kb98

CAUTION: CONTAINS AN EXPLOSIVE IDEA THAT MAXIMIZES CORPORATE PERFORMANCE AND SHAREHOLDER VALUE.

Kaufman and Broad Home Corporation is one of America's premier homebuilders. The company was founded in 1957 in Detroit, Michigan and has built more than 225,000 homes during its history, primarily targeted at first-time and first-move-up buyers. The company was the first U.S. homebuilder to be publicly traded. Today, Kaufman and Broad has 21 operating divisions in 7 Western states, France, and Mexico.

Financial Highlights

In thousands, except per share and unit amounts — Years ended November 30,	1998	1997	1996	1995	Compound Annual Growth Rate 1996–1998
Net Orders, Deliveries and Backlog					
Net orders	16,781	12,489	10,239	8,253	26.7%
Deliveries	15,213	11,443	10,249	7,857	24.6
Unit backlog	6,943	4,214	2,839	1,412	70.0
Revenues and Income					
Revenues	$2,449,362	$1,878,723	$1,787,525	$1,397,845	20.6%
Operating income*	170,085	116,259	111,419	74,879	31.5
Pretax income*	146,567	91,030	75,013	45,459	47.7
Net income*	95,267	58,230	48,013	29,059	48.6
Basic earnings per share*	2.41	1.50	1.17	.59	59.9
Diluted earnings per share*	2.32	1.45	1.15	.58	58.7
Assets, Debt and Equity					
Total assets	$1,860,204	$1,418,991	$1,243,494	$1,574,179	5.7%
Mortgages and notes payable	769,259	697,697	577,585	790,575	(0.9)
Mandatorily redeemable preferred securities (Feline Prides)	189,750	—	—	—	—
Stockholders' equity	474,511	383,056	340,350	415,478	—
Return on average stockholders' equity	22.2%	16.1%	12.7%	7.1%	—

*Before a $170.8 million pretax noncash charge for impairment of long-lived assets recorded in the second quarter of 1996. For further discussion of the noncash charge see "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the accompanying consolidated financial statements and notes thereto.

THINK
thinkbig
thinkbig
THINKBIG
BIG
thinkbig
BIG
BIG
THINK
BIG

it's an idea.

it's an attitude.

it's an expectation.

it's about record performance *today,*

and setting new records tomorrow.

IT'S KAUFMAN AND BROAD.

THINK BIG

TO OUR SHAREHOLDERS,

When I sat down to compose this message to you, I knew it would be one of the most ambitious letters I'd ever write.

I knew it would be hard to capture the pace of our change, the force of our strategic initiatives, and the extent of our record performance. I thought it would be almost impossible for words to convey the energy and drive displayed by our employees every day.

But when I looked at our results and reviewed our strategies and the talent of our people, I realized that we've already written the definitive summary of 1998. It's been captured in two words that have become an essential part of our corporate culture: *think* big.

It's a simple, powerful idea. "Thinking big" fueled a three-year journey which began with our purchase of San Antonio-based Rayco, gathered momentum from our commitment to fundamentally reshape our business, and will lead us to become the nation's largest, most disciplined homebuilder in 1999.

BIG RESULTS

The numbers alone tell much of the story of 1998. Our results were, well, *very* big.

- Exceptionally strong diluted earnings per share of $2.32 – 60.0% higher than our 1997 EPS. We've now had 14 straight quarters of earnings growth – and our compound annual EPS growth rate over the past three years stands at 58.7%.
- Deliveries soared 32.9% to 15,213. We've nearly doubled our total unit deliveries since 1995. On average, almost 42 families are moving into a Kaufman and Broad home every day of the year. To put it another way, by the time you've finished this letter, another family has received their new home in a new community in one of our markets.
- All-time record net income of $95.3 million, a 63.6% increase over 1997.
- Revenue also jumped, up 30.4% over last year to $2.45 billion.
- Backlog at the end of our fiscal year stood at 6,943 units – a 64.8% increase over 1997 and almost *five times* our year-end backlog just three years ago.
- Housing gross margin reached 20.2% in the 4th quarter of 1998, and 19.2% for the year. These margins increased every quarter during the year, and stood 1.3 percentage points higher in the 4th quarter of 1998 than in the 4th quarter of 1997.
- Return on average stockholders' equity rose to 22.2%, up 6.1 percentage points compared to 1997. The 1998 performance exceeded our goal of 20% for the first time in almost 10 years.
- Net debt to total capital ratio at year end stood at approximately 43% – slightly below our 45%–55% target range despite five major acquisitions made or announced during the course of the year.

59%

EPS GROWTH RATE

$2.32

$0.58

$0.58	$1.15	$1.45	$2.32
95	96	97	98

NUMBER ONE

THINKING BIG IS THE EASY PART. HAVING THE RIGHT STRATEGIES AND PEOPLE IN PLACE TO ACT ON THAT VISION IS SOMETHING ELSE ALTOGETHER.

Of course, what's important to you is how our *stock* responded to these exceptionally strong results. Simply put, KBH was a winner. In a year marked by instability in global equity markets, Kaufman and Broad's stock closed the calendar year on a great note – increasing 28.1% between January 1 and December 31. We significantly outperformed the Dow Jones Home Construction Index – which is one measure of how we're doing against other homebuilders – and also matched the gains of the S&P500 Index and the Dow Industrials.

But thinking big also means that we're *not* content.

When we launched our "Think Big" consumer marketing campaign – which communicated to homebuyers just how Kaufman and Broad can meet their demand for bigger floor space, bigger choices and bigger value – I asked an employee in our Denver division how she defined "Think Big." She thought for a moment, then replied *"'Think Big' means that we can always achieve more than we think we can."*

What a great answer. It speaks to the untapped possibilities that are inherent in all aspects of our business. It reflects on the ambition and drive in our employees. And it tells you a lot about this company's character and culture.

BIG STRATEGY

Of course, *thinking* big is the easy part. Any CEO can *talk* about breaking new ground and striving to be a market leader. Frankly, it's part of the job. But having the right strategies and people in place to *act* on that vision is something else altogether. And it's in our strategic execution that I believe Kaufman and Broad ranks among the country's finest companies.

KEY FINANCIAL GOALS

	GOAL	ACTUAL PERFORMANCE 1996–1998
ANNUAL EPS GROWTH	20–25%	58.7% [1]
UNIT DELIVERY GROWTH	10–15%	24.6% [1]
RETURN ON AVERAGE STOCKHOLDERS' EQUITY	20%	17.0% [2] [3]
NET DEBT TO TOTAL CAPITAL	45–55%	50.8% [2]

[1]COMPOUND ANNUAL GROWTH RATE [2]AVERAGE [3]COMPANY ACHIEVED A 22.2% ROE IN 1998

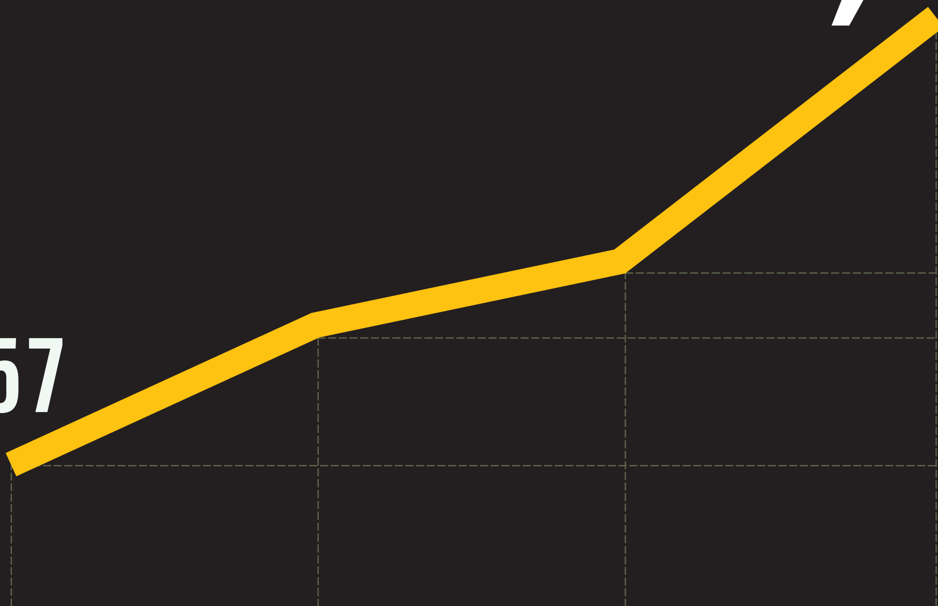
We've set specific, ambitious targets for our annual EPS growth, unit delivery growth, return on equity and net debt to total capital ratio. After three years, we've exceeded each one of these goals. We're not only setting a new performance standard for the homebuilding industry, we're beating the toughest critics around — ourselves.

We entered 1998 with four fundamental strategies in place – designed to maximize our performance and the returns we could offer to our stockholders. Above all, these strategies were developed to enable Kaufman and Broad to deliver consistent, predictable and sustainable performance – setting us apart from the cyclicality that is normally a hallmark of the homebuilding industry. We believe that homebuilding *doesn't* have to be more cyclical than other industries – as long as we stick to these basic principles.

1. KB2000. Simply put, KB2000 is the most innovative operating business model in the homebuilding industry. While there are 10 key elements of KB2000, it really boils down to a focus on customer choice and value, and maintaining control over costs.

Expanding Choice. Our ability to offer big choices has struck a chord with our customers. We've already distributed over 800,000 customer surveys, giving us a solid understanding about customer preferences in each of our markets. We're also now operating 13 New Home Showrooms in our major markets across the West and in Paris – having opened 8 in 1998 alone. These retail-style Showrooms offer as many as 5,000 choices and are a one-stop shop where buyers learn how to buy a home, qualify for a mortgage and find out about the different Kaufman and Broad communities in their area. We strongly believe home buying is increasingly becoming a retail experience, and our Showrooms will play an essential role in our efforts to stay in step with the needs of our customers.

15,213



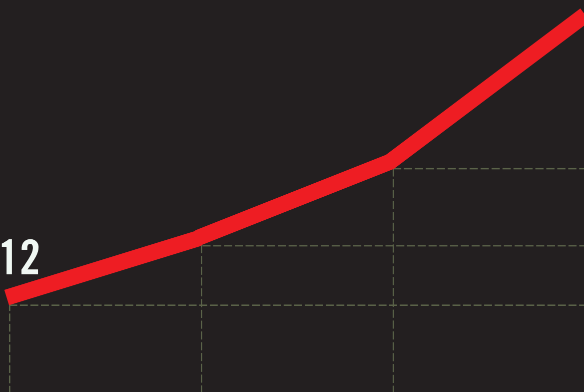
7,857

	7,857	10,249	11,443	15,213
	95	96	97	98

UNIT DELIVERY GROWTH

6,943

UNIT BACKLOG



1,412

1,412	2,839	4,214	6,943
95	96	97	98

THE 10 KEY PRINCIPLES OF KB2000

1. Know the buyer, through extensive surveying.
2. Determine which customers to target in a given market based on survey results.
3. Purchase land consistent with survey results and specific ROI hurdles.
4. Maximize the choices offered to the customer.
   - Base plans reflect features in highest demand as determined by survey results.
   - Give customers ability to upgrade and customize.
   - Operate large New Home Showrooms, to make home buying a retail experience.
5. Price the base home significantly below the competition.
6. Use even-flow production schedules, which minimize production and overhead costs.
7. Establish large backlogs through pre-sales.
8. Focus on construction quality and customer satisfaction.
9. Partner with outside brokers in all communities.
10. Finance new home purchases through the Kaufman and Broad Mortgage Company.

KB2000 COMMUNITIES HAVE APPROXIMATELY 2% HIGHER GROSS MARGINS THAN OUR NON-KB2000 COMMUNITIES.

The results are in. Throughout the year, we accelerated the implementation of KB2000 in our existing divisions, and "jump started" the model in our new acquisitions. As a result, homes built under our KB2000 disciplines comprised approximately 70% of our deliveries in the 4TH quarter of 1998 – compared with 45% in the 4TH quarter of 1997. Those KB2000 communities have approximately *2% higher* gross margins than our non-KB2000 communities – underscoring why we want and expect to approach 100% KB2000 (excluding the Lewis Homes acquisition) at the end of 1999. What's more, at the end of 1998 approximately 80% of our U.S. mortgage loan customers were using the Kaufman and Broad Mortgage Company, compared to 75% at the end of 1997.

Structured implementation. To manage the complexity of KB2000, as well as our rapid growth, we've invested heavily in technology and training. We've created uniform systems ensuring that while some of the principles of KB2000 may be copied by other builders *(and believe me, they're already trying!)*, our success with the model can never be truly matched.

IN 1999, WHICH WILL BE THE FIRST FULL YEAR OF DELIVERIES FROM OUR 1998 ACQUISITIONS, WE EXPECT TO DELIVER APPROXIMATELY 21,500 HOMES.

2. ACCELERATED GROWTH. We remain on a very aggressive growth track. Between 1996 and 1998, our deliveries increased at a 24.6% compound rate – jumping almost 33% in 1998 alone. In 1999, which will be the first full year of deliveries from our 1998 acquisitions, we expect to deliver approximately 21,500 homes.

Significantly, our growth is very well balanced throughout our Western markets. In the early 1990s, Kaufman and Broad was tied principally to the fortunes of two markets — California and Paris, France. However, in 1993 we launched an expansion to other lucrative markets in the West. Today, we're not only the largest homebuilder in terms of unit deliveries in California, but in Texas and Nevada as well.

Achieving this balanced growth has enabled us to take advantage of some of the fastest-growing housing markets in the country, such as Las Vegas, Phoenix and Denver. At the same time, it has reduced our exposure to the economic conditions affecting one state or region – helping us control our risk and increase the predictability of our performance.

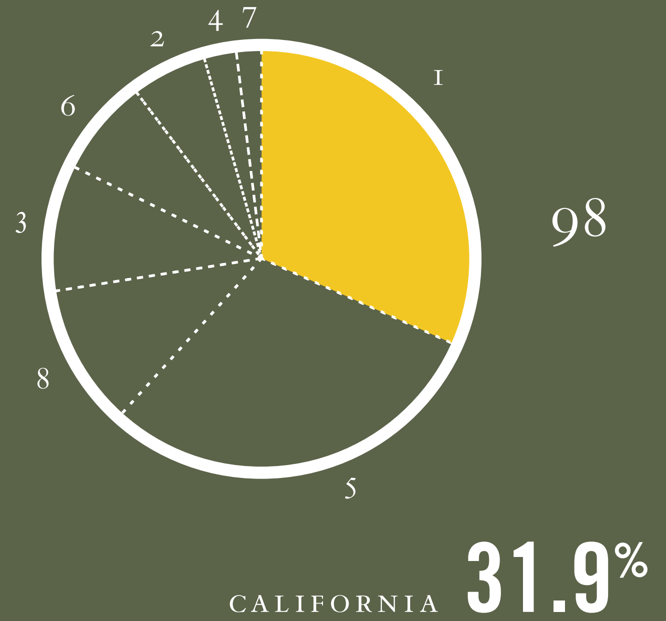
While many companies would have trouble controlling such rapid expansion, we've created a disciplined corporate structure that enables us to manage our growth. We've done away with the last vestiges of the kind of "seat of your pants" homebuilding that has limited the potential of so many other homebuilders. Instead, we have a focused, process-driven management team, and they're growing our business based on the demand of the market.

3. MARKET DOMINANCE. Our growth serves a specific purpose – to achieve a dominant position in every major market where we're building homes. When we achieve market dominance, we have the economies of scale that enable us to realize all the benefits of KB2000. It also gives us better leverage in our relationships with

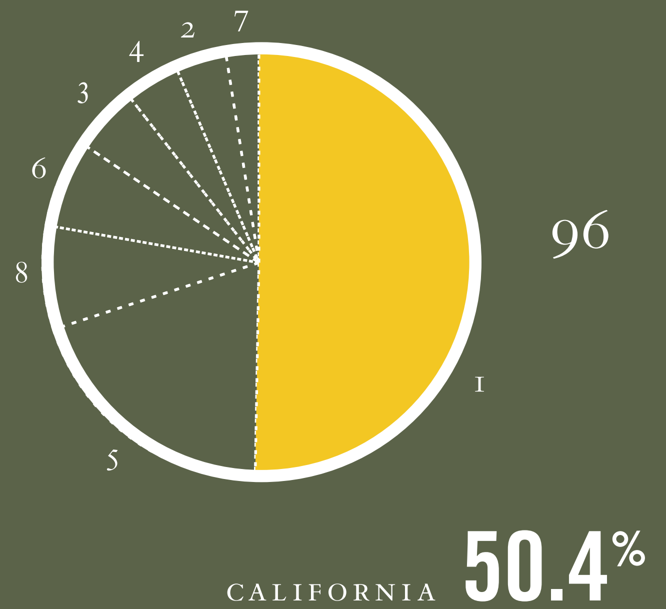
GEOGRAPHIC DIVERSITY

		93	96	98
1.	CALIFORNIA	84.9	50.4	31.9%
2.	NEVADA	3.1	3.9	5.9%
3.	ARIZONA	–	5.1	9.6%
4.	NEW MEXICO	–	4.1	2.5%
5.	TEXAS	–	19.8	30.0%
6.	COLORADO	–	6.8	7.5%
7.	UTAH	–	2.3	1.7%
8.	FOREIGN	12.0	7.6	10.9%

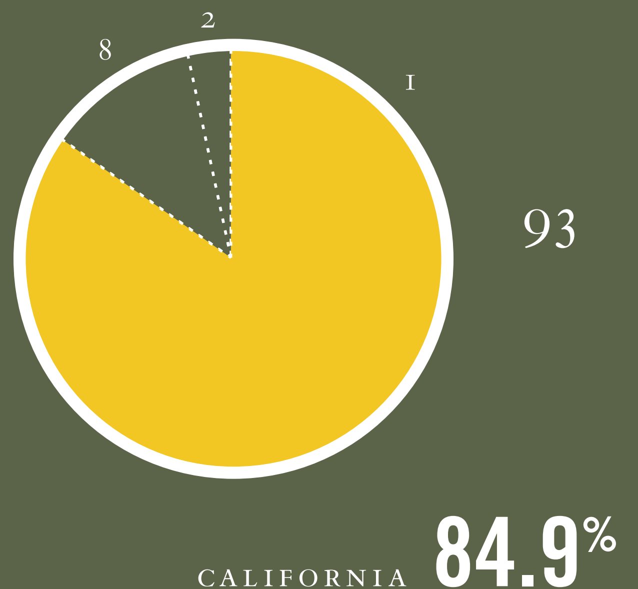
% BASED ON NUMBER OF DELIVERIES



CALIFORNIA 31.9%



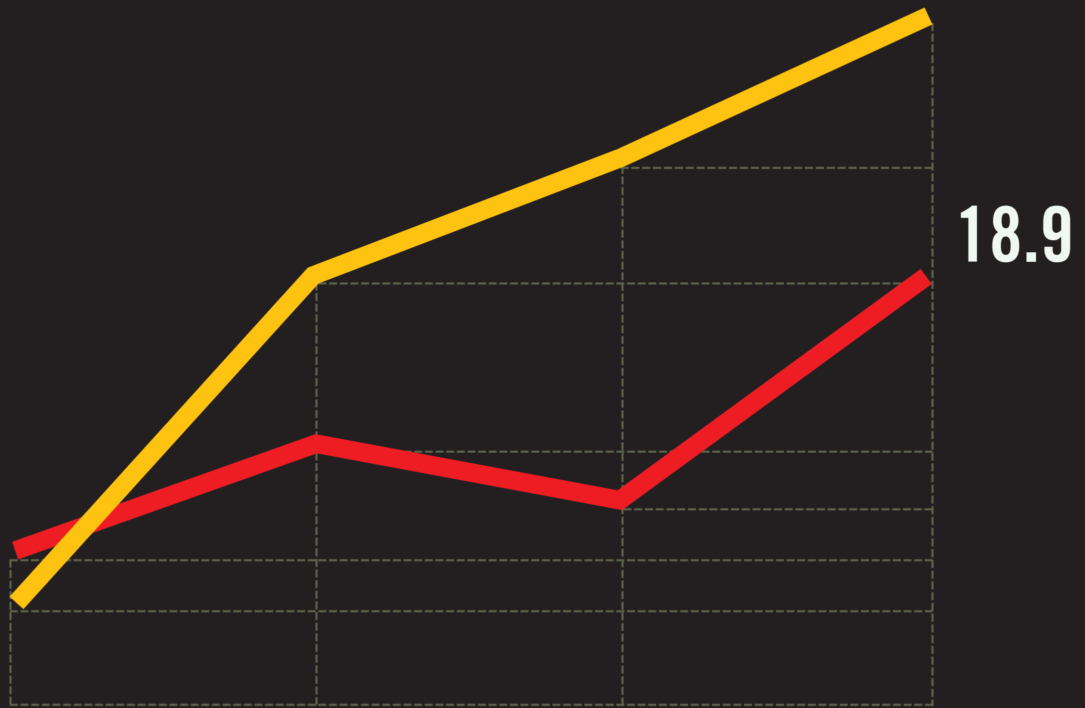
CALIFORNIA 50.4%



CALIFORNIA 84.9%

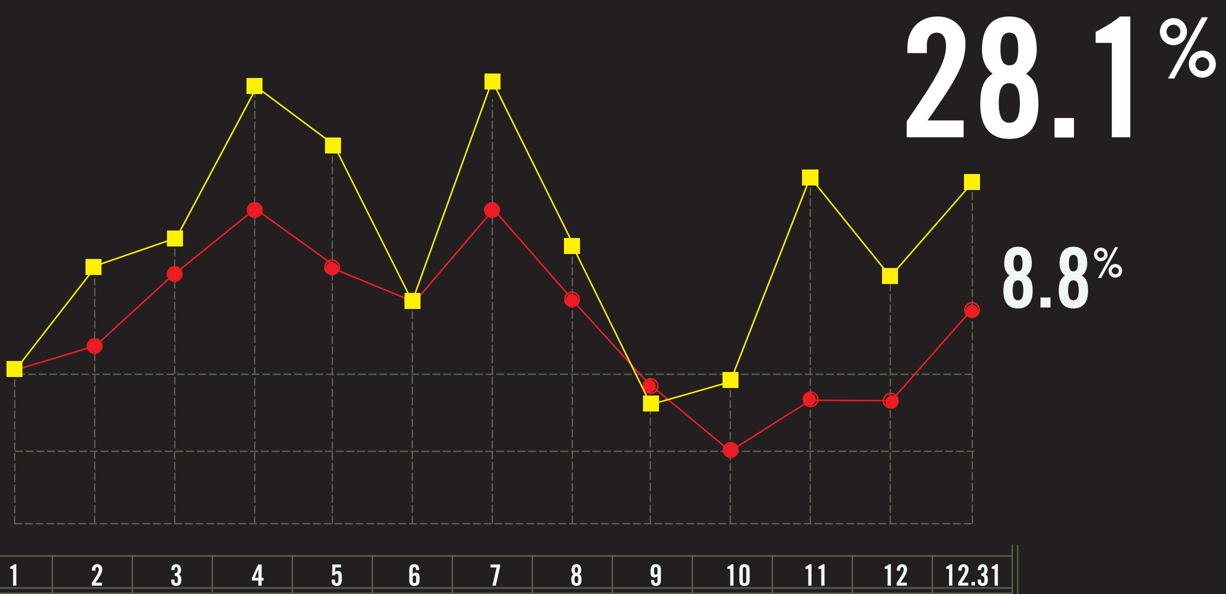
HOUSING GROSS MARGIN INCREASES

20.2



	Q1	Q2	Q3	Q4
● 1998	17.4	18.8	19.4	20.2
● 1997	17.5	18.0	17.7	18.9

KBH PERFORMANCE vs. DOW JONES HOME CONSTRUCTION INDEX



JANUARY 1 ~ DECEMBER 31, 1998

■ KBH
● DOW JONES HOME CONSTRUCTION INDEX

WE SHOULD BE ABLE TO CONTINUE GROWING IN A GIVEN MARKET INDEFINITELY EVEN AFTER WE ACHIEVE MARKET DOMINANCE.

land owners and subcontractors, as we become their "preferred customer" in terms of the steady volume of work we can offer them. This in turn helps keep our costs down through efficient procurement and our prices among the most competitive in the market. Additionally, we're able to attract and retain the highest caliber of management talent.

Market dominance isn't about controlling home prices or the fees of our suppliers and subcontractors. Rather, it's about achieving the minimum level of unit volume in a given market that enables us to take full advantage of the KB2000 operational business model. This volume level varies depending on the size and characteristics of each market, and we don't set specific market share or unit volume targets. In fact, we should be able to continue growing in a given market indefinitely – even after we achieve market dominance.

We entered 1998 with market dominance established in San Antonio. By the end of the year, four more divisions achieved market dominance – Denver, Las Vegas, San Diego and Phoenix. We expect more divisions to reach market dominance in 1999.

4. Acquisitions. At the beginning of 1998, we intended for acquisitions to play an important supplemental role in our growth. By acquiring great, regionally-based homebuilders, we knew we could enter new markets in force, and more rapidly achieve a dominant position in our existing markets. As a large, acquisition-minded builder, dozens of possible acquisition targets were brought to our attention. However, we showed the same discipline in targeting our acquisitions as we did in targeting our customers. We developed a strict set of evaluation criteria for any

KAUFMAN AND BROAD

SHARE AND RANK

IN KEY MARKETS

ENDING NOVEMBER 1998

MARKET	RANK	SHARE
Southern California	1	7.1%
Lewis Homes	*8*	*3.1%*
TOTAL		10.2%
Northern California	1	9.0%
Lewis Homes	*18*	*1.7%*
TOTAL		10.7%
Las Vegas	2	8.3%
Lewis Homes	*1*	*11.1%*
TOTAL		19.4%
Phoenix	5	4.9%
Denver	2	8.1%
San Antonio	1	44.4%

SOURCE: THE MEYERS GROUP, SHAW-LANDATA, INC., AMERICAN METRO STUDY

potential purchase, which includes ensuring it's accretive to earnings per share in the first full year, has an operational model that's either compatible with or easily adaptable to KB2000, has an attractive lot position, and is consistent with our 20% ROE and debt leverage objectives. As a result, we knew we could effectively manage our acquisitions and have them benefit our stockholders within the first year.

As it turned out, our acquisition strategy succeeded beyond any of our expectations. A string of acquisitions of homebuilders in Houston, Denver, and Phoenix/Tucson culminated in October with the announcement of our agreement to purchase Lewis Homes – one of America's largest and best-run family-owned homebuilders. In total, we acquired five companies in less than one year that are expected to deliver more than 6,500 homes, while keeping our net debt to total capital ratio well within our target range. Since our 1996 Rayco acquisition, we've made approximately $776.8 million worth of acquisitions, representing close to $1.5 billion in revenue.

These acquisitions do more for us than simply add to our deliveries and earnings. They also ensure that we can sustain our growth over the long term. In buying these great companies, in many instances we're also acquiring the talents of the people who made them great, who bring with them experience that adds to our operating knowledge. We're also discovering best practices which we're quickly incorporating into the rest of the company. Already, some great employees at the companies we've acquired are taking leadership roles in Kaufman and Broad.

HALLMARK GENERAL
LEWIS
ESTES PRIDEMARK

OVER 5,000
CHOICES
IN ONE STOP

Their belief in KB2000, our mission and vision, has helped in smoothing the transition – enabling us to focus on leveraging our acquisitions as a springboard for further growth in each market.

Consolidation in the homebuilding industry will continue, as builders learn to capitalize on the advantages brought by generating economies of scale. We've clearly established a core competency in making and integrating acquisitions, which will continue to serve us well in the months ahead.

BIG FUTURE

It's been a big year. Our performance has demonstrated the power of our strategic thinking, and offers a glimpse into the kind of big future that's in store for us. We certainly expect 1999 to be an even bigger and better year for Kaufman and Broad.

PROVEN STRATEGIES REMAIN UNCHANGED. As a result of our successful 1998, our strategies will remain essentially unchanged in 1999. We will continue to focus on implementing KB2000, accelerating our growth, striving for market dominance, and making smart acquisitions. They've served us very well so far, and we expect they'll continue producing outstanding results.

KAUFMAN AND BROAD ACQUISITIONS 1996 – PRESENT

	DATE CLOSED	COMPANY CONSIDERATION (*$ millions*)	UNITS*	LOTS	REVENUES (*$ millions*)
Rayco	3/96	$104.5	2,500	5,600	$238.3
Smci	7/97	$10.3	525	1,130	$45.6
Hallmark	3/98	$54.0	825	4,700	$89.0
PrideMark	3/98	$65.0	820	5,000	$100.4
Estes	4/98	$48.0	1,030	2,600	$114.0
General	9/98	$46.0	430	1,200	$52.1
Lewis	1/99	$449.0	3,500	24,000	$833.0
Total		$776.8	9,630	44,230	$1,472.4

* 1999E

WE WILL CONTINUE TO FOCUS ON IMPLEMENTING KB2000, ACCELERATING OUR GROWTH, STRIVING FOR MARKET DOMINANCE, AND MAKING SMART ACQUISITIONS.

WELL POSITIONED FOR GROWTH. In implementing these strategies, we think we're well positioned to take advantage of the strongest housing market seen in many years. We're still focused on first-time and first-move-up homebuyers – the biggest segment of the market. Mortgage rates continue to remain low, and the economic climate throughout the West remains robust. While the cost of land has certainly increased as a result, we have an excellent lot position (more than 90,000 lots, including new land acquired through our acquisitions), and our market dominance positions give us more leverage in our dealings with land sellers.

INVESTING IN OUR PEOPLE. To help sustain our growth, we're also implementing a sophisticated employee development and training program. When you're building approximately 21,500 homes every year, you need the best people on the job. Not only do we have them, we're making them better. We've put systems in place that take advantage of the depth of experience that exists at all levels of the company. As a result, we're developing the deepest bench in the industry – training a new generation of big thinkers that will lead us into the future.

CREATING BRAND VALUE. Our objective is simple – to make Kaufman and Broad the most recognizable brand in homebuilding. Consumers today are awash in a sea of brand names, and as a result, a distinctive brand identity in a highly competitive housing market becomes a tremendous asset. In many of our large markets, our brand recognition is *three times* that of our nearest competitor. We'll continue supplementing advertising that's designed to drive traffic to our communities with messages underscoring Kaufman and Broad's reputation for offering maximum

LEADERSHIP
TALENT
PERFORMANCE

BIG FUTURE

choice, great value, and more than 40 years' experience in building quality homes. These messages become even more essential in new markets or markets where we've increased our visibility through acquisitions.

RAISING OUR SIGHTS. In last year's annual report, I mentioned that we were pushing to deliver 13,500 homes in 1998 and 16,000 homes in 1999. Well, with more than 15,200 deliveries under our belt in 1998 and an estimated 21,500 1999 deliveries in the works, we've blasted through those projections. We'll continually raise our sights, and in light of our consistent record-breaking accomplishments, I challenge anybody to say that we're not capable of achieving any goal we set for ourselves.

THINK BIG

Despite our remarkable success, despite becoming America's leading homebuilder in 1999, despite our record performance and profits, the most important event in my life this past year occurred much closer to home – the birth of my first grandchild, Juliette.

Over the years, as I watch my granddaughter grow from a beautiful baby to a little girl to a young woman, I know I'll have many opportunities to offer her my advice on life, business and everything in between. But if I could only give one message to her, it would be this: WHEN SETTING YOUR GOALS, REMEMBER THAT YOU CAN ALWAYS ACHIEVE MORE THAN YOU THINK YOU CAN.

We'll always be thinking big at Kaufman and Broad. We'll always look for new ways to maximize the returns we can offer our stockholders. In KB2000, we've got an operating model that's also a core value of the company, enabling us to achieve increasingly higher levels of performance — and establishing Kaufman and Broad as the standard against which all other homebuilders are judged.

On behalf of the more than 3,000 big thinkers at Kaufman and Broad, I'd like to thank you for entrusting your investment dollars with us. We'll be working hard to justify your confidence, as we continue on a journey fueled by big thoughts and even bigger dreams.

Sincerely,

Bruce Karatz
CHAIRMAN AND CHIEF EXECUTIVE OFFICER

BIG
RESULTS

SELECTED FINANCIAL INFORMATION

In thousands, except per share amounts — Years Ended November 30,	1998	1997	1996	1995	1994
Construction:					
Revenues	$2,402,966	$1,843,614	$1,754,147	$1,366,866	$1,307,570
Operating income (loss)*	148,672	101,751	(72,078)	65,531	88,323
Total assets	1,542,544	1,133,861	1,000,159	1,269,208	1,167,136
Mortgages and notes payable	529,846	496,869	442,629	639,575	565,020
Mortgage banking:					
Revenues	$ 46,396	$ 35,109	$ 33,378	$ 30,979	$ 30,008
Operating income	21,413	14,508	12,740	9,348	6,003
Total assets	317,660	285,130	243,335	304,971	287,324
Notes payable	239,413	200,828	134,956	151,000	125,000
Collateralized mortgage obligations	49,264	60,058	68,381	84,764	96,731
Consolidated:					
Revenues	$2,449,362	$1,878,723	$1,787,525	$1,397,845	$1,337,578
Operating income (loss)*	170,085	116,259	(59,338)	74,879	94,326
Net income (loss)*	95,267	58,230	(61,244)	29,059	46,550
Total assets	1,860,204	1,418,991	1,243,494	1,574,179	1,454,460
Mortgages and notes payable	769,259	697,697	577,585	790,575	690,020
Collateralized mortgage obligations	49,264	60,058	68,381	84,764	96,731
Mandatorily redeemable preferred securities (Feline Prides)	189,750				
Stockholders' equity*	474,511	383,056	340,350	415,478	404,747
Basic earnings (loss) per share*	$ 2.41	$ 1.50	$ (1.80)	$ .59	$ 1.13
Diluted earnings (loss) per share*	2.32	1.45	(1.80)	.58	1.09
Cash dividends per common share	.30	.30	.30	.30	.30

*Reflects a $170.8 million pretax noncash charge for impairment of long-lived assets recorded in the second quarter of 1996.

MANAGEMENT'S DISCUSSION
AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

Overview Revenues are primarily generated from the Company's (i) housing operations in the western United States and France and (ii) its domestic mortgage banking operations.

The Company set a new all-time high earnings record in 1998 with net income totaling $95.3 million. Continued progress in implementing the Company's key operating strategies produced increases in revenues and earnings compared to the prior records set in 1997.

In particular, the Company remained tightly focused throughout 1998 on two overarching strategies: the implementation of its KB2000 operational business model and the acceleration of the Company's growth. To advance these initiatives, the Company concentrated on two complementary strategies consisting of establishing optimum local market positions in selected regional markets and maintaining its focus on strategic acquisitions of regional builders. During the year, the Company continued to make further progress in implementing the key elements of KB2000 throughout its domestic operations. The key elements of KB2000 include: improving the Company's understanding of customer desires and preferences through frequent and localized surveys; emphasizing pre-sales in contrast to speculative inventory; maintaining lower average levels of in-process and standing inventory; establishing even flow production; providing a wide spectrum of choice to customers in terms of location, design and options; offering low base prices; and reducing the use of sales incentives.

Total Company revenues increased to $2.45 billion in 1998, up 30.4% from $1.88 billion in 1997, which had increased 5.1% from revenues of $1.79 billion in 1996. The 1998 increase primarily resulted from higher housing revenues and land sale revenues, as well as increased revenues from mortgage banking operations. Included in the operating results for 1998 are results from the acquisitions of Houston-based Hallmark Residential Group ("Hallmark"), Denver-based PrideMark Homebuilding Group ("PrideMark") and Phoenix/Tucson-based Estes Homebuilding Co. ("Estes"), all of which the Company completed during the second quarter of 1998. Results for 1998 also reflect the Company's acquisition of a majority interest in Houston-based General Homes Corporation ("General Homes") as of August 18, 1998. The Company acquired the remaining minority interest in General Homes on January 4, 1999. The increase in revenues in 1997 compared to 1996 results was due to higher housing revenues, partially offset by lower land sale revenues. In addition, 1997 results included a full year's contribution from the Company's San Antonio homebuilding operations (formerly Rayco, Ltd.); in contrast, 1996 results included only a nine-month contribution as the Company's acquisition of these operations occurred on March 1, 1996. Included in total Company revenues were mortgage banking revenues of $46.4 million in 1998, $35.1 million in 1997 and $33.4 million in 1996.

Net income increased $37.0 million or 63.6% to $95.3 million or $2.32 per diluted share in 1998, up from $58.2 million or $1.45 per diluted share in 1997. The 60.0% increase in diluted earnings per share in 1998 was primarily driven by increases in unit deliveries and construction gross margin, and increased mortgage banking pretax income. The

Company's 1998 operating results also benefited from the earnings contributions of the three acquisitions completed during the second quarter of 1998, as well as the impact of the acquisition of the majority interest in General Homes. Net income of $58.2 million or $1.45 per diluted share in 1997 was 21.3% higher than the $48.0 million or $1.15 per diluted share recorded in 1996 (excluding the after-tax noncash charge of $109.3 million for impairment of long-lived assets recorded in 1996). Including the noncash charge, the Company recorded a net loss of $61.2 million or $1.80 diluted loss per share in 1996. Net income increased in 1997 due to higher unit deliveries, lower interest expense and higher earnings from mortgage banking operations. In addition, earnings for 1997 included a full year of operating results from the San Antonio operations acquired in the second quarter of 1996.

Construction

Revenues Construction revenues increased in 1998 to $2.40 billion from $1.84 billion in 1997, which had increased from $1.75 billion in 1996. The improvement in 1998 was mainly the result of increased housing revenues, partly due to the newly acquired operations in Houston, Denver and Phoenix/Tucson and the majority ownership investment in General Homes, and increased land sale revenues. In 1997, the increase in revenues primarily reflected increased housing revenues, which included a full year's operating results from the Company's San Antonio division, partially offset by a decline in revenues from land sales.

Housing revenues totaled $2.38 billion in 1998, $1.83 billion in 1997 and $1.67 billion in 1996. The increase in 1998 reflected a 33.0% increase in unit volume, partially offset by a 2.1% decline in average selling price. In 1997, housing revenues totaled $1.83 billion, up 9.2% from 1996 as a result of an 11.7% increase in unit volume, partially offset by a 2.2% lower average selling price. California housing operations generated 45.8% of Company-wide housing revenues in 1998, down from 54.0% in 1997 and 59.6% in 1996, mainly as a result of the Company's strategic acquisition activities and continued expansion of its Other U.S. operations. (The Company's housing operations in Arizona, Colorado, Nevada, New Mexico, Texas and Utah are collectively referred to as "Other U.S.".) Housing revenues from California operations were $1.09 billion in 1998, up 10.6% from $986.6 million in 1997. The Company's Other U.S. housing revenues totaled $1.04 billion in 1998, up 54.7% from $669.4 million in 1997. Other U.S. housing revenues rose in 1998 due to the inclusion of deliveries from the three businesses acquired in the second quarter of 1998 and from the majority ownership investment in General Homes as well as expansion of existing Other U.S. businesses. The Company's operations in France and Mexico generated housing revenues of $240.0 million and $12.5 million, respectively, in 1998 compared to $160.5 million and $10.8 million, respectively, in 1997, reflecting increases in housing deliveries in both locations. Housing revenues from operations in France and Mexico totaled $154.7 million and $6.4 million, respectively, in 1996.

	California	Other U.S.	Foreign	Total
Unit Deliveries				
1998				
First	1,022	1,341	266	2,629
Second	1,124	1,938	347	3,409
Third	1,225	2,567	375	4,167
Fourth	1,487	2,852	669	5,008
Total	4,858	8,698	1,657	15,213
1997				
First	914	1,102	92	2,108
Second	1,095	1,211	159	2,465
Third	1,204	1,513	299	3,016
Fourth	1,518	1,816	520	3,854
Total	4,731	5,642	1,070	11,443
Net Orders				
1998				
First	1,269	2,062	385	3,716
Second	1,391	2,907	563	4,861
Third	1,117	2,387	379	3,883
Fourth	985	2,630	706	4,321
Total	4,762	9,986	2,033	16,781
1997				
First	1,077	1,528	150	2,755
Second	1,476	1,681	239	3,396
Third	1,506	1,599	205	3,310
Fourth	1,134	1,368	526	3,028
Total	5,193	6,176	1,120	12,489

	California	Other U.S.	Foreign	Total
Ending Backlog-Units				
1998				
First	1,563	3,011	727	5,301
Second	1,830	4,808	943	7,581
Third	1,722	4,961	947	7,630
Fourth	1,220	4,739	984	6,943
1997				
First	1,017	2,182	287	3,486
Second	1,398	2,652	367	4,417
Third	1,700	2,738	602	5,040
Fourth	1,316	2,290	608	4,214
Ending Backlog-Value				
In thousands				
1998				
First	$337,424	$363,340	$ 98,378	$ 799,142
Second	394,144	588,820	136,929	1,119,893
Third	388,998	594,575	148,464	1,132,037
Fourth	288,317	560,307	151,668	1,000,292
1997				
First	$219,908	$248,835	$ 61,073	$ 529,816
Second	288,719	307,977	70,806	667,502
Third	377,332	321,007	79,361	777,700
Fourth	303,050	274,591	89,020	666,661

Housing deliveries rose 33.0% to 15,213 units in 1998, exceeding the previous Company-wide record of 11,443 units established in 1997. This improvement reflected increases in U.S. and French operations of 30.7% and 55.9%, respectively. Growth in domestic deliveries was primarily driven by a 54.2% increase in Other U.S. operations. In California, deliveries rose 2.7% to 4,858 units in 1998 from 4,731 units in 1997, despite a 17.9% decline in the Company's average number of active communities in the state. Other U.S. operations delivered 8,698 units in 1998, including 1,702 deliveries from the three newly acquired companies and the majority ownership investment in General Homes. Excluding results from these acquisitions, deliveries from Other U.S. operations increased 24.0% to 6,996 units, from 5,642 units delivered in 1997, due to a higher average number of active communities in existing Other U.S. businesses. In 1998, French deliveries increased primarily as a result of the inclusion of a full year of results from French home-builder SMCI. The Company acquired SMCI, a builder of condominiums in Paris and other cities in France, in mid-1997 for $2.2 million in cash and the assumption of approximately $8.1 million of debt.

Housing deliveries increased 11.7% to 11,443 units in 1997 from 10,249 units in 1996. This improvement reflected increases in U.S. and French operations of 9.6% and 37.8%, respec-

tively. Growth in domestic deliveries was driven by a 31.4% increase in results from Other U.S. operations, to 5,642 units in 1997 from 4,294 units in 1996, partially offset by a decline in California deliveries. Unit deliveries in Other U.S. operations increased in 1997 for several reasons:a higher average number of active communities, reflecting the Company's growth strategy; the inclusion of twelve months of operating results from the San Antonio acquisition; and first deliveries from start-up operations in Austin. California deliveries in 1997 decreased 8.5% to 4,731 units from 5,171 units in 1996, reflecting a decline in the Company's average number of active communities in the state. In France, 1997 deliveries increased from the previous year primarily as a result of the acquisition of certain active SMCI developments.

The Company-wide average new home price decreased 2.1% in 1998, to $156,400 from $159,700 in 1997. The 1997 average had decreased 2.2% from $163,300 in 1996. These decreases were primarily due to the Company's decision to generate a greater proportion of lower-priced domestic unit deliveries (primarily from the Company's Other U.S. operations) as well as to the lower average selling price in France resulting from the inclusion of SMCI deliveries. Other U.S. operations accounted for 64.2% of domestic deliveries in 1998 compared to 54.4% in 1997.

In California, the Company's average selling price rose 7.7% in 1998 to $224,500 from $208,500 in 1997, which had increased 8.1% from $192,900 in 1996. The 1998 increase resulted from strategic increases in sales prices in certain markets based on improved market conditions, as well as a change in product mix favoring a greater number of higher-priced urban in-fill locations and first-time move up sales. The increase in 1997 also reflected a shift in mix toward higher-priced homes in the state. The Company's average selling price in Other U.S. markets was $119,100 in 1998, compared with $118,700 in 1997 and $119,700 in 1996. The Company's average selling price in France decreased to $149,200 in 1998 from $155,500 in 1997, which had decreased from $206,600 in 1996. The average selling price in France declined in 1998 primarily due to the inclusion of a full year of lower-priced deliveries generated from SMCI developments acquired in 1997. The French average selling price also declined in 1997 as a result of the SMCI developments.

Revenues from the development of commercial buildings, all located in metropolitan Paris, totaled $1.5 million in 1998, $2.7 million in 1997 and $12.2 million in 1996. Declines in 1998 and 1997 reflected both the Company's decision to refocus on its expanded French residential business and the reduced opportunities in French commercial markets due to lingering effects of the country's mid-1990 recession.

Land sale revenues totaled $22.5 million in 1998, $13.6 million in 1997 and $68.2 million in 1996. The results for 1998 and 1997 are more representative of typical Company land sales activity levels when viewed historically. The 1996 results were unusually high due to an aggressive asset sale program undertaken as part of the Company's 1996 debt reduction strategy. Land sold in 1996 was primarily property previously held for long-term development, which the Company disposed of in order to redeploy the invested capital at potentially higher returns. Generally, land sale revenues fluctuate as a result of the Company's decision to maintain or decrease its land ownership position in certain markets based upon the volume of its holdings, the strength and number of competing developers

entering particular markets at given points in time, the availability of land in markets served by the Company's housing divisions, and prevailing market conditions.

Operating Income Operating income increased 46.1% to $148.7 million in 1998 from $101.8 million in 1997. The increase was primarily due to higher housing gross profits, resulting from higher unit volume, partially offset by increased selling, general and administrative expenses. Housing gross profits in 1998 increased 37.5% or $124.5 million to $456.4 million from $331.9 million in 1997. As a percentage of related revenues, the Company's housing gross profit margin was 19.2% in 1998, up from 18.2% in the prior year. The Company's housing gross margin increased primarily due to the rising proportion of higher margin deliveries produced by the Company's KB2000 communities, as well as price increases in certain fast-selling, hard to replace communities, particularly in certain California markets. Company-wide land sales produced a loss of $3.2 million in 1998, compared to a loss of $1.4 million in 1997.

Selling, general and administrative expenses increased 32.9% or $75.5 million in 1998 to $304.6 million. This increase was mainly due to the inclusion of selling, general and administrative expenses of acquired entities, including goodwill amortization, expenditures incurred in connection with extensive information systems revisions required to support the KB2000 operational business model, system conversions related to acquisitions and year 2000 compliance, new market entries in Texas and higher third-party sales commissions. Sales commissions rose because a higher percentage of the Company's domestic sales were generated from third-party brokers as part of the KB2000 operational business model. As a percentage of housing revenues, to which these expenses are most closely correlated, selling, general and administrative expenses increased .3 percentage points to 12.8% in 1998 from 12.5% in 1997. The Company remains focused on cost-containment and will seek to reduce selling, general and administrative expenses as a percentage of housing revenues.

Operating income increased to $101.8 million in 1997 from $98.7 million (excluding the $170.8 million noncash charge for impairment of long-lived assets) in 1996. This increase was primarily due to higher housing gross profits, resulting from higher unit volume, partially offset by lower gross profits from commercial activities and losses from land sales. Gross profits in 1997 (excluding profits from land sales) increased by $15.7 million to $332.2 million from $316.5 million in 1996. As a percentage of related revenues, the Company's gross profit margin (excluding losses from land sales) was 18.2% in 1997, down from 18.8% in the prior year. The Company's housing gross margin dropped to 18.2% in 1997 from 18.7% in 1996, primarily due to the accelerated sell-through of older, lower margin non-KB2000 communities, particularly in California, and lower margins associated with the Company's entry into new markets in Austin and Dallas, Texas, partially offset by improved gross margins from KB2000 communities. Company-wide land sales produced a loss of $1.4 million in 1997, compared to profits of $2.6 million in 1996.

Selling, general and administrative expenses increased by $8.7 million in 1997. This increase was primarily due to the inclusion of a full year of results from the San Antonio operations in 1997 (including the amortization of goodwill), compared to nine months of results in 1996, and higher sales commissions, partially offset by cost-containment efforts

that reduced sales incentives and advertising expenses. As a percentage of housing revenues, selling, general and administrative expenses decreased .7 percentage points to 12.5% in 1997 from 13.2% in 1996. This improvement reflected higher unit volume, as well as more favorable ratios for sales incentives, advertising expenses and general and administrative expenses. These improvements were partially offset by the increased sales commissions associated with the Company's KB2000 operational business model.

In the second quarter of 1996, the Company decided to accelerate the disposition of certain real estate assets in order to help effectuate the Company's strategies to improve overall return on investment, restore financial leverage to targeted levels, and position the Company for continued geographic expansion. In addition, in 1996, the Company substantially eliminated its prior practice of investing in long-term development projects in order to reduce the operating risk associated with such projects. The accelerated disposition of long-term development assets caused certain assets, primarily inventories and investments in unconsolidated joint ventures in California and France, to be identified as being impaired and to be written down. Certain of the Company's California properties were impacted by the charge, while none of its non-California domestic properties were affected. The Company's non-California domestic properties were not affected as they were not held for long-term development and were expected to be economically successful, and as such were determined not to be impaired.

Based on the Company's evaluation of impaired assets, a noncash write-down of $170.8 million ($109.3 million, net of income taxes) was recorded in the second quarter of 1996 to state the impaired assets at their fair values. The fair values established were based on various methods, including discounted cash flow projections, appraisals and evaluations of comparable market prices, as appropriate. The inventories affected by the charge primarily consisted of land which was not under active development and the charge did not have a material effect on gross margins for the balance of 1996, or in 1997 or 1998.

The write-down for impairment of long-lived assets was calculated in accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" ("SFAS No. 121"), which the Company decided to adopt in the second quarter of 1996; however, the write-down was not necessitated by implementation of this standard. Had the Company not adopted SFAS No. 121, a substantial write-down would have nonetheless been recorded. SFAS No. 121 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable, and requires impairment losses to be recorded on long-lived assets when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount.

Under the standard, when an impairment write-down is required, the related assets are adjusted to their estimated fair value. Fair value for purposes of SFAS No. 121 is deemed to be the amount a willing buyer would pay a willing seller for such property in a current transaction, that is, other than in a forced or liquidation sale. This is a change from the previous accounting standard which required homebuilders to carry real estate assets at the lower of cost or net realizable value.

Interest Income and Expense Interest income, which is generated from short-term investments and mortgages receivable, amounted to $5.7 million in 1998, $5.1 million in 1997 and $2.7 million in 1996. The rise in interest income in 1998 and 1997 primarily reflected increases in the interest bearing average balances of mortgages receivable each year.

Interest expense results principally from borrowings to finance land purchases, housing inventory and other operating and capital needs. In 1998, interest expense, net of amounts capitalized, decreased to $23.3 million from $29.8 million in 1997. This decrease was primarily due to the impact of the Company's issuance of the Feline Prides in the third quarter of 1998 since distributions associated with the Feline Prides are included in minority interests rather than interest expense. Gross interest incurred in 1998 was higher than that incurred in 1997 by $1.8 million, reflecting an increase in average indebtedness in 1998, partially offset by a lower average interest rate as a result of more favorable financing terms obtained by the Company due to the redemption of its $100.0 million $10\frac{3}{8}\%$ senior notes and the issuance of $175.0 million of $7\frac{3}{4}\%$ senior notes in the fourth quarter of 1997.

In 1998, the Company issued $189.8 million of Feline Prides and used the proceeds to immediately pay down outstanding debt under the Company's domestic unsecured revolving credit facility. The distributions associated with the Feline Prides are included in minority interests; therefore, interest expense in future periods will generally be lower than it would be without this financing. The percentage of interest capitalized in 1998 and 1997 was 57.0% and 43.1%, respectively. The higher capitalization rate resulted from the effects of the issuance of the Feline Prides in 1998 and a higher proportion of land under development in 1998 compared to the previous year. The amount of interest capitalized as a percentage of gross interest incurred and distributions associated with the Feline Prides was 51.3% in 1998.

In 1997, interest expense, net of amounts capitalized, decreased to $29.8 million from $36.7 million in the prior year primarily due to a decrease in the amount of gross interest incurred. In 1997, the amount of gross interest incurred was lower than that incurred in 1996 by $11.2 million, reflecting a decrease in average indebtedness in 1997. The Company's average debt level for 1997 decreased primarily as a result of the Company's 1996 debt reduction strategy. The percentage of interest capitalized in 1997 and 1996 was 43.1% and 42.3%, respectively.

Minority Interests Minority interests are comprised of two major components: pretax income of consolidated subsidiaries and joint ventures related to residential and commercial activities and distributions associated with the Company's Feline Prides issued in July 1998. Operating income was reduced by minority interests of $7.0 million in 1998, $.4 million in 1997 and $.2 million in 1996. The 1998 amount increased principally due to the inclusion of $6.1 million in distributions related to the Feline Prides. In the aggregate, minority interests are expected to increase in future periods due to higher joint venture activity and higher distributions associated with the Feline Prides.

Equity in Pretax Income (Loss) of Unconsolidated Joint Ventures The Company's unconsolidated joint venture activities, located in

California, New Mexico, Texas and France, posted combined revenues of $17.7 million in 1998, $98.2 million in 1997 and $6.7 million in 1996. Of these amounts, French commercial activities accounted for $6.5 million in 1998, $87.7 million in 1997 and $.1 million in 1996. Combined revenues recorded by the Company's joint ventures fluctuated widely during the three year period mainly due to the sale of a French commercial project in 1997. The Company's unconsolidated joint ventures generated combined pretax income of $5.0 million in 1998, compared with losses of $2.9 million and $14.8 million generated in 1997 and 1996, respectively. The Company's share of pretax income from unconsolidated joint ventures totaled $1.2 million in 1998. In 1997 and 1996, the Company's share of pretax losses totaled $.1 million and $2.1 million, respectively.

Mortgage Banking

Interest Income and Expense The Company's mortgage banking operations provide financing to purchasers of homes sold by the Company's domestic housing operations through the origination of residential mortgages. Interest income is earned primarily from first mortgages, and mortgage-backed securities held for long-term investment as collateral, while interest expense results from notes payable and the collateralized mortgage obligations. Interest income increased to $15.6 million in 1998 from $13.3 million in 1997 and $14.6 million in 1996. Interest expense also increased in 1998 to $15.0 million from $12.7 million in 1997 and $13.5 million in 1996. In 1998, interest income increased primarily due to the higher balance of first mortgages held under commitment of sale and other receivables outstanding compared to 1997. Interest expense rose in 1998 due to the higher amount of notes payable outstanding during 1998 compared to the prior year. In 1997, interest income and interest expense decreased primarily due to the declining balances of outstanding mortgage-backed securities and related collateralized mortgage obligations, stemming from both regularly scheduled, monthly principal amortization and prepayment of mortgage collateral. Combined interest income and expense resulted in net interest income of $.6 million in 1998, $.6 million in 1997 and $1.1 million in 1996. These differences reflect variations in mortgage production mix; movements in short-term versus long-term interest rates; and the amount, timing and rates of return on interim reinvestments of monthly principal amortization and prepayments.

Other Mortgage Banking Revenues Other mortgage banking revenues, which principally consist of gains on sales of mortgages and servicing rights and, to a lesser extent, mortgage servicing fees, totaled $30.8 million in 1998, $21.8 million in 1997 and $18.8 million in 1996. The increases in 1998 and 1997 reflected higher gains on the sales of mortgages and servicing rights due to a higher volume of mortgage originations associated with increases in housing unit volume. In addition, in 1998, improved retention and a more favorable mix of fixed to variable interest rate loans also contributed to the increased revenues.

General and Administrative Expenses General and administrative expenses associated with mortgage banking operations increased to $9.9 million in 1998 from $7.9 million in 1997 and $7.2 million in 1996. The increases in general and administrative expenses in 1998 and 1997 were primarily due to higher mortgage production volume.

Income Taxes

The Company recorded income tax expense of $51.3 million in 1998 and $32.8 million in 1997 and an income tax benefit of $34.5 million in 1996. These amounts represented effective income tax rates of approximately 35.0% in 1998 and 36.0% in both 1997 and 1996. The effective tax rate declined in 1998 as a result of greater utilization of affordable housing tax credits. The tax benefit in 1996 reflected the pretax loss reported by the Company as a result of the noncash charge for impairment of long-lived assets recorded in the second quarter of that year. The pretax income (loss) for financial reporting purposes and taxable income (loss) for income tax purposes historically have differed primarily due to the impact of state income taxes, foreign tax rate differences, intercompany dividends and the use of affordable housing tax credits.

Liquidity and Capital Resources

The Company assesses its liquidity in terms of its ability to generate cash to fund its operating and investing activities. Historically, the Company has funded its construction and mortgage banking activities with internally generated cash flows and external sources of debt and equity financing. In 1998, operating, investing and financing activities used net cash of $4.9 million; in 1997, these activities provided net cash of $58.5 million.

Operating activities in 1998 used $12.8 million, while 1997 operating activities used $29.0 million. In 1998, the Company's primary uses of operating cash included an investment of $125.7 million in inventories (excluding the effect of acquisitions and $29.9 million of inventories acquired through seller financing) and an increase in receivables of $50.0 million. Excluding the effect of the Company's acquisitions of Hallmark, PrideMark and Estes, and a majority ownership investment in General Homes, inventories increased in 1998, primarily in the Company's domestic operations, reflecting continued growth throughout its U.S. markets. The use of cash was partially offset by the Company's earnings of $95.3 million, an increase of $51.3 million in accounts payable, accrued expenses and other liabilities, and various noncash items deducted from net income.

In 1997, uses of operating cash included an increase in receivables of $118.1 million and a change in deferred taxes of $5.0 million. The use of cash was partially offset by the Company's earnings of $58.2 million, an increase of $20.1 million in accounts payable, accrued expenses and other liabilities, a reduction in inventories of $5.2 million (excluding $15.1 million of inventories acquired through seller financing), and various noncash items deducted from net income.

Cash used by investing activities totaled $161.8 million in 1998 compared to $6.2 million provided in 1997. In 1998, a total of $162.8 million, net of cash acquired, was used for the acquisitions of Hallmark, PrideMark and Estes, and the acquisition of a majority ownership interest in General Homes. During this same period, $15.9 million was used for net purchases of property and equipment. Among amounts partially offsetting these uses were $12.9 million of proceeds received from mortgage-backed securities, which were principally used to pay down the collateralized mortgage obligations for which the mortgage-backed securities had served as collateral, $2.2 million in distributions related to invest-

ments in unconsolidated joint ventures and $1.7 million from the net sales of mortgages held for long-term investment.

In 1997, cash provided by investing activities included $10.0 million in proceeds from mortgage-backed securities and $1.9 million in distributions related to investments in unconsolidated joint ventures. Partially offsetting these proceeds was $5.9 million of cash used for net purchases of property and equipment.

Financing activities in 1998 provided $169.8 million of cash compared to $81.3 million provided in 1997. In 1998, sources of cash included proceeds of $183.1 million from the issuance of the Feline Prides and net proceeds from borrowings of $17.9 million. Partially offsetting the cash provided in 1998 were payments to minority interests of $7.0 million, payments on collateralized mortgage obligations of $12.3 million and cash dividend payments of $11.9 million. The Company's financial leverage, as measured by the ratio of debt to total capital, net of invested cash, was 43.4% at the end of 1998 compared to 52.7% at the end of 1997. These ratios were adjusted to reflect $20.2 million and $70.4 million of invested cash at November 30, 1998 and 1997, respectively. The sharply improved debt ratio at the end of 1998 was due primarily to an increase in capital from the Company's offering of $189.8 million of Feline Prides in the third quarter of 1998. The Company seeks to maintain its ratio of net debt to total capital within a targeted range of 45% to 55%.

Financing activities in 1997 provided $172.2 million from the issuance of 7¾% senior notes and net proceeds of $29.9 million from borrowings. Partially offsetting the cash provided was cash used for the redemption of the Company's 10⅜% senior notes of $100.0 million, dividend payments of $11.7 million and payments on collateralized mortgage obligations of $9.5 million.

During the second quarter of 1998, the Company acquired three privately held homebuilders with regional operations in certain key markets. On March 19, 1998, the Company acquired all of the issued and outstanding capital stock of Houston-based Hallmark for approximately $54.0 million, including the assumption of debt. Hallmark built single-family homes primarily in Houston (with additional operations in San Antonio and Austin, Texas) under the trade names of Dover Homes and Ideal Builders. The acquisition of Hallmark marked the Company's entry into the Houston market and formed the core of those operations, while strengthening the Company's existing market positions in San Antonio and Austin.

The Company acquired substantially all of the assets of Denver-based PrideMark on March 23, 1998 for approximately $65.0 million, including the assumption of trade liabilities and debt. PrideMark built single-family homes in Denver, Colorado, and its acquisition significantly increased the Company's already substantial market presence in Denver.

On April 9, 1998, the Company acquired all of the issued and outstanding capital stock of Estes for approximately $48.0 million, including the assumption of debt. Estes built single-family homes in Phoenix and Tucson, Arizona. Estes provided the Company's entry into the Tucson market and significantly increased the Company's already substantial market presence in Phoenix.

On August 18, 1998, the Company acquired a majority ownership investment in General Homes, a builder of single-family homes primarily in Houston, Texas. The Company invested approximately $31.8 million, including the assumption of debt, to acquire 50.3% of the outstanding stock of General Homes, pursuant to a completed plan of reorganization. Subsequent to year end, on January 4, 1999, the Company acquired the remaining minority interest in General Homes.

Each acquisition and investment was accounted for under the purchase method and the results of operations of the acquired entities are included in the Company's consolidated financial statements from the respective dates of acquisition. These acquisitions were financed by borrowings under the Company's domestic unsecured revolving credit facility.

External sources of financing for the Company's construction activities include its domestic unsecured revolving credit facility, other domestic and foreign bank lines, third-party secured financings, and the public debt and equity markets. Substantial unused lines of credit remain available for the Company's future use, if required, principally through its domestic unsecured revolving credit facility. Under this facility, $493.0 million remained committed and $475.3 million was available for the Company's future use at November 30, 1998. The domestic unsecured revolving credit facility is comprised of a $400 million revolving credit facility scheduled to expire on April 30, 2001 and a 364-day revolving credit facility which has provisions for annual renewal. In addition, the Company's French subsidiaries have lines of credit with various banks which totaled $110.8 million at November 30, 1998 and have various committed expiration dates through November 2000. Under these unsecured financing agreements, $77.2 million was available in the aggregate at November 30, 1998 in France.

Depending upon available terms and its negotiating leverage related to specific market conditions, the Company also finances certain land acquisitions with purchase-money financing from land sellers and other third parties. At November 30, 1998, the Company had outstanding seller-financed notes payable of $22.5 million secured primarily by the underlying property which had a carrying value of $45.1 million.

On December 5, 1997, the Company filed a universal shelf registration statement with the Securities and Exchange Commission for up to $500 million of the Company's debt and equity securities. The universal shelf registration provides that securities may be offered from time to time in one or more series and in the form of senior, senior subordinated or subordinated debt, preferred stock, common stock, and/or warrants to purchase such securities. The registration was declared effective on December 16, 1997, and no securities have been issued thereunder.

On July 7, 1998, the Company, together with a KBHC Trust, of which all the common securities are owned by the Company, issued an aggregate of (i) 18,975,000 Feline Prides, and (ii)1,000,000 KBHC Trust capital securities, with a $10 stated liquidation amount. The Feline Prides consist of (i) 17,975,000 Income Prides with the stated amount per Income Prides of $10, which are units comprised of a capital security and a stock purchase contract under which the holders will purchase common stock from the Company not later than August 16, 2001 and the Company will pay to the holders certain unsecured

contract adjustment payments, and (ii) 1,000,000 Growth Prides with a face amount per Growth Prides equal to the $10 stated amount, which are units consisting of a 1/100th beneficial interest in a zero-coupon U.S. treasury security and a stock purchase contract under which the holders will purchase common stock from the Company not later than August 16, 2001 and the Company will pay to the holders certain unsecured contract adjustment payments.

The distribution rate on the Income Prides is 8.25% per annum, and the distribution rate on the Growth Prides is .75% per annum. Under the stock purchase contracts, investors will be required to purchase shares of common stock of the Company for an effective price ranging between a minimum of $31.75 per share and a maximum of $38.10 per share, and the Company will issue approximately 5 million to 6 million common shares by August 16, 2001, depending upon the price of the Company's common stock upon settlement of the purchase contracts (subject to adjustment under certain circumstances). The capital securities associated with the Income Prides and the U.S. treasury securities associated with the Growth Prides have been pledged as collateral to secure the holders' obligations in respect of the common stock purchase contracts. The capital securities issued by the KBHC Trust are entitled to a distribution rate of 8% per annum of their $10 stated liquidation amount.

The proceeds from the issuance of Feline Prides were used immediately to pay down outstanding debt under the Company's domestic unsecured revolving credit facility. Subsequently, the unsecured revolving credit facility was used for general corporate purposes, including support of the Company's growth strategies and acquisitions.

The Company uses its capital resources primarily for land purchases, land development and housing construction. The Company typically manages its investments in land by purchasing property under options and other types of conditional contracts whenever possible, and similarly controls its investment in housing inventories by emphasizing the presale of homes and carefully managing the timing of the production process. During the 1990's, the Company's inventories have become more geographically diverse, primarily through domestic expansion outside of California. The Company continues to concentrate its housing operations in desirable areas within targeted growth markets, principally oriented toward entry-level purchasers.

The principal sources of liquidity for the Company's mortgage banking operations are internally generated funds from the sales of mortgages and related servicing rights. Mortgages originated by the mortgage banking operations are generally sold in the secondary market within 60 days of origination. External sources of financing for these operations include a $250 million revolving mortgage warehouse facility, which expires on February 23, 2000. The amount outstanding under the facility is secured by a borrowing base, which includes certain mortgage loans held under commitment of sale and is repayable from proceeds on the sales of first mortgages. At November 30, 1998, the mortgage banking operations had $10.6 million available for future use under the facility.

Debt service on the Company's collateralized mortgage obligations is funded by receipts from mortgage-backed securities. Such funds are expected to be adequate to meet future

debt-payment schedules for the collateralized mortgage obligations and therefore these securities have virtually no impact on the capital resources and liquidity of the mortgage banking operations.

The Company continues to benefit in all of its operations from the strength of its capital position, which has allowed it to maintain overall profitability during troubled economic times, finance expansion, re-engineer product lines and diversify into new homebuilding markets. Among other reasons, secure access to capital at competitive rates should enable the Company to continue to grow and expand. As a result of its geographic diversification, the disciplines of the KB2000 operational business model and a strong capital position, the Company believes it has adequate resources and sufficient credit line facilities to satisfy its current and reasonably anticipated future requirements for funds to acquire capital assets and land, to construct homes, to fund its mortgage banking operations, and to meet other needs of its business, both on a short and long-term basis.

Subsequent Events

Subsequent to year end, effective January 4, 1999, the Company acquired the remaining equity interest in Houston-based General Homes. The Company invested approximately $14.5 million to acquire 49.7% of the outstanding stock of General Homes, bringing its ownership interest to 100%. This transaction was financed by borrowings under the Company's domestic unsecured revolving credit facility.

Effective January 7, 1999, the Company acquired substantially all of the homebuilding assets of the Lewis Homes group of companies ("Lewis Homes"). Prior to the acquisition, Lewis Homes, based in Upland, California, was one of the largest privately held single-family homebuilders in the United States based on units delivered, with estimated revenues for the year ended December 31, 1998 of $700 million on approximately 3,600 unit deliveries. Lewis Homes also owned or controlled approximately 24,000 lots and had a backlog of approximately 900 homes at December 31, 1998. Lewis Homes' principal markets are Las Vegas and Northern Nevada, Southern California and the greater Sacramento area in Northern California.

The estimated purchase price for Lewis Homes is $449.0 million, comprised of the assumption of approximately $303.0 million in debt and the issuance of 7,886,686 shares of the Company's common stock valued at approximately $146.0 million. The estimated purchase price was based on the net book values of the entities purchased and is subject to adjustment based on the closing balance sheets as of December 31, 1998, which are expected to be finalized on or before April 1, 1999. While it is anticipated that there will be further adjustments to the purchase price, the Company does not expect such adjustments to be material.

In connection with the acquisition of Lewis Homes, the Company obtained a $200 million unsecured term loan to refinance certain debt assumed. The financing was obtained under a term loan agreement dated January 7, 1999 among the Company and various banks, which provides for payments of $25 million due on January 31, 2000, April 30, 2000, and July 31, 2000, with the remaining principal balance due on April 30, 2001. Interest is payable monthly at the London Interbank Offered Rate plus an applicable

spread. The financing obtained under the term loan agreement did not impact the amounts available under the Company's pre-existing borrowing arrangements. The Company used borrowings under its existing domestic unsecured revolving credit facility to refinance certain other debt assumed in the acquisition.

The acquisition consideration for Lewis Homes was determined by arm's-length negotiations between the parties. The acquisition will be accounted for as a purchase, with the results of Lewis Homes included in the Company's consolidated financial statements as of January 7, 1999.

Year 2000 Issue

The term "year 2000 issue" is a general term used to describe the complications that may arise from the use of existing computer hardware and software designed by applicable manufacturers without consideration for the upcoming change in the century. If not corrected, software programs with this embedded problem may cause computer systems to fail or to miscalculate data.

The Company has invested in information systems required to support its KB2000 operational business model and effectively manage and control growth. In conjunction with its investment in technology, with respect to the year 2000 issue, the Company has undertaken a project to modify or replace portions of its existing computer operating systems to ensure they will function properly with respect to dates in the year 2000 and thereafter. A "Year 2000 Project Office" has been formed to direct the Company-wide efforts encompassed by this project. The Year 2000 Project Office is responsible to assure proper planning, sufficient resources, contemporaneous monitoring, proper certification and timely completion of the year 2000 projects. The Company's year 2000 projects encompass its information technology systems as well as its non-information technology systems, such as systems embedded in its office equipment and facilities.

State of Year 2000 Readiness The scope of the Company's year 2000 compliance effort has been defined to include 13 distinct projects. Four of the 13 projects address areas of greatest business risk and require the greatest technical effort and, therefore, have been given the highest priority. These four high priority projects are the following: conversion and upgrade of the Company's JD Edwards primary accounting programs (the "JD Edwards Programs"); conversion and upgrade of the operating systems for the Company's Texas operations which were not associated with the JD Edwards Programs; conversion and upgrade of the operating systems for the Company's mortgage banking operations which were not associated with the JD Edwards Programs; and the upgrade of the Company's primary computer network and personal computers. Of these four high priority projects, as of January 22, 1999, the upgrade of the Company's primary computer network and personal computers is substantially complete and is being tested, the remediation of the JD Edwards Programs is complete and is being tested, and the conversion and upgrade of the operating systems for the Company's Texas operations and the Company's mortgage banking operations are in the process of being remediated. These four projects are on schedule for completion by June 1999.

The remaining nine projects that comprise the balance of the Company's year 2000 compliance effort present a lower business risk and require less technical effort to complete.

Eight of these nine projects are comprised of the following: conversion of business unit personal computer applications and templates that are not associated with the JD Edwards Programs; upgrade of the Company's telephone and voice mail systems; certification of year 2000 readiness or upgrade of the Company's fax machines, copiers, miscellaneous equipment and office facilities; verification, involving three projects, that material third-party suppliers to the Company are year 2000 compliant; upgrade and/or certification of the systems used by the Company's operations in France; and certification and/or upgrade of the systems used by the Company's operations in Mexico. These eight projects are in various stages of assessment and/or remediation. The ninth project is comprised of the Company's contingency plan in the event problems are encountered as the year 2000 begins. This project is in the assessment stage and is expected to be completed by September 1999.

As noted, three of the 13 projects that comprise the Company's year 2000 compliance effort involve verification that the third parties with which the Company has a material relationship are year 2000 compliant. The Company is currently in various stages of assessment with respect to these third-party verification projects. As part of these projects, the Company's relationships with suppliers, subcontractors, financial institutions and other third parties will be examined to determine the status of their year 2000 issue efforts as related to the Company's operations. As a general matter, the Company is vulnerable to its suppliers' inability to remedy their own year 2000 issues. Furthermore, the Company relies both domestically and internationally on financial institutions, government agencies (particularly for zoning, building permits and related matters), utility companies, telecommunication service companies and other service providers outside of its control. There is no assurance that such third parties will not suffer a year 2000 business disruption and it is conceivable that such failures could, in turn, have a material adverse effect on the Company's liquidity, financial condition or results of operations.

Costs of Addressing Year 2000 Issues Several of the projects included in the Company's year 2000 plan are projects which were necessary to support the Company's KB2000 operational business model, and would have been undertaken regardless of year 2000 exposure. The total cost of all of the Company's projects associated with its year 2000 plan is currently estimated to be approximately $4.0 million; however, because such projects involve conversions and upgrades that were not necessitated to meet year 2000 concerns, it is not possible to determine the portion of that amount which is specifically attributable to year 2000 compliance efforts. The total amount expended on all projects related to year 2000 compliance was $1.7 million as of November 30, 1998. The Company believes that the total costs incurred to specifically address the year 2000 issue will not have a material impact on the Company's liquidity, financial condition or results of operations, for any year in the reasonably foreseeable future. The schedule for the successful completion of the Company's year 2000 project and the estimated costs are based upon certain assumptions by management regarding future events, including the continued availability of qualified resources to implement the program and the costs of such resources.

Risks Presented by Year 2000 Issues The Company's failure to resolve a material year 2000 issue could result in the interruption in, or a failure of, certain normal

business activities or operations. Such failures could materially and adversely affect the Company's results of operations. Although the Company considers its exposure to the year 2000 issue risks from third-party suppliers as generally low, due to the uncertainty of the year 2000 readiness of third party suppliers, the Company is unable to determine at this time the consequences of a year 2000 failure. In addition, the Company could be materially impacted by the widespread economic or financial market disruption by year 2000 computer system failures at government agencies on which the Company is dependent for mortgage lending, zoning, building permits and related matters. Possible risks of year 2000 failure could include, among other things, delays or errors with respect to payments, third-party delivery of materials and government approvals. The Company's year 2000 project is expected to significantly reduce the Company's level of uncertainty and exposure to the year 2000 issue and, in particular, its vulnerability to the year 2000 compliance of material third parties. To date, the Company has not identified any operating systems, either of its own or of a third-party supplier, that present a material risk of not being year 2000 ready or for which a suitable alternative cannot be implemented.

Contingency Plan The Company's year 2000 project calls for a year 2000-specific contingency plan to be developed. This plan is expected to be completed by August 1999. As a normal course of business, the Company maintains contingency plans designed to address various other potential business interruptions. In addition to the Company's year 2000-specific contingency plan, these pre-existing contingency plans should assist in mitigating any adverse affect because of the interruption of support provided by third parties resulting from their failure to be year 2000 ready.

Management currently anticipates that its operating systems will be year 2000 compliant well before January 1, 2000, and that its third party verification and overall contingency plans should enable it to mitigate third-party disruptions to its business which are of short duration or geographically localized. At the present time, management believes that the year 2000 issue will not have a material adverse effect on the Company's liquidity, financial condition or results of operations.

Conversion to the Euro Currency

On January 1, 1999, certain member countries of the European Union (the "EU") established fixed conversion rates between their existing currencies and the European Union's common currency (the "euro"). The Company conducts substantial business in France, an EU member country. During the established transition period for the introduction of the euro, January 1, 1999 to June 30, 2002, the Company will address the issues involved with the adoption of the new currency. The most important issues facing the Company include: converting information technology systems; reassessing currency risk; negotiating and amending contracts; and processing tax and accounting records.

Based upon progress to date, the Company believes that use of the euro will not have a significant impact on the manner in which it conducts its business affairs and processes its business and accounting records. Accordingly, conversion to the euro is not expected to have a material effect on the Company's financial condition or results of operations.

Outlook

The Company's residential backlog at November 30, 1998 consisted of 6,943 units, representing aggregate future revenues of $1.00 billion. Both amounts represent record year end figures and represent increases of 64.8% and 50.0%, respectively, when compared to the 4,214 units in residential backlog, representing aggregate future revenues of $666.7 million, at year end 1997. Company-wide net orders for the fourth quarter of 1998 totaled 4,321, up 42.7% from the comparable quarter of 1997. The 1998 fourth quarter total included 583 net orders generated by the Company's three 1998 acquisitions in Houston, Denver and Phoenix/Tucson and its majority ownership investment in General Homes. Excluding the net orders generated by these operations, Company-wide net orders rose 23.4% in the fourth quarter of 1998 compared to the year-earlier quarter.

The Company's domestic residential backlog at November 30, 1998 increased to $848.6 million on 5,959 units, up 65.3% on a unit basis from $577.6 million on 3,606 units at year end 1997. The increase reflects a higher ending backlog within Other U.S. operations, partially offset by a slightly lower ending backlog within California operations. The Company's Other U.S. operations produced substantial year-over-year growth, with backlog at November 30, 1998 rising to $560.3 million on 4,739 units from $274.6 million on 2,290 units at November 30, 1997. Net orders from Other U.S. operations increased 92.3% in the fourth quarter of 1998 to 2,630 units, up from 1,368 units in the fourth quarter of 1997. Excluding the 583 net orders associated with the Company's three acquisitions and its majority ownership investment, the increase in net orders in Other U.S. operations was 49.6%. In California, backlog decreased to $288.3 million on 1,220 units at November 30, 1998, down from $303.1 million on 1,316 units at November 30, 1997, as the Company's average number of active communities in California declined 17.9% in 1998 from the prior year. Fourth quarter 1998 net orders in California decreased 13.1% to 985 units from 1,134 units in the year-earlier period.

In France, residential backlog at November 30, 1998 totaled $145.9 million on 961 units, up 76.4% and 64.0%, respectively, from $82.8 million on 586 units at year end 1997. The Company's net orders in France in the fourth quarter of 1998 rose 36.1% to 698 units from 513 units in the year-earlier period. The value of the backlog associated with the Company's French commercial development activities declined to $1.8 million at November 30, 1998 from $5.1 million at year end 1997, reflecting a reduced level of activity.

In Mexico, residential backlog at November 30, 1998 totaled $5.7 million on 23 units, compared to $6.3 million on 22 units at year end 1997. Net orders in the fourth quarter of 1998 decreased to 8 units from 13 units in 1997.

Substantially all homes included in the year end 1998 backlog are expected to be delivered during 1999. However, cancellations could occur, particularly if market conditions deteriorate or mortgage interest rates increase, thereby decreasing backlog and related future revenues.

Company-wide net orders during the first two months of fiscal 1999 increased 27.1% over the comparable period of 1998. Domestic net orders during the two-month period rose 29.3% due to a 3.8% increase in net orders from California operations and a 43.0% increase in net orders from Other U.S. operations, including results from the Company's

1998 acquisitions (including General Homes) and its January 1999 acquisition of Lewis Homes. Excluding the net orders from these operations, domestic net orders remained essentially flat in the first two months of fiscal 1999 compared to the same period a year ago. In France, net orders for the first two months of fiscal 1999 increased 14.8% compared to the same period in 1998. Despite the overall improvement in Company-wide net orders during the first two months of fiscal 1999, current global market uncertainties, mortgage interest rate volatility, softening of general domestic business conditions, declines in consumer confidence and/or other factors could have mitigating effects on full year results.

As a result of continued domestic expansion outside of California, the percentage of the Company's domestic unit deliveries generated from California operations decreased to 35.8% in 1998 from 45.6% in 1997. In response to persistently weak conditions for new housing and general recessionary trends in California during the first half of the 1990's, the Company diversified its business through aggressive expansion into other western states. Since then, the housing market has improved significantly in California, and the Company remains cautiously optimistic that the improved economic climate in the state will continue for the foreseeable future, thereby generally enabling the housing market in the state to retain its strength.

The Company's Other U.S. operations continued to experience substantial growth in 1998. Acquisitions in Houston, Denver and Phoenix/Tucson, coupled with the continued expansion of existing, non-California operations resulted in a 54.2% increase in deliveries from Other U.S. operations in 1998 compared to the prior year. The Company has also achieved its most significant penetration of its KB2000 operational business model in these Other U.S. markets. The Company expects to explore additional opportunities for expansion of its Other U.S. operations in both existing and new markets, through either de novo entry or the acquisition of existing businesses.

The French housing market improved in 1998 from the prior year. The Company anticipates increases in deliveries from its French housing operations in 1999 will be in line with that nation's moderately improving economy. The Company's French commercial activities are likely to remain at low levels, consistent with the Company's strategy to focus primarily on the expansion of its residential development business.

Mexico's economy appears to be recovering from the country's deep recession brought on by the 1994 devaluation of its currency. Nevertheless, economic and political conditions remain unsettled and the Company continues to closely monitor its level of activity there.

During 1999, the Company plans to remain focused on the two primary initiatives it originally established in 1997: deepening the implementation of its KB2000 operational business model throughout the Company's operations and continued acceleration of the Company's growth. To advance these initiatives, the Company also continues to concentrate on two complementary strategies consisting of establishing optimum local market positions and maintaining its focus on acquisitions.

In order to leverage the benefits of the KB2000 operational business model, the Company has been implementing a strategy designed to achieve a dominant market posi-

tion in its major markets. The Company's use of the term "dominant" is not intended to imply that the Company will become the largest builder in any market in terms of unit deliveries, revenues or market share; nor is it the Company's intent to attempt to, in any way "control" the pricing of homes in any market. Rather, the Company's "dominance"goal is only intended to achieve a market position sufficiently large that it will enable its local business to maximize the benefits of its KB2000 operational business model. The Company believes that by operating at large volume levels it can better execute its KB2000 operational business model and use economies of scale to increase profits in fewer, larger markets. These benefits can include lower land acquisition costs, improved terms with suppliers and subcontractors, the ability to offer maximum choice and the best value to customers, and the retention of the best management talent.

The Company hopes to continue to increase overall unit delivery growth in future years. The Company's growth strategies include expanding existing operations to optimal market volume levels, as well as entering new markets at high volume levels, principally through acquisitions. Growth in existing markets will be driven by the Company's ability to increase the average number of active communities in its major markets through the successful implementation of its KB2000 operational business model. The Company's ongoing acquisition strategy is expected to supplement growth in existing markets and facilitate expansion into new markets.

In identifying acquisition targets, the Company seeks homebuilders that possess the following characteristics: a business model similar to KB2000; access to or control of land to support growth; a strong management team; and a financial condition positioned to be accretive to earnings in the first full year following acquisition. The Company believes that acquisitions fitting these criteria will enable it to expand its operations in 1999 and beyond in a focused and disciplined manner. However, the Company's continued success in acquiring other homebuilders could be affected by several factors, including, among other things, conditions in U.S. securities markets, the general availability of applicable acquisition candidates, pricing for such transactions, competition among other national or regional builders for such target companies, changes in general and economic conditions nationally and in target markets, and capital or credit market conditions.

In January 1999, the Company continued its growth through acquiring the remaining minority interest in General Homes and completing its purchase of Lewis Homes. Including the Lewis Homes operations, which are expected to deliver approximately 3,500 homes in 1999, the Company believes it will be the largest homebuilder in the United States in 1999, as measured by unit volume. The Company continues to explore opportunities to enter new markets and plans to grow in its existing markets. Growth in both new and existing markets is expected to be supplemented by strategic acquisitions from time to time. In the aggregate, the Company has established a goal of delivering approximately 21,500 units Company-wide in 1999.

This goal could be materially affected by various risk factors such as changes in general economic conditions either nationally or in the regions in which the Company operates or may commence operations, job growth and employment levels, home mortgage interest rates or consumer confidence, among other things. Nevertheless, the Company remains optimistic about its ability to continue to grow its business in 1999. With the addition of Lewis Homes and high current backlog levels, the Company believes it is well-positioned to achieve record earnings in 1999.

Impact of Inflation

The Company's business is significantly affected by general economic conditions, particularly by inflation and its generally associated adverse effect on interest rates. Although inflation rates have been low in recent years, rising inflation would likely affect the Company's revenues and earning power by reducing demand for homes as a result of correspondingly higher interest rates. In periods of high inflation, the rising costs of land, construction, labor, interest and administrative expenses have often been recoverable through increased selling prices, although this has not always been possible because of high mortgage interest rates and competitive factors in the marketplace. In recent years, inflation has had no significant adverse impact on the Company, as average annual cost increases have not exceeded the average rate of inflation.

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Investors are cautioned that certain statements contained in this document, as well as some statements by the Company in periodic press releases and some oral statements by Company officials to securities analysts and stockholders during presentations about the Company are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"). Statements which are predictive in nature, which depend upon or refer to future events or conditions, or which include words such as "expects", "anticipates", "intends", "plans", "believes", "estimates", "hopes", and similar expressions constitute forward-looking statements. In addition, any statements concerning future financial performance (including future revenues, earnings or growth rates), ongoing business strategies or prospects, and possible future Company actions, which may be provided by management are also forward-looking statements as defined by the Act. Forward-looking statements are based on current expectations and projections about future events and are subject to risks, uncertainties, and assumptions about the Company, economic and market factors and the homebuilding industry, among other things. These statements are not guaranties of future performance, and the Company has no specific intention to update these statements.

Actual events and results may differ materially from those expressed or forecasted in the forward-looking statements made by the Company or Company officials due to a number of factors. The principal important risk factors that could cause the Company's actual performance and future events and actions to differ materially from such forward-looking statements include, but are not limited to, changes in general economic conditions either nationally or in regions where the Company operates or may commence operations, employment growth or unemployment rates, lumber or other homebuilding material prices, labor costs, home mortgage interest rates, competition, currency exchange rates as they affect the Company's operations in France and Mexico, consumer confidence, and government regulation or restrictions on real estate development, costs and effects of unanticipated legal or administrative proceedings and capital or credit market conditions affecting the Company's cost of capital; the availability and cost of land in desirable areas, and conditions in the overall homebuilding market in the Company's geographic markets (including the historic cyclicality of the industry); the success of the Company and its significant suppliers in identifying and addressing operating systems and programs that are not year 2000 ready; as well as seasonality, competition, population growth, property taxes, and unanticipated delays in the Company's operations.

CONSOLIDATED STATEMENTS OF INCOME

In thousands, except per share amounts — Years Ended November 30,	1998	1997	1996
Total revenues	$ 2,449,362	$ 1,878,723	$ 1,787,525
Construction:			
Revenues	$ 2,402,966	$ 1,843,614	$ 1,754,147
Construction and land costs	(1,949,729)	(1,512,766)	(1,435,081)
Selling, general and administrative expenses	(304,565)	(229,097)	(220,387)
Noncash charge for impairment of long-lived assets			(170,757)
Operating income (loss)	148,672	101,751	(72,078)
Interest income	5,674	5,078	2,666
Interest expense, net of amounts capitalized	(23,341)	(29,829)	(36,691)
Minority interests	(7,002)	(425)	(233)
Equity in pretax income (loss) of unconsolidated joint ventures	1,151	(53)	(2,148)
Construction pretax income (loss)	125,154	76,522	(108,484)
Mortgage banking:			
Revenues:			
Interest income	15,569	13,303	14,594
Other	30,827	21,806	18,784
	46,396	35,109	33,378
Expenses:			
Interest	(15,046)	(12,699)	(13,462)
General and administrative	(9,937)	(7,902)	(7,176)
Mortgage banking pretax income	21,413	14,508	12,740
Total pretax income (loss)	146,567	91,030	(95,744)
Income taxes	(51,300)	(32,800)	34,500
Net income (loss)	$ 95,267	$ 58,230	$ (61,244)
Basic earnings (loss) per share	$ 2.41	$ 1.50	$ (1.80)
Diluted earnings (loss) per share	$ 2.32	$ 1.45	$ (1.80)

See accompanying notes.

CONSOLIDATED
BALANCE SHEETS

In thousands, except shares — November 30,	1998	1997
Assets		
Construction:		
Cash and cash equivalents	$ 56,602	$ 66,343
Trade and other receivables	194,841	169,988
Inventories	1,134,402	790,243
Investments in unconsolidated joint ventures	5,608	6,338
Goodwill	45,533	31,283
Other assets	105,558	69,666
	1,542,544	1,133,861
Mortgage banking:		
Cash and cash equivalents	6,751	1,899
Receivables:		
First mortgages and mortgage-backed securities	58,262	71,976
First mortgages held under commitment of sale and other receivables	249,702	208,254
Other assets	2,945	3,001
	317,660	285,130
Total assets	$1,860,204	$1,418,991
Liabilities and stockholders' equity		
Construction:		
Accounts payable	$ 211,380	$ 163,646
Accrued expenses and other liabilities	148,508	105,376
Mortgages and notes payable	529,846	496,869
	889,734	765,891
Mortgage banking:		
Accounts payable and accrued expenses	8,924	7,300
Notes payable	239,413	200,828
Collateralized mortgage obligations secured by mortgage-backed securities	49,264	60,058
	297,601	268,186
Minority interests:		
Consolidated subsidiaries and joint ventures	8,608	1,858
Company obligated mandatorily redeemable preferred securities of subsidiary trust holding solely debentures of the Company	189,750	
	198,358	1,858
Stockholders' equity:		
Preferred stock—$1.00 par value; authorized, 10,000,000 shares: none outstanding		
Common stock—$1.00 par value; authorized, 100,000,000 shares; 39,992,004 and 38,996,769 shares outstanding at November 30, 1998 and 1997, respectively	39,992	38,997
Paid-in capital	193,520	186,086
Retained earnings	243,356	159,960
Cumulative foreign currency translation adjustments	(2,357)	(1,987)
Total stockholders' equity	474,511	383,056
Total liabilities and stockholders' equity	$1,860,204	$1,418,991

See accompanying notes.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

In thousands — Years Ended November 30, 1998, 1997 and 1996	Series B Convertible Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Foreign Currency Translation	Total Stockholders' Equity
Balance at November 30, 1995	$ 1,300	$32,347	$188,839	$190,749	$ 2,243	$415,478
Net loss				(61,244)		(61,244)
Dividends on Series B convertible preferred stock				(4,940)		(4,940)
Dividends on common stock				(11,167)		(11,167)
Conversion of Series B convertible preferred stock	(1,300)	6,500	(5,200)			
Exercise of employee stock options		37	390			427
Cancellation of restricted stock		(56)	(228)			(284)
Foreign currency translation adjustments					2,080	2,080
Balance at November 30, 1996		38,828	183,801	113,398	4,323	340,350
Net income				58,230		58,230
Dividends on common stock				(11,668)		(11,668)
Exercise of employee stock options		169	2,285			2,454
Foreign currency translation adjustments					(6,310)	(6,310)
Balance at November 30, 1997		38,997	186,086	159,960	(1,987)	383,056
Net income				95,267		95,267
Dividends on common stock				(11,871)		(11,871)
Exercise of employee stock options		995	15,699			16,694
Company obligated mandatorily redeemable preferred securities of subsidiary trust holding solely debentures of the Company–contract adjustment payments and issuance costs			(8,265)			(8,265)
Foreign currency translation adjustments					(370)	(370)
Balance at November 30, 1998		$39,992	$193,520	$243,356	$(2,357)	$474,511

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

In thousands — Years Ended November 30,	1998	1997	1996
Cash flows from operating activities:			
Net income (loss)	$ 95,267	$ 58,230	$ (61,244)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:			
Equity in pretax (income) loss of unconsolidated joint ventures	(1,151)	53	2,148
Minority interests	7,002	425	233
Amortization of discounts and issuance costs	1,882	2,341	1,510
Depreciation and amortization	16,178	11,860	10,819
Provision for deferred income taxes	474	(5,028)	(41,208)
Noncash charge for impairment of long-lived assets			170,757
Change in assets and liabilities, net of effects from acquisitions:			
Receivables	(50,040)	(118,123)	36,572
Inventories	(125,719)	5,157	232,871
Accounts payable, accrued expenses and other liabilities	51,283	20,064	(21,918)
Other, net	(8,025)	(4,023)	244
Net cash provided (used) by operating activities	(12,849)	(29,044)	330,784
Cash flows from investing activities:			
Acquisitions, net of cash acquired	(162,818)		(80,556)
Investments in unconsolidated joint ventures	2,214	1,921	(7,644)
Net sales (originations) of mortgages held for long-term investment	1,686	164	(996)
Payments received on first mortgages and mortgage-backed securities	12,933	9,988	18,069
Purchases of property and equipment, net	(15,859)	(5,917)	(2,799)
Net cash provided (used) by investing activities	(161,844)	6,156	(73,926)
Cash flows from financing activities:			
Net proceeds from (payments on) credit agreements and other short-term borrowings	63,187	37,900	(325,323)
Proceeds from Company obligated mandatorily redeemable preferred securities of subsidiary trust holding solely debentures of the Company	183,057		
Proceeds from issuance of senior subordinated notes			124,406
Proceeds from issuance of senior notes		172,182	
Payments on collateralized mortgage obligations	(12,324)	(9,531)	(17,309)
Payments on mortgages, land contracts and other loans	(45,239)	(8,047)	(53,894)
Redemption of senior notes		(100,000)	
Payments from (to) minority interests	(7,006)	513	(2,232)
Payments of cash dividends	(11,871)	(11,668)	(16,107)
Net cash provided (used) for financing activities	169,804	81,349	(290,459)
Net increase (decrease) in cash and cash equivalents	(4,889)	58,461	(33,601)
Cash and cash equivalents at beginning of year	68,242	9,781	43,382
Cash and cash equivalents at end of year	$ 63,353	$ 68,242	$ 9,781
Supplemental disclosures of cash flow information:			
Interest paid, net of amounts capitalized	$ 37,915	$ 43,559	$ 52,063
Income taxes paid	40,521	29,982	5,093
Supplemental disclosures of noncash activities:			
Cost of inventories acquired through seller financing	$ 29,911	$ 15,098	$ 16,977

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Summary of Significant Accounting Policies

Operations Kaufman and Broad Home Corporation (the "Company") is a regional builder of single-family homes with domestic operations throughout the western United States, and international operations in France and Mexico. In France, the Company is also a developer of commercial and high-density residential projects. Through its mortgage banking subsidiary, Kaufman and Broad Mortgage Company, the Company provides mortgage banking services to its domestic homebuyers.

Basis of Presentation The consolidated financial statements include the accounts of the Company and all significant subsidiaries and joint ventures in which a controlling interest is held. All significant intercompany transactions have been eliminated. Investments in unconsolidated joint ventures in which the Company has less than a controlling interest are accounted for using the equity method.

Use of Estimates The financial statements have been prepared in conformity with generally accepted accounting principles and, as such, include amounts based on informed estimates and judgments of management. Actual results could differ from these estimates.

Cash and Cash Equivalents The Company considers all highly liquid debt instruments and other short-term investments purchased with a maturity of three months or less to be cash equivalents. As of November 30, 1998 and 1997, the Company's cash equivalents totaled $20,246,000 and $70,365,000, respectively.

Foreign Currency Translation Results of operations for foreign entities are translated using the average exchange rates during the period. For foreign entities, assets and liabilities are translated to U.S. dollars using the exchange rates in effect at the balance sheet date. Resulting translation adjustments are recorded in a separate component of stockholders' equity, "Cumulative Foreign Currency Translation Adjustments."

Construction Operations Housing and other real estate sales are recognized when title passes to the buyer and all of the following conditions are met: a sale is consummated, a significant down payment is received, the earnings process is complete and the collection of any remaining receivables is reasonably assured. In France, revenues from development and construction of apartments, condominiums and commercial buildings, under long-term contracts with individual investors who own the land, are recognized using the percentage of completion method, which is generally based on costs incurred as a percentage of estimated total costs of individual projects. Revenues recognized in excess of amounts billed are classified as receivables. Amounts received from buyers in excess of revenues recognized, if any, are classified as other liabilities.

Construction and land costs are comprised of direct and allocated costs, including estimated future costs for warranties and amenities. Land, land improvements and other common costs are allocated on a relative fair value basis to units within a parcel or subdivision. Land and land development costs generally include related interest and property taxes incurred until development is substantially completed or deliveries have begun within a subdivision.

The Company adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" ("SFAS No. 121"), in the second quarter of 1996. Prior to the adoption of SFAS No. 121, inventories were stated at the lower of cost or estimated net realizable value for each parcel or subdivision. Under SFAS No. 121, land to be developed and projects under development are stated at cost unless the carrying amount of the parcel or subdivision is determined not to be recoverable, in which case the impaired inventories are written down to fair value. Write-downs of impaired inventories are recorded as adjustments to the cost basis of the inventory. The Company's inventories typically do not consist of completed projects.

Goodwill represents the excess of the purchase price over the fair value of net assets acquired and is amortized by the Company over periods ranging from five to ten years using the straight-line method. Accumulated amortization was $25,804,000 and $16,547,000 at November 30, 1998 and 1997, respectively. In the event that facts and circumstances indicate that the carrying value of goodwill may be impaired, an evaluation of recoverability would be performed. If an evaluation is required, the estimated future undiscounted cash flows associated with the goodwillwould be compared to its carrying amount to determine if a write-down to fair value or discounted cash flow is required.

CHARGE FOR IMPAIRMENT OF LONG-LIVED ASSETS In 1996, the Company decided to accelerate the disposition of certain real estate assets in order to help effectuate the Company's strategies to improve its overall return on investment, restore financial leverage to targeted levels, and position the Company for continued geographic expansion. In addition, in 1996, the Company substantially eliminated its prior practice of investing in long-term development projects in order to reduce the operating risk associated with such projects. The accelerated disposition of long-term development assets caused certain assets, primarily inventories and investments in unconsolidated joint ventures in California and France, to be identified as being impaired and to be written down. Certain of the Company's California properties were impacted by the charge, while none of its non-California domestic properties were affected. The Company's non-California domestic properties were not affected as they were not held for long-term development and were expected to be economically successful, and as such were determined not to be impaired.

Based on the Company's evaluation of impaired assets, a noncash write-down of $170,757,000 ($109,257,000, net of income taxes) was recorded in the second quarter of 1996 to state the impaired assets at their fair values. The fair values established were based on various methods, including discounted cash flow projections, appraisals and evaluations of comparable market prices, as appropriate. The inventories affected by the charge primarily consisted of land which was not under active development and the charge did not have a material effect on gross margins in the balance of 1996, or in 1997 or 1998.

The write-down for impairment of long-lived assets was calculated in accordance with the requirements of SFAS No. 121 but was not necessitated by implementation of this standard. Had the Company not adopted SFAS No. 121, a substantial write-down would have nonetheless been recorded. SFAS No. 121 requires that long-lived assets be

reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable, and requires impairment losses to be recorded on long-lived assets when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount.

Under the standard, when an impairment write-down is required, the related assets are adjusted to their estimated fair value. Fair value for purposes of SFAS No. 121 is deemed to be the amount a willing buyer would pay a willing seller for such property in a current transaction, that is, other than in a forced or liquidation sale. This is a change from the previous accounting standard which required homebuilders to carry real estate assets at the lower of cost or net realizable value.

The estimation process involved in determining if assets have been impaired and in the determination of fair value is inherently uncertain since it requires estimates of current market yields as well as future events and conditions. Such future events and conditions include economic and market conditions, as well as the availability of suitable financing to fund development and construction activities. The realization of the estimates applied to the Company's real estate projects is dependent upon future uncertain events and conditions and, accordingly, the actual timing and amounts realized by the Company may be materially different from the estimated fair values as described herein.

Mortgage Banking Operations First mortgages and mortgage-backed securities consist of securities held for long-term investment and are valued at amortized cost. First mortgages held under commitment of sale are valued at the lower of aggregate cost or market. Market is principally based on public market quotations or outstanding commitments obtained from investors to purchase first mortgages receivable.

Principal and interest payments received on mortgage-backed securities are invested in short-term securities maturing on the next debt service date of the collateralized mortgage obligations for which the securities are held as collateral. Such payments are restricted to the payment of the debt service on the collateralized mortgage obligations.

Income Taxes Income taxes are provided for at rates applicable in the countries in which the income is earned. Provision is made currently for United States federal income taxes on earnings of foreign subsidiaries which are not expected to be reinvested indefinitely.

Earnings (Loss) Per Share During the quarter ended February 28, 1998, the Company adopted Statement of Financial Accounting Standards No. 128, "Earnings Per Share" ("SFAS No. 128"), which simplifies existing computational guidelines, revises disclosure requirements and increases the comparability of earnings per share on an international basis. Basic earnings (loss) per share is calculated by dividing net income (loss) by average common shares outstanding for the period. Diluted earnings (loss) per share is calculated by dividing net income (loss) by the average number of shares outstanding including all dilutive potentially issuable shares under various stock option plans and stock purchase contracts. All earnings (loss) per share amounts for all periods have been

presented and, where necessary, restated to conform to the SFAS No. 128 requirements. In 1996, the net loss, for purposes of the loss per share calculations, was adjusted for dividends on the Series B Convertible Preferred Stock. The following table presents a reconciliation of average shares outstanding:

In thousands — Years Ended November 30,	1998	1997	1996
Basic average shares outstanding	39,553	38,889	36,693
Net effect of stock options assumed to be exercised	1,480	1,169	
Diluted average shares outstanding	41,033	40,058	36,693

Recent Accounting Pronouncements In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS No. 130"), which establishes standards for reporting and display of comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. The Company will adopt SFAS No. 130 in its fiscal year 1999.

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 131, "Disclosure about Segments of an Enterprise and Related Information" ("SFAS No. 131"), which changes the way public companies report information about operating segments. SFAS No. 131, which is based on the management approach to segment reporting, establishes requirements to report selected segment information quarterly and to report entity-wide disclosures about products and services, major customers, and the material countries in which the entity holds assets and reports revenues. The Company will adopt SFAS No. 131 in its fiscal year 1999.

Reclassifications Certain amounts in the consolidated financial statements of prior years have been reclassified to conform to the 1998 presentation.

note 2. Acquisitions

On March 1, 1996, the Company acquired San Antonio, Texas-based Rayco, Ltd. and affiliates (the "San Antonio operations") for a total purchase price of approximately $104,500,000, including cash used to pay off certain assumed debt. The acquisition was financed through borrowings under the Company's revolving credit agreement. The total purchase price for the San Antonio operations was based on the net assets of the entities purchased and the assumption of certain debt. The acquisition was accounted for as a purchase with the results of operations of the acquired entities included in the Company's consolidated financial statements as of the date of acquisition. The purchase price was allocated based on estimated fair values at the date of acquisition. The excess of the purchase price over the fair value of net assets acquired was $32,274,000 and is being amortized on a straight-line basis over a period of seven years.

During the second quarter of 1998, the Company acquired three privately held homebuilders with regional operations in certain key markets. On March 19, 1998, the Company acquired all of the issued and outstanding capital stock of Houston-based Hallmark

Residential Group ("Hallmark") for approximately $54,000,000, including the assumption of debt. Hallmark built single-family homes primarily in Houston (with additional operations in San Antonio and Austin, Texas) under the trade names of Dover Homes and Ideal Builders. The Company acquired substantially all of the assets of Denver-based PrideMark Homebuilding Group ("PrideMark") on March 23, 1998 for approximately $65,000,000, including the assumption of trade liabilities and debt. PrideMark built single family homes in Denver, Colorado. On April 9, 1998, the Company acquired all of the issued and outstanding capital stock of Estes Homebuilding Co. ("Estes") for approximately $48,000,000, including the assumption of debt. Estes built single-family homes in Phoenix and Tucson, Arizona.

On August 18, 1998, the Company acquired a majority ownership investment in General Homes Corporation ("General Homes"), a builder of single-family homes primarily in Houston, Texas. The Company invested approximately $31,837,000, including the assumption of debt, to acquire 50.3% of the outstanding stock of General Homes, pursuant to a completed plan of reorganization. Subsequent to year end, on January 4, 1999, the Company acquired the remaining minority interest in General Homes (See Note 15. Subsequent Events).

The acquisitions of Hallmark, PrideMark, and Estes and the majority ownership investment in General Homes were financed by borrowings under the Company's domestic unsecured revolving credit facility. Accounted for under the purchase method, the results of operations of the acquired entities are included in the Company's consolidated financial statements as of their respective dates of acquisition. The purchase prices were allocated to the assets acquired and liabilities assumed based upon their estimated fair market values at the date of acquisition. The excess of the purchase prices over the fair value of net assets acquired was $23,450,000 on an aggregate basis and was allocated to goodwill. The Company is amortizing goodwill related to the acquisitions on a straight-line basis over a period of ten years.

The following unaudited pro forma information presents a summary of consolidated results of operations of the Company as if the acquisitions had occurred as of December 1, 1996 with pro forma adjustments to give effect to amortization of goodwill, interest expense on acquisition debt and certain other adjustments, together with related income tax effects:

In thousands, except per share amounts — Years Ended November 30,	1998	1997
Total revenues	$2,564,170	$2,199,555
Total pretax income	144,648	85,951
Net income	94,048	54,951
Basic earnings per share	2.38	1.41
Diluted earnings per share	2.29	1.37

This pro forma financial information is presented for informational purposes only and is not necessarily indicative of the operating results that would have occurred had the four acquisitions been consummated as of December 1, 1996, nor are they necessarily indicative of future operating results.

NOTE 3. Receivables

Construction Trade receivables amounted to $67,771,000 and $42,591,000 at November 30, 1998 and 1997, respectively. Included in these amounts are unbilled receivables due from buyers on French apartment, condominium and commercial building sales accounted for using the percentage of completion method, totaling $37,804,000 at November 30, 1998 and $13,160,000 at November 30, 1997. The buyers are contractually obligated to remit payments against their unbilled balances. Other receivables of $127,070,000 at November 30, 1998 and $127,397,000 at November 30, 1997 included mortgages receivable, escrow deposits and amounts due from municipalities and utility companies.

At November 30, 1998 and 1997, receivables were net of allowances for doubtful accounts of $9,146,000 and $5,728,000, respectively.

Mortgage Banking First mortgages and mortgage-backed securities consisted of loans of $6,334,000 at November 30, 1998 and $8,019,000 at November 30, 1997 and mortgage-backed securities of $51,928,000 and $63,957,000 at November 30, 1998 and 1997, respectively. The mortgage-backed securities serve as collateral for related collateralized mortgage obligations. The property covered by the mortgages underlying the mortgage-backed securities are single-family residences. Issuers of the mortgage-backed securities are the Government National Mortgage Association and Fannie Mae. The first mortgages and mortgage-backed securities bore interest at an average rate of $8\frac{2}{5}\%$ and $8\frac{1}{2}\%$ at November 30, 1998 and 1997, respectively (with rates ranging from 7% to 12% in 1998 and 1997).

First mortgages and mortgage-backed securities were net of discounts and premiums of $546,000 at November 30, 1998 and $1,371,000 at November 30, 1997. These discounts and premiums, which primarily represent loan origination discount points and acquisition price discounts or premiums, are deferred as an adjustment to the carrying value of the related first mortgages and mortgage-backed securities and amortized into interest income using the interest method.

The Company's mortgage-backed securities held for long-term investment have been classified as held-to-maturity and are stated at amortized cost, adjusted for amortization of discounts and premiums to maturity. Such amortization is included in interest income. The total gross unrealized gains and gross unrealized losses on the mortgage-backed securities were $3,457,000 and $0, respectively at November 30, 1998 and $4,782,000 and $0, respectively at November 30, 1997.

First mortgages held under commitment of sale and other receivables consisted of first mortgages held under commitment of sale of $242,537,000 at November 30, 1998 and $203,113,000 at November 30, 1997 and other receivables of $7,165,000 and $5,141,000 at November 30, 1998 and 1997, respectively. The first mortgages held under commitment of sale bore interest at an average rate of $7\frac{1}{2}\%$ and $7\frac{1}{3}\%$ at November 30, 1998 and 1997, respectively. The balance in first mortgages held under commitment of sale and other receivables fluctuates significantly during the year and typically reaches its highest level at quarter-ends, corresponding with the Company's home and mortgage delivery activity.

NOTE 4. INVENTORIES

Inventories consisted of the following:

In thousands November 30,	1998	1997
Homes, lots and improvements in production	$ 835,300	$605,227
Land under development	299,102	185,016
Total inventories	$1,134,402	$790,243

Land under development primarily consists of parcels on which 50% or less of estimated development costs have been incurred.

The impact of capitalizing interest costs on consolidated pretax income is as follows:

In thousands Years Ended November 30,	1998	1997	1996
Interest incurred	$ 54,299	$ 52,468	$ 63,628
Interest expensed	(23,341)	(29,829)	(36,691)
Interest capitalized	30,958	22,639	26,937
Interest amortized	(30,752)	(25,480)	(24,893)
Net impact on consolidated pretax income	$ 206	$ (2,841)	$ 2,044

NOTE 5. INVESTMENTS IN UNCONSOLIDATED JOINT VENTURES

The Company participates in a number of joint ventures in which it has less than a controlling interest. These joint ventures are based in California, New Mexico, Texas and France and are engaged in the development, construction and sale of residential properties and commercial projects. Combined condensed financial information concerning the Company's unconsolidated joint venture activities follows:

In thousands November 30,	1998	1997
Cash	$ 6,286	$ 3,376
Receivables	5,727	7,532
Inventories	15,042	18,421
Other assets	637	183
Total assets	$27,692	$29,512
Mortgages and notes payable	$ 4,593	$ 4,528
Other liabilities	5,696	5,549
Equity of:		
The Company	5,608	6,338
Others	11,795	13,097
Total liabilities and equity	$27,692	$29,512

The joint ventures finance land and inventory investments primarily through a variety of borrowing arrangements. The Company typically does not guarantee these financing arrangements.

In thousands — Years Ended November 30,	1998	1997	1996
Revenues	$ 17,657	$ 98,183	$ 6,678
Cost of sales	(12,245)	(94,901)	(8,232)
Other expenses, net	(384)	(6,147)	(13,207)
Total pretax income (loss)	$ 5,028	$ (2,865)	$(14,761)
The Company's share of pretax income (loss)	$ 1,151	$ (53)	$ (2,148)

The Company's share of pretax income (loss) includes management fees earned from the unconsolidated joint ventures.

Note 6. Mortgages and Notes Payable

Construction Mortgages and notes payable consisted of the following (interest rates are as of November 30):

In thousands — November 30,	1998	1997
Unsecured French borrowings (4 1/5% to 5 3/8% in 1998 and 4% to 5 3/8% in 1997)	$ 33,647	$ 9,045
Mortgages and land contracts due to land sellers and other loans (8% to 10 1/4% in 1998 and 8 1/10% to 11% in 1997)	22,492	14,294
Senior notes due 2004 at 7 3/4%	175,000	175,000
Senior subordinated notes due 2003 at 9 3/8%	174,221	174,085
Senior subordinated notes due 2006 at 9 5/8%	124,486	124,445
Total mortgages and notes payable	$529,846	$496,869

On April 21, 1997, the Company entered into a $500,000,000 domestic unsecured revolving credit agreement (the "Revolving Credit Facility") with various banks. The Revolving Credit Facility is comprised of a $400,000,000 revolving credit facility scheduled to expire on April 30, 2001 and a $100,000,000 364-day revolving credit facility. Upon expiration, the $100,000,000 revolving credit facility is renewable at the lenders' option or may be converted, at the Company's option, to a term loan expiring on April 30, 2001. Under the Revolving Credit Facility, $493,000,000 remained committed and $475,287,000 was available for the Company's future use at November 30, 1998. The Revolving Credit Facility provides for interest on borrowings at either the applicable bank reference rate or the London Interbank Offered Rate plus an applicable spread and an annual commitment fee based on the unused portion of the commitment.

The Company's French subsidiaries have lines of credit with various banks which totaled $110,838,000 at November 30, 1998 and have various committed expiration dates through November 2000. These lines of credit provide for interest on borrowings at either the French Federal Funds Rate or the Paris Interbank Offered Rate plus an applicable spread.

The weighted average interest rate on aggregate unsecured borrowings, excluding the senior and senior subordinated notes, was $4\frac{3}{5}$% and $4\frac{3}{10}$% at November 30, 1998 and 1997, respectively.

On April 26, 1993, the Company issued $175,000,000 principal amount of $9\frac{3}{8}$% senior subordinated notes at 99.202%. The notes are due May 1, 2003 with interest payable semi-annually. The notes represent unsecured obligations of the Company and are subordinated to all existing and future senior indebtedness of the Company. The Company may redeem the notes, in whole or in part, at any time on or after May 1, 2000 at 100% of their principal amount.

On October 29, 1996, the Company filed a universal shelf registration statement (the "1996 Shelf Registration") with the Securities and Exchange Commission for up to $300,000,000 of the Company's debt and equity securities. The Company's previously outstanding shelf registration for debt securities in the amount of $100,000,000 was subsumed within the 1996 Shelf Registration. On November 14, 1996, the Company utilized the 1996 Shelf Registration to issue $125,000,000 of $9\frac{5}{8}$% senior subordinated notes at 99.525%. The notes, which are due November 15, 2006 with interest payable semi-annually, represent unsecured obligations of the Company and are subordinated to all existing and future senior indebtedness of the Company. The notes are redeemable at the option of the Company, in whole or in part, at 104.8125% of their principal amount beginning November 15, 2001, and thereafter at prices declining annually to 100% on and after November 15, 2004.

On September 4, 1997, the Company completed the optional redemption of its $100,000,000 principal amount of $10\frac{3}{8}$% senior notes due in 1999. The Company used borrowings under its Revolving Credit Facility to retire the entire $100,000,000 of senior notes at 100% of the principal amount of the notes, together with accrued and unpaid interest.

On October 14, 1997, pursuant to the 1996 Shelf Registration, the Company issued $175,000,000 of $7\frac{3}{4}$% senior notes at 100% of the principal amount of the notes. The notes, which are due October 15, 2004 with interest payable semi-annually, represent unsecured obligations of the Company and rank pari passu in right of payment with all other senior unsecured indebtedness of the Company. The notes are not redeemable by the Company prior to stated maturity. This offering resulted in the issuance of all available securities under the 1996 Shelf Registration.

The $7\frac{3}{4}$% senior notes and $9\frac{3}{8}$% and $9\frac{5}{8}$% senior subordinated notes contain certain restrictive covenants that, among other things, limit the ability of the Company to incur additional indebtedness, pay dividends, make certain investments, create certain liens, engage in mergers, consolidations, or sales of assets, or engage in certain transactions with officers, directors and employees. Under the terms of the Revolving Credit Facility, the Company is required, among other things, to maintain certain financial statement ratios and a minimum net worth and is subject to limitations on acquisitions, inventories and indebtedness. Based on the terms of the Company's Revolving Credit Facility, senior notes and senior subordinated notes, retained earnings of $163,535,000 were available for payment of cash dividends or stock repurchases at November 30, 1998.

Principal payments on senior and senior subordinated notes, mortgages, land contracts and other loans are due as follows: 1999, $18,999,000; 2000, $3,346,000; 2001, $77,000; 2002, $70,000; 2003, $174,221,000; and thereafter, $299,486,000.

Assets (primarily inventories) having a carrying value of approximately $45,060,000 are pledged to collateralize mortgages, land contracts and other secured loans.

On December 5, 1997, the Company filed a new universal shelf registration statement with the Securities and Exchange Commission for up to $500,000,000 of the Company's debt and equity securities. This universal shelf registration provides that securities may be offered from time to time in one or more series and in the form of senior, senior subordinated or subordinated debt, preferred stock, common stock, and/or warrants to purchase
such securities. The registration was declared effective on December 16, 1997, and no securities have been issued thereunder.

MORTGAGE BANKING Notes payable included the following (interest rates are as of November 30):

IN THOUSANDS NOVEMBER 30,	1998	1997
Notes payable secured by trust deed notes (5 3/5% in 1998 and 6% in 1997)	$239,413	$200,828
Total notes payable	$239,413	$200,828

First mortgages receivable are financed through a $250,000,000 revolving mortgage warehouse agreement (the "Mortgage Warehouse Facility"). The Mortgage Warehouse Facility, which expires on February 23, 2000, provides for an annual fee based on the committed balance of the facility and provides for interest at either the Federal Funds Rate or the London Interbank Offered Rate plus an applicable spread on amounts borrowed.

The amount outstanding under the Mortgage Warehouse Facility is secured by a borrowing base, which includes certain mortgage loans held under commitment of sale and is repayable from proceeds on the sale of first mortgages. There are no compensating balance requirements under the facility. The terms of the Mortgage Warehouse Facility include financial covenants and restrictions which, among other things, require the maintenance of certain financial statement ratios and a minimum tangible net worth.

Collateralized mortgage obligations represent bonds issued to third parties which are collateralized by mortgage-backed securities with substantially the same terms. At both November 30, 1998 and 1997, the collateralized mortgage obligations bore interest at rates ranging from 8% to 12 1/4% with stated original principal maturities ranging from 3 to 30 years. Actual maturities are dependent on the rate at which the underlying mortgage-backed securities are repaid. No collateralized mortgage obligations have been issued since 1988.

NOTE 7. Company Obligated Mandatorily Redeemable Preferred Securities of Subsidiary Trust Holding Solely Debentures of the Company (Feline Prides)

On July 7, 1998, the Company, together with KBHC Financing I, a Delaware statutory business trust (the "KBHC Trust"), of which all the common securities are owned by the Company, issued an aggregate of (i) 18,975,000 Feline Prides, and (ii) 1,000,000 KBHC Trust capital securities, with a $10 stated liquidation amount. The Feline Prides consist of (i) 17,975,000 Income Prides with a stated amount per Income Prides of $10 (the "Stated Amount"), which are units comprised of a capital security and a stock purchase contract under which the holders will purchase common stock from the Company not later than August 16, 2001 and the Company will pay to the holders certain unsecured contract adjustment payments, and (ii) 1,000,000 Growth Prides with a face amount per Growth Prides equal to the Stated Amount, which are units consisting of a 1/100th beneficial interest in a zero-coupon U.S. treasury security and a stock purchase contract under which the holders will purchase common stock from the Company not later than August 16, 2001 and the Company will pay to the holders certain unsecured contract adjustment payments.

The distribution rate on the Income Prides is 8.25% per annum, and the distribution rate on the Growth Prides is .75% per annum. Under the stock purchase contracts, investors will be required to purchase shares of common stock of the Company for an effective price ranging between a minimum of $31.75 per share and a maximum of $38.10 per share, and the Company will issue approximately 5,000,000 to 6,000,000 common shares by August 16, 2001, depending upon the price of the Company's common stock upon settlement of the purchase contracts (subject to adjustment under certain circumstances). The capital securities associated with the Income Prides and the U.S. treasury securities associated with the Growth Prides have been pledged as collateral to secure the holders' obligations in respect of the common stock purchase contracts. The capital securities issued by the KBHC Trust are entitled to a distribution rate of 8% per annum of their $10 stated liquidation amount.

The KBHC Trust utilized the proceeds from the issuance of the Feline Prides and capital securities to purchase an equivalent principal amount of the Company's 8% Debentures due August 16, 2003 (the "8% Debentures"). The 8% Debentures are the sole asset of the KBHC Trust. The Company's obligations under the Debentures and related agreements, taken together constitute a firm and unconditional guarantee by the Company of the KBHC Trust's obligations under the capital securities. The interest rate on the 8% Debentures and the distribution rate on the capital securities of the KBHC Trust are to be reset, subject to certain limitations, effective August 16, 2001. The Company has recorded the present value of the contract adjustment payments on the Feline Prides, totaling $1,600,000, as a liability and a reduction of stockholders' equity. The liability will be reduced as the contract adjustment payments are made. The Company has the right to defer the contract adjustment payments and the payment of interest on the 8% Debentures, but any such election will subject the Company to restrictions on the payment of dividends on, and redemption of, its outstanding shares of common stock, and on the payment of interest on, or redemption of, debt securities of the Company junior in rank

to the 8% Debentures, none of which are currently outstanding. Distributions totaling $6,072,000 are included as minority interests in the Company's results of operations for the year ended November 30, 1998.

The proceeds from the issuance of Feline Prides were used immediately to pay down outstanding debt under the Company's domestic unsecured revolving credit facility. Subsequently, the unsecured revolving credit facility was used for general corporate purposes, including support of the Company's growth strategies and acquisitions. The Company incurred costs of approximately $6,700,000 in connection with the issuance of the Feline Prides and the capital securities.

NOTE 8. FAIR VALUES OF FINANCIAL INSTRUMENTS

The estimated fair values of financial instruments have been determined based on available market information and appropriate valuation methodologies. However, judgment is necessarily required in interpreting market data to develop the estimates of fair value. In that regard, the estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current market exchange.

The carrying values and estimated fair values of the Company's financial instruments, except for those financial instruments for which the carrying values approximate fair values, are summarized as follows:

In thousands — November 30,	1998		1997	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Construction:				
Financial liabilities				
7¾% Senior notes	$175,000	$169,698	$175,000	$173,688
9⅜% Senior subordinated notes	174,221	178,833	174,085	182,158
9⅝% Senior subordinated notes	124,486	134,288	124,445	131,988
Mortgage banking:				
Financial assets				
Mortgage-backed securities	51,928	55,386	63,957	68,739
Financial liabilities				
Collateralized mortgage obligations secured by mortgage-backed securities	49,264	53,693	60,058	67,451
Company obligated mandatorily redeemable preferred securities of subsidiary trust holding solely debentures of the Company	189,750	162,200		

The Company used the following methods and assumptions in estimating fair values:

Cash and cash equivalents; first mortgages held under commitment of sale and other receivables; borrowings under the Revolving Credit Facility, French lines of credit and Mortgage Warehouse Facility: The carrying amounts reported approximate fair values.

Senior notes and senior subordinated notes: The fair values of the Company's senior notes and senior subordinated notes are estimated based on quoted market prices.

Mortgage-backed securities and collateralized mortgage obligations secured by mortgage-backed securities: The fair values of these financial instruments are estimated based on quoted market prices for the same or similar issues.

Company obligated mandatorily redeemable preferred securities of subsidiary trust holding solely debentures of the Company: The fair values of these financial instruments are based on quoted market prices on the New York Stock Exchange.

NOTE 9. COMMITMENTS AND CONTINGENCIES

Commitments and contingencies include the usual obligations of homebuilders for the completion of contracts and those incurred in the ordinary course of business. The Company is also involved in litigation incidental to its business, the disposition of which should have no material effect on the Company's financial position or results of operations.

NOTE 10. STOCKHOLDERS' EQUITY

PREFERRED STOCK On January 11, 1989, the Company adopted a Stockholder Rights Plan (the "1989 Rights Plan") and declared a dividend distribution of one preferred share purchase right for each outstanding share of common stock. Under certain circumstances, each right entitles the holder to purchase 1/100th of a share of a new Series A Participating Cumulative Preferred Stock at a price of $30.00, subject to certain antidilution provisions. The rights are not exercisable until the earlier to occur of (i) 10 days following a public announcement that a person or group has acquired 20% or more of the aggregate votes entitled from all shares of common stock or (ii) 10 days following the commencement of a tender offer for 20% or more of the aggregate votes entitled from all shares of common stock. In the event the Company is acquired in a merger or other business combination transaction, or 50% or more of the Company's assets or earning power is sold, each right will entitle its holder to receive, upon exercise, common stock of the acquiring company having a market value of twice the exercisable price of the right. At the option of the Company, the rights are redeemable prior to becoming exercisable at $.01 per right. Unless previously redeemed, the rights will expire on March 7, 1999. Until a right is exercised, the holder will have no rights as a stockholder of the Company, including the right to vote or receive dividends. Subsequent to year end, on February 4, 1999, the Company adopted a new Stockholder Rights Agreement (See Note 15. Subsequent Events).

In 1993, the Company issued 6,500,000 depository shares, each representing a one-fifth ownership interest in a share of Series B Mandatory Conversion Premium Dividend Preferred Stock (the Series B Convertible Preferred Stock). Dividends were cumulative and payable quarterly in arrears at an annual dividend rate of $1.52 per depository share. On the mandatory conversion date of April 1, 1996, each of the Company's 6,500,000 depository shares was converted into one share of the Company's common stock.

NOTE 11. EMPLOYEE BENEFIT AND STOCK PLANS

Benefits are provided to most employees under the Company's 401(k) Savings Plan under which contributions by employees are partially matched by the Company. The aggregate cost of this plan to the Company was $3,025,000 in 1998, $2,081,000 in 1997 and $1,867,000 in 1996.

The Company's 1988 Employee Stock Plan (the "1988 Plan") provides that stock options, associated limited stock appreciation rights, restricted shares of common stock, stock units and other securities may be awarded to eligible individuals for periods of up to 15 years. The 1988 Plan is the Company's primary existing employee stock plan. The Company also has a Performance-Based Incentive Plan for Senior Management (the "Incentive Plan") and the 1998 Stock Incentive Plan which provide for the same awards as may be made under the 1988 Plan, but require that such awards be subject to certain conditions which are designed to assure that annual compensation paid in excess of $1,000,000 to participating executives is tax deductible for the Company.

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), issued in October 1995, established financial accounting and reporting standards for stock-based employee compensation plans. As permitted by SFAS No. 123, the Company elected to continue to use Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations, in accounting for its stock options. Had compensation expense for the Company's stock option plans been determined based on the fair value at the grant date for awards in 1998, 1997 and 1996 consistent with the provisions of SFAS No. 123, the Company's net income (loss) and diluted earnings (loss) per share would have been reduced to the pro forma amounts as follows:

IN THOUSANDS, EXCEPT PER SHARE AMOUNTS — YEARS ENDED NOVEMBER 30,	1998	1997	1996
Net income (loss) — as reported	$95,267	$58,230	$(61,244)
Net income (loss) — pro forma	91,398	57,463	(61,757)
Diluted earnings (loss) per share — as reported	2.32	1.45	(1.80)
Diluted earnings (loss) per share — pro forma	2.24	1.44	(1.82)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions used for grants in 1998, 1997 and 1996, respectively: a risk free interest rate of 4.38%, 5.84% and 5.88%, an expected volatility factor for the market price of the Company's common stock of 41.31%, 34.62% and 40.06%; a dividend yield of 1.19%, 1.38% and 2.33% and an expected life of 4 years, 4 years and 6 years. The weighted average fair value of options granted in 1998, 1997 and 1996 was $6.09, $3.68 and $4.48, respectively.

Stock option transactions are summarized as follows:

	1998		1997		1996	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Options outstanding at beginning of year	2,747,318	$ 9.98	2,830,268	$10.00	2,406,718	$ 9.30
Granted	1,318,017	22.83	387,000	14.07	665,000	14.21
Exercised	(995,235)	10.70	(169,183)	12.10	(37,100)	10.12
Cancelled	(105,033)	16.56	(300,767)	14.25	(204,350)	15.38
Options outstanding at end of year	2,965,067	$15.22	2,747,318	$ 9.98	2,830,268	$10.00
Options exercisable at end of year	1,586,455	$12.16	1,816,346	$ 7.92	1,732,468	$ 7.54
Options available for grant at end of year	2,464,014		1,776,998		1,863,431	

Stock options outstanding at November 30, 1998 are as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
$ 4.38 to $ 4.75	847,222	4.65	$ 4.75	847,222	$ 4.75
$ 5.50 to $14.56	770,728	11.96	13.72	231,116	13.34
$16.13 to $21.59	858,100	9.01	21.32	61,600	18.53
$23.74 to $33.94	489,017	9.54	25.02	446,517	24.75
$ 4.38 to $33.94	2,965,067	8.62	$15.22	1,586,455	$12.16

The Company records proceeds from the exercise of stock options as additions to common stock and paid-in capital. The tax benefit, if any, is recorded as additional paid-in capital.

In 1991, the Board of Directors approved the issuance of restricted stock awards under the 1988 Plan of up to an aggregate 600,000 shares of common stock to certain officers and key employees. Restrictions lapse each year through May 10, 2005 on specified portions of the shares awarded to each participant so long as the participant has remained in the continuous employ of the Company. Restricted shares under this grant outstanding at the end of the year totaled 151,665 in 1998, 226,668 in 1997 and 255,001 in 1996.

NOTE 12. INCOME TAXES

The components of pretax income (loss) are as follows:

In thousands — Years Ended November 30,	1998	1997	1996
Domestic	$136,042	$87,545	$(51,399)
Foreign	10,525	3,485	(44,345)
Total pretax income (loss)	$146,567	$91,030	$(95,744)

The components of income taxes are as follows:

In thousands	Total	Federal	State	Foreign
1998				
Currently payable	$ 52,628	$ 39,989	$ 8,498	$ 4,141
Deferred	(1,328)	(3,145)		1,817
Total	$ 51,300	$ 36,844	$ 8,498	$ 5,958
1997				
Currently payable	$ 35,159	$ 28,254	$ 4,847	$ 2,058
Deferred	(2,359)	(1,892)		(467)
Total	$ 32,800	$ 26,362	$ 4,847	$ 1,591
1996				
Currently payable	$ 5,659	$ 17,013	$(7,003)	$ (4,351)
Deferred	(40,159)	(28,754)		(11,405)
Total	$(34,500)	$(11,741)	$(7,003)	$(15,756)

Deferred income taxes result from temporary differences in the financial and tax bases of assets and liabilities. Significant components of the Company's deferred tax liabilities and assets are as follows:

In thousands November 30,	1998	1997
Deferred tax liabilities:		
Installment sales	$ 6,520	$ 2,372
Bad debt and other reserves	166	333
Capitalized expenses	20,800	17,789
Partnerships and joint ventures	2,457	2,712
Computer equipment leases		432
Repatriation of foreign subsidiaries	12,018	11,785
Other	3,491	3,314
Total deferred tax liabilities	45,452	38,737
Deferred tax assets:		
Warranty, legal and other accruals	15,315	12,394
Depreciation and amortization	7,476	4,764
Capitalized expenses	9,827	6,684
Noncash charge for impairment of long-lived assets	8,902	13,307
Foreign tax credits	11,857	11,603
Net operating losses	931	1,099
Other	15,238	10,674
Total deferred tax assets	69,546	60,525
Net deferred tax assets	$24,094	$21,788

Net operating loss carryforwards expire in 1999, 2000, 2001 and 2003. The Company expects that the entire deferred tax benefit of the tax loss carryforwards will be recognized in future periods.

Income taxes computed at the statutory United States federal income tax rate and income tax expense provided in the financial statements differ as follows:

In thousands Years Ended November 30,	1998	1997	1996
Amount computed at statutory rate	$51,298	$31,861	$(33,510)
Increase (decrease) resulting from:			
State taxes, net of federal income tax benefit	5,524	3,150	(4,552)
Differences in foreign tax rates	1,594	(885)	(167)
Intercompany dividends	977	352	1,170
Affordable housing credits	(3,351)	(2,046)	(2,024)
Other, net	(4,742)	368	4,583
Total	$51,300	$32,800	$(34,500)

The Company has commitments to invest $13,123,000 over six years in affordable housing partnerships which are scheduled to provide tax credits.

The Company had foreign tax credit carryforwards at November 30, 1998 of $4,666,000 for United States federal income tax purposes which expire in 2000, 2002 and 2003.

The undistributed earnings of foreign subsidiaries, which the Company plans to invest indefinitely and for which no United States federal income taxes have been provided, totaled $17,565,000 at November 30, 1998. If these earnings were currently distributed, the resulting withholding taxes payable would be $877,000.

NOTE 13. Geographical and Segment Information

Geographical and segment information follows:

In thousands	Revenues	Operating Income (Loss)	Identifiable Assets
1998			
Construction:			
California	$1,105,849	$ 79,871	$ 655,920
Other U.S.	1,042,408	55,343	656,389
Foreign	254,709	13,458	230,235
Total construction	2,402,966	148,672	1,542,544
Mortgage banking	46,396	21,413	317,660
Total	$2,449,362	$ 170,085	$1,860,204
1997			
Construction:			
California	$ 993,921	$ 65,554	$ 717,949
Other U.S.	670,590	34,166	283,794
Foreign	179,103	2,031	132,118
Total construction	1,843,614	101,751	1,133,861
Mortgage banking	35,109	14,508	285,130
Total	$1,878,723	$ 116,259	$1,418,991
1996			
Construction:			
California	$1,057,980	$ 65,308	$ 620,823
Other U.S.	516,921	33,251	234,959
Foreign	179,246	120	144,377
Noncash charge for impairment of long-lived assets*		(170,757)	
Total construction	1,754,147	(72,078)	1,000,159
Mortgage banking	33,378	12,740	243,335
Total	$1,787,525	$ (59,338)	$1,243,494

*The $170.8 million pretax noncash charge for impairment of long-lived assets was recorded in the geographic regions as follows: California $112.1 million; France $43.5 million; and Other $15.2 million.

NOTE 14. Quarterly Results (unaudited)

Quarterly results for the years ended November 30, 1998 and 1997 follow:

In thousands, except per share amounts	First	Second	Third	Fourth
1998				
Revenues	$426,245	$537,459	$659,014	$826,644
Operating income	18,323	32,637	48,888	70,237
Pretax income	12,698	26,222	43,298	64,349
Net income	8,098	17,222	28,098	41,849
Basic earnings per share	.21	.44	.70	1.05
Diluted earnings per share	.20	.42	.68	1.02
1997				
Revenues	$347,246	$415,000	$469,171	$647,306
Operating income	14,266	23,629	29,595	48,769
Pretax income	6,944	16,705	23,763	43,618
Net income	4,444	10,705	15,163	27,918
Basic earnings per share	.11	.28	.39	.72
Diluted earnings per share	.11	.27	.38	.69

Quarterly and year-to-date computations of per share amounts are made independently. Therefore, the sum of per share amounts for the quarters may not agree with per share amounts for the year.

NOTE 15. Subsequent Events

Subsequent to year end, effective January 4, 1999, the Company acquired the remaining equity interest in Houston-based General Homes. The Company invested approximately $14,500,000 to acquire 49.7% of the outstanding stock of General Homes, bringing its ownership interest to 100%. This transaction was financed by borrowings under the Company's domestic unsecured revolving credit facility.

Effective January 7, 1999, the Company acquired substantially all of the homebuilding assets of the Lewis Homes group of companies ("Lewis Homes"). Lewis Homes is engaged in the acquisition, development and sale of residential real estate in California and Nevada. Prior to the acquisition, Lewis Homes, based in Upland, California, was one of the largest privately held single-family homebuilders in the United States based on units delivered, with estimated unaudited revenues for the year ended December 31, 1998 of $700,000,000 on approximately 3,600 unit deliveries. Lewis Homes also owned or controlled approximately 24,000 lots and had a backlog of approximately 900 homes at December 31, 1998. Lewis Homes' principal markets are Las Vegas and Northern Nevada, Southern California, and the greater Sacramento area in Northern California.

The estimated purchase price for Lewis Homes is $449,000,000, comprised of the assumption of approximately $303,000,000 in debt and the issuance of 7,886,686 shares of the Company's common stock valued at approximately $146,000,000. The current estimated purchase price was based on the net book values of the entities purchased and is subject to

adjustment based on the closing balance sheets as of December 31, 1998, which are expected to be finalized before April 1, 1999. While it is anticipated that there will be further adjustments to the purchase price, the Company does not expect such adjustments to be material. The shares of Company common stock issued in the acquisition are "restricted" shares and may not be resold without a registration statement or compliance with Securities and Exchange Commission regulations that limit the number of shares that may be resold in a given period. The Company has agreed to file a registration statement for those shares in three increments at the Lewis family's request from July 1, 2000 to July 1, 2002. Under the terms of the purchase agreement, a Lewis family member has also been appointed to the Company's board of directors.

In connection with the acquisition of Lewis Homes, the Company obtained a $200,000,000 unsecured term loan agreement with various banks (the "Term Loan Agreement") to refinance certain debt assumed. The Term Loan Agreement dated January 7, 1999 provides for payments of $25,000,000 due on January 31, 2000, April 30, 2000 and July 31, 2000, with the remaining principal balance due on April 30, 2001. Interest is payable monthly at the London Interbank Offered Rate plus an applicable spread. Under the terms of the Term Loan Agreement, the Company is required, among other things, to maintain certain financial statement ratios and a minimum net worth and is subject to limitations on acquisitions, inventories and indebtedness. The financing obtained under the Term Loan Agreement did not impact the amounts available under the Company's preexisting borrowing arrangements. The Company used borrowings under its existing domestic unsecured revolving credit facility to refinance certain other debt assumed in the Lewis Homes acquisition.

The acquisition consideration for Lewis Homes was determined by arm's-length negotiations between the parties. The acquisition will be accounted for as a purchase, with the results of Lewis Homes included in the Company's consolidated financial statements as of January 7, 1999.

On February 4, 1999, the Company adopted a new Stockholder Rights Plan to replace the 1989 Rights Plan, and declared a dividend distribution of one preferred share purchase right for each outstanding share of common stock, such rights to be issued on March 7, 1999, simultaneously with the expiration of the rights issued under the 1989 Rights Plan. Under certain circumstances, each right entitles the holder to purchase 1/100th of a share of the Company's Series A Participating Cumulative Preferred Stock at a price of $135.00, subject to certain antidilution provisions. The rights are not exercisable until the earlier to occur of (i) 10 days following a public announcement that a person or group has acquired Company stock representing 15% or more of the aggregate votes entitled to be cast by all shares of common stock or (ii) 10 days following the commencement of a tender offer for Company stock representing 15% or more of the aggregate votes entitled to be cast by all shares of common stock. The holdings of or acquisitions by any of the members of the Lewis family, a former officer of Lewis Homes and any entity controlled by any of them (the "Lewis Holders"), who held in the aggregate approximately 16% of the Company's common stock as of January 7, 1999, will not cause the rights to become exercisable by virtue of their ownership so long as their aggregate ownership remains below 17% of the issued and outstanding common stock. In the event the aggregate ownership of the Lewis Holders falls below 15.5% of the issued and outstanding shares of the Company's common stock, the rights will become exercisable as described

above if their holdings should at anytime thereafter exceed 16% of the issued and outstanding shares of the Company's common stock. In the event the aggregate ownership of the Lewis Holders falls below 14.5% of the issued and outstanding shares of the Company's common stock, the Lewis Holders' exemption will terminate, and the rights will become exercisable as described above. If, without approval of the Board of Directors, the Company is acquired in a merger or other business combination transaction, or 50% or more of the Company's assets or earning power is sold, each right will entitle its holder to receive, upon exercise, common stock of the acquiring company having a market value of twice the exercise price of the right; and if, without approval of the Board of Directors, any person or group acquires Company stock representing 15% or more of the aggregate votes entitled to be cast by all shares of common stock, each right will entitle its holder to receive, upon exercise, common stock of the Company having a market value of twice the exercise price of the right. At the option of the Company, the rights are redeemable prior to becoming exercisable at $.005 per right. Unless previously redeemed, the rights will expire on March 7, 2009. Until a right is exercised, the holder will have no rights as a stockholder of the Company, including the right to vote or receive dividends.

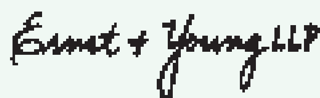
REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Stockholders of Kaufman and Broad Home Corporation:

We have audited the accompanying consolidated balance sheets of Kaufman and Broad Home Corporation as of November 30, 1998 and 1997, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended November 30, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Kaufman and Broad Home Corporation at November 30, 1998 and 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended November 30, 1998, in conformity with generally accepted accounting principles.



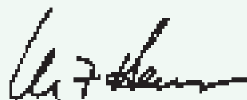
Los Angeles, California
December 31, 1998, except as to Note 15, as to which the date is February 4, 1999

REPORT ON FINANCIAL STATEMENTS

The accompanying consolidated financial statements are the responsibility of management. The statements have been prepared in conformity with generally accepted accounting principles. Estimates and judgments of management based on its current knowledge of anticipated transactions and events are made to prepare the financial statements as required by generally accepted accounting principles. Management relies on internal accounting controls, among other things, to produce records suitable for the preparation of financial statements.

The responsibility of our external auditors for the financial statements is limited to their expressed opinion on the fairness of the consolidated financial statements taken as a whole. Their examination is performed in accordance with generally accepted auditing standards which include tests of our accounting records and internal accounting controls and evaluation of estimates and judgments used to prepare the financial statements. The Company employs a staff of internal auditors whose work includes evaluating and testing internal accounting controls.

An audit committee of outside members of the Board of Directors periodically meets with management, the external auditors and the internal auditors to evaluate the scope of auditing activities and review results. Both the external and internal auditors have the unrestricted opportunity to communicate privately with the audit committee.



Michael F. Henn
Senior Vice President and Chief Financial Officer
December 31, 1998

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Senior Vice President and Regional General Manager

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Senior Vice President and Regional General Manager

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Senior Vice President, Marketing and Communications

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Vice President, Government and Public Affairs

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Senior Vice President and Chief Financial Officer

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Albert Z. Praw
Senior Vice President, Business Development

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Vice President, Information Systems

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Michael A. Costa
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Mark Crivelli
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Los Angeles

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Sigoloff & Associates, Inc.
Los Angeles

OFFICE LOCATIONS

United States

Architecture Group
801 Corporate Center Drive
Suite 180
Pomona, California 91768
(949) 509-7505
(949) 854-5108 Fax

Colorado Division
8401 E. Belleview Avenue, Suite 200
Denver, Colorado 80237
(303) 220-6000
(303) 773-1930 Fax

Corporate Office
10990 Wilshire Boulevard,
Seventh Floor
Los Angeles, California 90024
(310) 231-4000
(310) 231-4222 Fax

Greater LA Division
801 Corporate Center Drive
Suite 201
Pomona, California 91768
(909) 802-1100
(909) 802-1111 Fax

houseCALL Center
4226 Rosewood Drive
Pleasanton, California 94588
1(800) 34-HOMES
(925) 467-5506 Fax

Monterey Bay Division
1604 North Main Street
Salinas, California 93906
(408) 442-7615
(408) 442-8839 Fax

Mortgage Company
21650 Oxnard Street
Third Floor
Woodland Hills, California 91367
(818) 887-2275
(818) 712-2422 Fax

Multi-Housing Group
320 Golden Shore, Suite 200
Long Beach, California 90802
(562) 256-2000
(562) 256-2001 Fax

Nevada Region
Las Vegas Division
7440 S. Industrial Road, Suite 201
Las Vegas, Nevada 89139
(702) 261-1300
(702) 261-1301 Fax

Reno Office:
1380 Greg Street, #230
Sparks, Nevada 89431
(702) 331-0345
(702) 331-0360 Fax

New Mexico Division
4921 Alexander, NE, Suite B
Albuquerque, New Mexico 87107
(505) 344-9400
(505) 344-5700 Fax

Northern California Division
Modesto Office:
4701 Sisk Road
Modesto, California 95356
(209) 545-6500
(209) 545-6550 Fax

Sacramento Office:
9216 Kiefer Boulevard
Sacramento, California 95826
(916) 362-9275
(916) 364-9364 Fax

San Ramon Office:
3130 Crow Canyon Place, Suite 300
San Ramon, California 94583
(925) 866-9669
(925) 866-7137 Fax

Orange County Division
36 Technology Drive, Suite 150
Irvine, California 92618
(949) 790-9100
(949) 790-9119 Fax

Phoenix Division
Two Gateway
432 North 44th Street #115
Phoenix, Arizona 85008
(602) 306-1000
(602) 306-1010 Fax

San Diego Division
12235 El Camino Real, Suite 100
San Diego, California 92130
(619) 259-6000
(619) 259-5108 Fax

South Bay Division
2201 Walnut Avenue, Suite 150
Fremont, California 94538
(510) 792-2900
(510) 792-5262 Fax

Texas Region
Austin Division
11911 Burnet Road
Austin, Texas 78758
(512) 833-8880
(512) 833-9850 Fax

Dallas Division
2611 Westgrove, Suite 101
Carrollton, Texas 75006
(972) 267-0700
(972) 267-0701 Fax

Houston Division
9990 Richmond Suite 400
Houston, Texas 77042
(713) 977-6633
(713) 977-6678 Fax

San Antonio Division
4800 Fredericksburg Road
San Antonio, Texas 78229
(210) 349-1111
(210) 344-7511 Fax

Tucson Division
5780 N. Swan Road, Suite 100
Tucson, Arizona 85718
(520) 577-7007
(520) 299-2725 Fax

Utah Division
1225 East Fort Union Boulevard
Suite 215
Midvale, Utah 84047
(801) 561-4500
(801) 561-4608 Fax

International

Kaufman and Broad France
Tour Maine Montparnasse
33 Avenue due Maine
75755 Paris, Cedex 15
011-331-4-538-2000
011-331-4-538-2250 Fax

Kaufman y Broad de Mexico
Andres Bello #45, Piso 22
Col. Polanco CP
11560 Mexico, D.F.
011-525-280-6222
011-525-280-6833 Fax

SMCI
44 rue Washington
75008 PARIS
011-331-45-61-70-00
011-331-45-61-72-75 Fax

STOCKHOLDER INFORMATION

Common Stock Prices

	1998		1997	
	High	Low	High	Low
First Quarter	$26 7/8	$20 5/16	$14 5/8	$11 3/4
Second Quarter	34 1/2	22 5/16	15 1/4	12 7/8
Third Quarter	35	21 3/8	22 1/8	14 3/4
Fourth Quarter	31 1/4	17 1/8	23 1/8	18 15/16

Dividend Data

Kaufman and Broad Home Corporation paid a quarterly cash dividend of $.075 per common share in 1998 and 1997.

Annual Stockholders' Meeting

The annual stockholders' meeting will be held at the Company's offices at 10990 Wilshire Boulevard, Seventh Floor, in Los Angeles, California, at 9:00 a.m. on Thursday, April 1, 1999.

Stock Exchange Listings

The Company's common stock (ticker symbol: KBH) is listed on the New York Stock Exchange and is also traded on the Boston, Cincinnati, Midwest, Pacific and Philadelphia Exchanges.

Transfer Agent

ChaseMellon Shareholder Services
85 Challenger Road
Ridgefield Park, New Jersey 07660
(800) 356-2017
www.chasemellon.com

Independent Auditors

Ernst & Young LLP
Los Angeles, California

Shareholder Information

Kaufman and Broad Home Corporation common stock is traded on the New York Stock Exchange under the symbol KBH. There were approximately 47,898,793 shares outstanding as of February 1, 1999.

Form 10-K

The Company's Report on Form 10-K filed with the Securities and Exchange Commission may be obtained without charge by writing to Investor Relations, Kaufman and Broad Home Corporation or by calling 1-888-KBH-NYSE toll free.

Company Information

News and earnings releases may be obtained at no charge by facsimile. Call 1-888-KBH-NYSE toll free. Company information may also be obtained on-line through Company News On Call at HYPERLINK www.prnewswire.com.

Headquarters

Kaufman and Broad Home Corporation
10990 Wilshire Boulevard, Seventh Floor
Los Angeles, California 90024
(310) 231-4000
(310) 231-4222 Fax
www.kaufmanandbroad.com
Location and Community Information:
(800) 34-HOMES

Investor Contact

Mary M. McAboy
Vice President, Investor Relations
Kaufman and Broad Home Corporation
10990 Wilshire Boulevard, Seventh Floor
Los Angeles, California 90024
(310) 231-4033
mmcaboy@kbhomes.com

Bondholder Services Addresses & Phone Numbers

8 1/4% $189,750,000 FELINE PRIDES – Due 8/16/01
Trustee:
The First National Bank of Chicago
Corporate Trust Investor Relations
One First National Plaza
Mail Suite 0126
Chicago, Illinois 60670-0126
bondholder@em.fcnbd.com
(800) 524-9472

9 3/8% $175,000,000 Note – Due 5/1/03
Trustee:
State Street Bank and Trust Company
of California, N.A.
Corporate Trust Department
633 West 5th Street, 12th Floor
Los Angeles, California 90071
corporatetrust.statestreet.com
(800) 531-0368

7 3/4% $175,000,000 Note – Due 10/15/04
9 5/8% $125,000,000 Note – Due 11/15/06
Trustee:
Sun Trust Bank, Atlanta
Corporate Trust Division
3495 Piedmont Road
Building 10, Suite 810
Atlanta, Georgia 30305
(800) 711-1614