
Meritage Corp.	6/30/11	NA	NA	NA	NA	NA	NA
NVR, Inc.	6/30/11	202,629	88,089	61,638	26,502	43.0%	30.1%
Pulte Corporation	6/30/11	148,549	148,549	98,750	(7,015)	-7.1%	-4.7%
Ryland Group, Inc.	6/30/11	NA	NA	25,971	4,280	16.5%	NA
Standard Pacific Corp.	6/30/11	59,707	23,657	9,770	(533)	-5.5%	-2.3%
Toll Brothers, Inc.	7/31/11	NA	NA	NA	NA	NA	NA
<b>AVERAGES</b>		189,092	92,349	62,606	9,251	26.8%	18.3%
<b>MEDIANS</b>		130,331	95,607	28,474	7,529	21.8%	12.3%

From the table below, which includes the results of DHI, HOV, KBH, LEN, MDC, NVR, PHM and SPF, average total assets fell 12.0% vs. prior year levels. Capital invested was down 12.8%. On a trailing 12 month basis (R12), average revenues declined 7.5%, but operating income increased 14.6%, with all of the gains coming over the prior three quarters. For the quarter, average financial services revenue fell 19.5% and operating income fell 67.2%. Return on average assets (R12) rose from 5.1% to 5.8%, while the average return on capital (R12) rose from 10.2% to 11.3%.

Figures after 09Q3 on the table below are not directly comparable to prior quarters, because Centex dropped out of the analysis group as a result of its acquisition by Pulte. Likewise, the table below has excluded RYL since 06Q2, because it dropped most disclosures on its financial services operations. Thus the quarterly figures are not exactly comparable, but should provide a reasonable indication of trends in financial services returns and profits.

#### Average Performance of Financial Services Operations of Large Homebuilders

	Total Assets	Capital Invested	Capital/ Assets	R12 Revenues	R12 Oper Income	Op/ Revenues	Ret. on Avg. Assets	Ret. on Avg. Capital
11Q2	189,092	92,349	48.8%	73,319	10,357	14.1%	5.8%	11.3%
11Q1	151,487	83,628	55.2%	78,603	14,329	18.2%	7.7%	15.0%
10Q4	189,470	100,441	53.0%	79,473	15,141	19.1%	8.2%	16.0%
10Q3	185,231	91,181	49.2%	77,572	11,008	14.2%	6.2%	12.2%
10Q2	214,975	105,900	49.8%	79,238	9,034	11.4%	5.1%	10.2%
10Q1	144,942	79,843	55.1%	74,633	7,433	10.0%	4.3%	8.9%
09Q4	165,361	84,274	51.0%	76,366	5,499	7.2%	3.0%	6.5%
09Q3	181,960	85,811	47.2%	75,323	5,172	6.9%	2.7%	5.8%
09Q2	195,232	82,366	42.2%	84,380	129	0.2%	0.1%	0.1%
09Q1	190,515	84,262	44.2%	93,808	(946)	-1.0%	-0.4%	-0.9%
08Q4	211,098	106,867	50.6%	107,131	1,067	1.0%	0.4%	0.9%
08Q3	241,835	118,273	48.9%	117,577	(88)	-0.1%	0.0%	-0.1%
08Q2	267,004	129,784	48.6%	127,820	2,958	2.3%	0.9%	2.3%
08Q1	264,488	102,055	38.6%	139,015	7,858	5.7%	2.1%	6.2%
07Q4	347,847	140,813	40.5%	153,212	16,985	11.1%	3.8%	13.1%
07Q3	396,234	144,308	36.4%	179,055	38,906	21.7%	7.3%	30.9%
07Q2	499,732	123,269	24.7%	199,442	59,958	30.1%	9.8%	49.7%
07Q1	536,260	110,794	20.7%	211,574	66,794	31.6%	8.2%	51.0%
06Q4	703,155	125,233	17.8%	216,928	69,124	31.9%	6.9%	53.6%

(Continued from page 1)

months, there is now less justification for adjusting EBITDA for impairments. Most impairment charges taken today are likely to be attributable to costs incurred at or near the current period, which suggests that they belong in current measures of profitability. However, roughly about half of the current quarter's average impairment charges are attributable to a \$656 million goodwill impairment charge taken by Pulte in the 2010 third quarter. This fits the definition of a one-time or unusual charge and hence should be added back.

The decline in average builder profitability was accompanied by a deterioration in balance sheet metrics. Debt levels, on average, declined 2.3%, but equity book values declined by 10.2%. As a result, the average ratio of debt-to-total capitalization increased from 56.1% in 10Q2 to 58.1% in 11Q2.

Meanwhile, inventories increased 5.7% on average, so that the average inventory turnover ratio declined sharply from 1.40 times to 0.96 times. This rise in inventories in the face of the sharp drop in revenues was due primarily to an increase in active subdivisions by nearly all of the builders.

The rise in inventories combined with the reported net losses over the past year has drained cash from homebuilder coffers. On average, cash balances of these builders declined by 32.6% year-over-year..

Most valuation measures (at least those that are calculated on current or expected profits), suggest that the market already implicitly anticipates a recovery in homebuilder profitability. For example, the average P/E ratio, calculated only for the three builders that have reported a profit in the latest 12-month period, is 28, compared with 26 last year.

Forward P/E multiples, calculated only for those builders that are anticipated to report a profit in 2011 and 2012 are 43 and 23, respectively.

The average EBITDA multiple is 21.2 times, which is also well above market averages.

It is a fair bet, therefore, that homebuilder share prices could be vulnerable to further declines, even from these extremely low levels, if profits do not improve over the next couple of years.

On the other hand, given the operating leverage inherent in the business and recent bargain land purchases, profits could rebound sharply with even a modest improvement in sales.

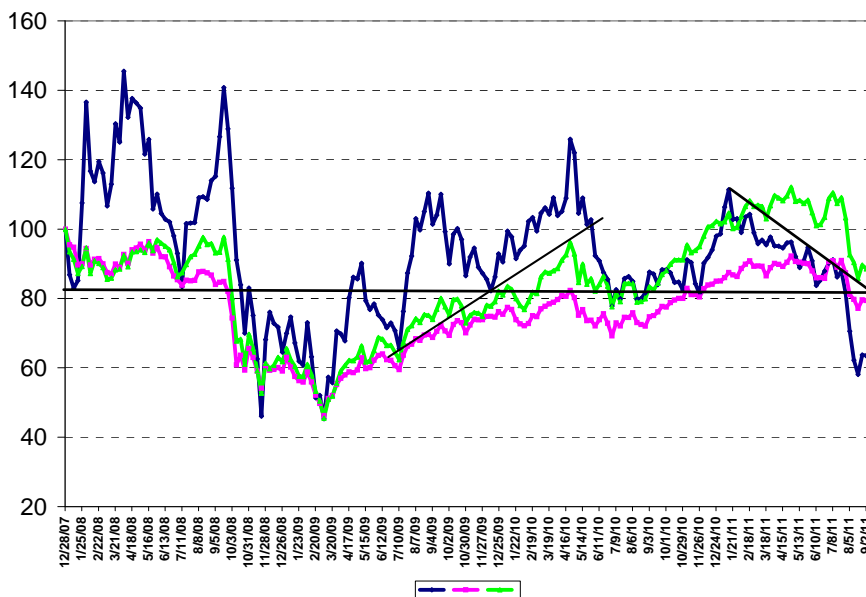
On balance, the recent declines in homebuilder share prices, while seemingly excessive, are not totally inappropriate in light of concerns about the sustainability of the

economic recovery and the deterioration in builders' leverage and liquidity measures. Clearly, these publicly-traded builders have taken a presumably calculated risk by expanding their active subdivision counts by 5%-10% on average in anticipation of at least a modest improvement in new home sales. For the most part, these new subdivisions were added in attractive locations and at bargain prices. In many cases, they are smaller in size than the typical subdivision, which should help to limit downside risk.

Perhaps the one bright spot for the quarter, therefore, was that new orders were up 3.7% on average. This was less than the estimated growth in community counts, so sales per subdivision are still on the decline. But the new order data suggests that the new homes market has been stable over the past year, which is a good sign, especially since it has been operating without the aid of federal tax stimulus.

Up until the summer sell-off and August madness, more builders were expressing cautious optimism about the outlook for their businesses. Many were reporting increases in traffic levels and an improvement in the apparent readiness of buyers to commit to a purchase. Coupled with their recent new subdivision openings and further efforts to reduce operating costs, many were optimistic about returning to or improving profitability in the second half of the year. Now with the August sell-off, which has

**Figure 1**  
**Lark Research Homebuilder Stock Index vs. S&P 500 and Russell 2000**  
(Dec. 28, 2007 = 100)



(Continued on page 12)

**Lark Research, Inc.**  
P.O. Box 768  
Norwood, MA 02062

Phone: 732-763-0763  
Email:  
webmaster@larkresearch.com

*(Continued from page 11)*

affected buyer traffic, they are clearly more guarded in their outlooks.

Yet, despite the seemingly never-ending parade of new negative developments both in the U.S. and especially in Europe, the damage has so far been contained primarily to the equity markets. Bond prices, with the exception of high yield, are flat or up. Interest rates on money market obligations are still quite low. If this continues, it suggests that what we are witnessing is primarily a stock market correction.

Admittedly, given the fragile nature of the economic recovery, a stock market correction has the potential to damage consumer confidence, so it cannot be taken lightly. Still, there are positive signs out there - for example, in industrial production, auto and retail sales, durable goods orders and others - that suggest that sentiment about the economy can bounce back.

Figure 1 on the previous page shows that the Lark Research Homebuilder Stock Index has broken through key support levels of around 82 or so. Those support levels, by my eye, stretch back to 2002. With the exception of the recent breach and a bigger one during the 2008-2009 financial crisis, the Index has been essentially trading in a wide range for the past three years. The latest decline looks like a retest of the 2008-2009 lows, which so far has held. While it may take some time to regain its footing, the Index could very well bounce back sharply, if recent history is a guide.

*Start my subscription to Net Realizable Value!*

4 issues for \$195

Name: \_\_\_\_\_

Company: \_\_\_\_\_

Address: \_\_\_\_\_

City: \_\_\_\_\_, State \_\_\_\_\_ Zip \_\_\_\_\_

Phone: \_\_\_\_\_ E-mail: \_\_\_\_\_

Pay by: Check  (Payable to Lark Research, Inc.) Bill Me

From a fundamental view, there is still a mixed picture on the longer-term outlook for the housing sector. On the one hand, inventories of existing homes, and especially vacant homes being held off the market, are high. Add to this the potential 1-2 million houses that could come on to the market, if their owners are unable to cure the defaults on their mortgages. Because of these supply sources, some economists have suggested that no new homes should be built for several years to absorb this excess supply.

On the flip side, the working through of this excess supply has so far been orderly. Distressed sales account for roughly a third of existing home sales. Although there have been concerns about a further slide, prices have in fact moved up over the past three months. All of this suggests that these sales are being managed successfully to avoid another steep slide in house prices.

At the same time, there is some evidence of pent-up demand for housing. Reports in the press and from builders suggest that many buyers remain on the sidelines because of concerns about the economy; but they recognize that affordability - the combination of low house prices and exceptionally low mortgage rates - is near an all-time

high. More buyers should come off the fence, if confidence in the economic outlook improves.

In addition, the Obama administration, for better or worse, appears to be focused on addressing the problems in housing. In his jobs speech last week, President Obama proposed refinancing a large number of homeowners at around 4%, which could put \$2,000-\$3,000 of annual disposable income in their pockets. On the other front, federal housing regulators and state attorneys general are pushing the banks to undertake a new mortgage modification effort that would enable more significant principle reductions to stave off foreclosures. If these efforts succeed, it should provide at least a temporary boost to both the economy and housing market.

On balance, therefore, while the publicly-traded builders still face significant risks, I think that it is a good bet that they will be able to report improved performance over the next year that should lead to a meaningful rebound in their share prices. While some builders are clearly closer to the edge than others, I believe that all should see higher stock prices, as long as even a modest recovery in housing begins to take hold by the beginning of next year.

The information contained in this report represents the opinion of Lark Research, Inc. and is based on independent information and research obtained from various sources. Although Lark Research, Inc. believes these sources to be reliable, it has not independently confirmed the accuracy of such information or research. Lark Research, Inc. shall not be responsible for errors contained in this report, regardless of whether such errors result from errors or omissions in such information or otherwise. No representation or warranty of any type or kind shall be expressed or implied by the publication, dissemination or delivery of this report.

This report is for information purposes only and shall not be construed as investment advice. Lark Research, Inc. is not registered as an investment adviser with the Securities and Exchange Commission, pursuant to exemptions from such registration provided in the Investment Company Act of 1940. This report is intended solely for the use, on a confidential basis, of those persons to whom it is directly distributed by Lark Research, Inc. This report shall at all times remain the property of Lark Research, Inc. and may not be reproduced, copied, forwarded or otherwise disseminated, in whole or in part, without the prior express written consent of Lark Research, Inc.