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Form 10-Q
July 10, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended May 31, 2008.

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from [ ] to [ ].

Commission File No. 001-09195

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(Exact name of registrant as specified in its charter)

Delaware	95-3666267
(State of incorporation)	(IRS employer identification number)

10990 Wilshire Boulevard
Los Angeles, California 90024
(310) 231-4000
(Address and telephone number of principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of May 31, 2008.
Common stock, par value $1.00 per share: 89,605,999 shares outstanding, including 12,091,182 shares held by the Registrant s Grantor Stock Ownership Trust and excluding 25,483,921 shares held in treasury.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

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CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Amounts Unaudited)

	Six Months Ended May 31,		Three Months Ended May 31,	
	2008	2007	2008	2007
Total revenues	$ 1,433,289	$ 2,802,046	$ 639,065	$ 1,413,208
Homebuilding:				
Revenues	$ 1,428,402	$ 2,794,635	$ 637,094	$ 1,409,986
Construction and land costs	(1,668,481)	(2,655,684)	(755,840)	(1,479,405)
Selling, general and administrative expenses	(246,703)	(398,807)	(119,065)	(193,585)
Goodwill impairment	(24,570)		(24,570)	
Operating loss	(511,352)	(259,856)	(262,381)	(263,004)
Interest income	22,554	10,268	9,522	5,600
Equity in loss of unconsolidated joint ventures	(45,361)	(41,700)	(5,483)	(39,495)
Homebuilding pretax loss	(534,159)	(291,288)	(258,342)	(296,899)
Financial services:				
Revenues	4,887	7,411	1,971	3,222
Expenses	(2,232)	(2,411)	(1,113)	(1,071)
Equity in income of unconsolidated joint venture	8,302	10,191	2,154	3,396
Financial services pretax income	10,957	15,191	3,012	5,547
Loss from continuing operations before income taxes	(523,202)	(276,097)	(255,330)	(291,352)
Income tax benefit (expense)	(900)	112,600	(600)	117,200
Loss from continuing operations	(524,102)	(163,497)	(255,930)	(174,152)
Income from discontinued operations, net of income taxes		42,348		25,466
Net loss	$ (524,102)	$ (121,149)	$ (255,930)	$ (148,686)
Basic earnings (loss) per share:				
Continuing operations	$ (6.77)	$ (2.12)	$ (3.30)	$ (2.26)
Discontinued operations		.55		.33
Basic loss per share	$ (6.77)	$ (1.57)	$ (3.30)	$ (1.93)
Diluted earnings (loss) per share:				
Continuing operations	$ (6.77)	$ (2.12)	$ (3.30)	$ (2.26)

Discontinued operations		.55		.33
Diluted loss per share	$ (6.77)	$ (1.57)	$ (3.30)	$ (1.93)
Basic average shares outstanding	77,413	77,046	77,462	77,102
Diluted average shares outstanding	77,413	77,046	77,462	77,102
Cash dividends declared per common share	$ .75	$ .50	$ .50	$ .25

See accompanying notes.

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CONSOLIDATED BALANCE SHEETS
(In Thousands)

	May 31, 2008 (unaudited)	November 30, 2007
Assets		
Homebuilding:		
Cash and cash equivalents	$ 1,305,077	$ 1,325,255
Receivables	190,010	295,739
Inventories	2,608,823	3,312,420
Investments in unconsolidated joint ventures	294,504	297,010
Deferred income taxes	222,458	222,458
Goodwill	43,400	67,970
Other assets	123,500	140,712
	4,787,772	5,661,564
Financial services	53,236	44,392
Total assets	$ 4,841,008	$ 5,705,956
Liabilities and stockholders equity		
Homebuilding:		
Accounts payable	$ 609,989	$ 699,851
Accrued expenses and other liabilities	778,261	975,828
Mortgages and notes payable	2,161,220	2,161,794
	3,549,470	3,837,473
Financial services	17,109	17,796
Common stock	115,090	114,976
Paid-in capital	859,258	851,628
Retained earnings	1,384,218	1,968,881
Accumulated other comprehensive loss	(22,923)	(22,923)
Grantor stock ownership trust, at cost	(131,390)	(132,608)
Treasury stock, at cost	(929,824)	(929,267)
Total stockholders equity	1,274,429	1,850,687
Total liabilities and stockholders equity	$ 4,841,008	$ 5,705,956

See accompanying notes.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands Unaudited)

	Six Months Ended May 31, 2008	2007
Cash flows from operating activities:		
Net loss	$ (524,102)	$ (121,149)
Income from discontinued operations, net of income taxes		(42,348)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Equity in loss of unconsolidated joint ventures	37,059	41,804
Distributions of earnings from unconsolidated joint ventures	8,975	12,427
Amortization of discounts and issuance costs	1,180	1,274
Depreciation and amortization	5,161	9,060
Provision for deferred income taxes		(117,634)
Tax benefit associated with exercise of stock options	2,046	(705)
Stock-based compensation expense	2,631	3,561
Inventory and joint venture impairments and land option contract abandonments	400,462	316,882
Goodwill impairment	24,570	
Changes in assets and liabilities:		
Receivables	107,594	(9,104)
Inventories	218,121	76,307
Accounts payable, accrued expenses and other liabilities	(188,471)	(267,463)
Other, net	10,008	24,811
Net cash provided (used) by operating activities continuing operations	105,234	(72,277)
Net cash provided by operating activities discontinued operations		188,223
Net cash provided by operating activities	105,234	115,946
Cash flows from investing activities:		
Investments in unconsolidated joint ventures	(97,704)	(86,730)
Sales (purchases) of property and equipment, net	4,378	(3,891)
Net cash used by investing activities continuing operations	(93,326)	(90,621)
Net cash used by investing activities discontinued operations		(14,720)
Net cash used by investing activities	(93,326)	(105,341)
Cash flows from financing activities:		
Payments on mortgages, land contracts and other loans	(1,335)	(113,246)
Issuance of common stock under employee stock plans	3,593	8,276
Excess tax benefit associated with exercise of stock options		705
Payments of cash dividends	(38,723)	(38,533)
Repurchases of common stock	(557)	(4,238)
Net cash used by financing activities continuing operations	(37,022)	(147,036)
Net cash used by financing activities discontinued operations		(196,139)

Net cash used by financing activities	(37,022)	(343,175)
Net decrease in cash and cash equivalents	(25,114)	(332,570)
Cash and cash equivalents at beginning of period	1,343,742	804,182
Cash and cash equivalents at end of period	$ 1,318,628	$ 471,612

See accompanying notes.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted.

In the opinion of KB Home (the Company), the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the Company s consolidated financial position as of May 31, 2008, the results of its consolidated operations for the six months and three months ended May 31, 2008 and 2007, and its consolidated cash flows for the six months ended May 31, 2008 and 2007. The results of consolidated operations for the six months and three months ended May 31, 2008 are not necessarily indicative of the results to be expected for the full year. The consolidated balance sheet at November 30, 2007 has been taken from the audited consolidated financial statements as of that date. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended November 30, 2007, which are contained in the Company s Annual Report on Form 10-K for that period.

Earnings (loss) per share

Basic earnings (loss) per share is calculated by dividing net income (loss) by the average number of common shares outstanding for the period. Diluted earnings (loss) per share is calculated by dividing net income (loss) by the average number of common shares outstanding including all potentially dilutive shares issuable under outstanding stock options. All outstanding stock options were excluded from the diluted loss per share calculation for the six months and three months ended May 31, 2008 and 2007 because the effect of their inclusion would be antidilutive, or would decrease the reported loss per share.

The following table presents a reconciliation of average shares outstanding (in thousands):

	Six Months Ended May 31,		Three Months Ended May 31,	
	2008	2007	2008	2007
Basic average shares outstanding	77,413	77,046	77,462	77,102
Net effect of stock options assumed to be exercised				
Diluted average shares outstanding	77,413	77,046	77,462	77,102

Comprehensive loss

The following table presents the components of comprehensive loss (in thousands):

Six Months Ended May 31,

			Three Months Ended May 31,	
	2008	2007	2008	2007
Net loss	$ (524,102)	$ (121,149)	$ (255,930)	$ (148,686)
Foreign currency translation adjustment		4,956		5,353
Comprehensive loss	$ (524,102)	$ (116,193)	$ (255,930)	$ (143,333)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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1. Basis of Presentation and Significant Accounting Policies (continued)

The balances of accumulated other comprehensive loss reported in the consolidated balance sheets as of May 31, 2008 and November 30, 2007 are comprised solely of an adjustment of $22.9 million recorded directly to accumulated other comprehensive loss at the end of 2007 to initially apply Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R), which requires an employer to recognize the funded status of a defined postretirement benefit plan as an asset or liability on the balance sheet and requires any unrecognized prior service costs and actuarial gains/losses to be recognized in accumulated other comprehensive income (loss).

Reclassifications

Certain amounts in the consolidated financial statements of prior periods have been reclassified to conform to the 2008 presentation.

2. Stock-Based Compensation

The Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment (SFAS No. 123(R)), using the modified prospective transition method effective December 1, 2005. SFAS No. 123(R) requires a public entity to measure compensation cost associated with awards of equity instruments based on the grant-date fair value of the awards over the requisite service period. SFAS No. 123(R) requires public entities to initially measure compensation cost associated with awards of liability instruments based on their current fair value. The fair value of that award is to be remeasured subsequently at each reporting date through the settlement date. Changes in fair value during the requisite service period will be recognized as compensation cost over that period.

Stock Options

In accordance with SFAS No. 123(R), the Company estimates the grant-date fair value of its stock options using the Black-Scholes option-pricing model, which takes into account assumptions regarding the dividend yield, the risk-free interest rate, the expected stock-price volatility and the expected term of the stock options. The following table summarizes the stock options outstanding as of May 31, 2008 as well as activity during the six months then ended:

	Options		Weighted Average Exercise Price
Options outstanding at beginning of period	8,173,464	$	30.17
Exercised	(113,635)		20.39
Cancelled	(112,598)		44.43
Options outstanding at end of period	7,947,231	$	30.11
Options exercisable at end of period	7,127,745	$	29.02

As of May 31, 2008, the weighted average remaining contractual life of stock options outstanding and stock options exercisable was 9.6 years. There was $4.5 million of total unrecognized compensation cost related to unvested stock option awards as of May 31, 2008. For the three months ended May 31, 2008 and 2007, stock-based compensation expense associated with stock options totaled $1.3 million and $1.7 million, respectively. For the six months ended May 31, 2008 and 2007, stock-based compensation expense totaled $2.6 million and $3.5 million, respectively. The aggregate intrinsic value of both stock options outstanding and stock options exercisable was $9.2 million as of May 31, 2008. (The intrinsic value of a stock option is the amount by which

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2. Stock-Based Compensation (continued)

the market value of a share of the Company s common stock exceeds the exercise price of the stock option.) The intrinsic value of stock options exercised during the six months ended May 31, 2008 was $.7 million.

Other Stock-Based Awards

From time to time, the Company grants restricted stock, phantom shares and stock appreciation rights to various employees. The Company recognized total compensation expense of $3.7 million in the three months ended May 31, 2008 and $1.1 million in the three months ended May 31, 2007 related to these stock-based awards. The Company recognized total compensation expense of $6.6 million in the six months ended May 31, 2008 and $2.3 million in the six months ended May 31, 2007 related to restricted stock, phantom shares and stock appreciation rights.

3. Segment Information

As of May 31, 2008, the Company has identified five reporting segments, comprised of four homebuilding reporting segments and one financial services reporting segment, within its consolidated operations in accordance with Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information. As of May 31, 2008, the Company s homebuilding reporting segments conducted ongoing operations in the following states:

West Coast: California
Southwest: Arizona and Nevada
Central: Colorado and Texas
Southeast: Florida, Georgia, North Carolina and South Carolina

The Company s homebuilding reporting segments are engaged in the acquisition and development of land primarily for residential purposes and offer a wide variety of homes that are designed to appeal to first-time, first move-up and active adult buyers.

The Company s homebuilding reporting segments were identified based primarily on similarities in economic and geographic characteristics, as well as similar product type, regulatory environments, methods used to sell and construct homes and land acquisition characteristics. The Company evaluates segment performance primarily based on pretax income.

The Company s financial services reporting segment provides title and insurance services to the Company s homebuyers and provided escrow coordination services until the second quarter of 2007, when the Company terminated the escrow coordination business. The financial services reporting segment also provides mortgage banking services to the Company s homebuyers indirectly through Countrywide KB Home Loans, a joint venture with Countrywide Financial Corporation (Countrywide). On July 1, 2008, Bank of America Corporation completed its purchase of Countrywide. At this time, the Company believes this transaction will not have a material effect on the joint venture s activities. The Company s financial services reporting segment conducts operations in the same markets as the Company s homebuilding reporting segments.

The Company s reporting segments follow the same accounting policies used for the Company s consolidated financial statements. Operational results of each segment are not necessarily indicative of the results that would have occurred had the segment operated as an independent, stand-alone entity during the periods presented.

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3. Segment Information (continued)

The following tables present financial information relating to the Company s reporting segments (in thousands):

	Six Months Ended May 31, 2008	Six Months Ended May 31, 2007	Three Months Ended May 31, 2008	Three Months Ended May 31, 2007
Revenues:				
West Coast	$ 440,939	$ 922,296	$ 199,863	$ 501,817
Southwest	364,201	671,698	122,354	332,202
Central	300,475	449,340	148,586	216,678
Southeast	322,787	751,301	166,291	359,289
Total homebuilding revenues	1,428,402	2,794,635	637,094	1,409,986
Financial services	4,887	7,411	1,971	3,222
Total revenues	$ 1,433,289	$ 2,802,046	$ 639,065	$ 1,413,208
Income (loss) from continuing operations before income taxes:				
West Coast	$ (173,436)	$ (181,716)	$ (110,236)	$ (196,289)
Southwest	(118,080)	29,574	(62,653)	(2,141)
Central	(41,780)	(33,405)	(11,838)	(18,894)
Southeast	(144,892)	(38,857)	(40,779)	(47,807)
Corporate and other (a)	(55,971)	(66,884)	(32,836)	(31,768)
Total homebuilding loss from continuing operations before income taxes	(534,159)	(291,288)	(258,342)	(296,899)
Financial services	10,957	15,191	3,012	5,547
Total loss from continuing operations before income taxes	$ (523,202)	$ (276,097)	$ (255,330)	$ (291,352)
Interest cost:				
West Coast	$ 16,317	$ 14,047	$ 8,354	$ 11,121
Southwest	14,939	17,265	8,097	8,230
Central	9,425	11,107	4,751	6,178
Southeast	13,595	9,727	7,923	4,705
Corporate and other	622	1,452	(2,803)	(2,409)

Total (b)	$ 54,898	$ 53,598	$ 26,322	$ 27,825

(a) Corporate and other includes corporate general and administrative expenses.

(b) Interest cost for the three months ended May 31, 2008 and 2007 represents $26.3 million and $27.8 million, respectively, of interest amortized in construction and land costs. Interest cost for the six months ended May 31, 2008 and 2007 represents $54.9 million and $53.6 million, respectively, of interest amortized in construction and land costs.

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3. Segment Information (continued)

	Six Months Ended May 31,		Three Months Ended May 31,	
	2008	2007	2008	2007
Equity in income (loss) of unconsolidated joint ventures:				
West Coast	$ (10,806)	$ (7,760)	$ (1,432)	$ (6,196)
Southwest	(6,016)	5,269	(841)	5,207
Central	(4,594)	(1,740)	(3,080)	(1,311)
Southeast	(23,945)	(37,469)	(130)	(37,195)
Total	$ (45,361)	$ (41,700)	$ (5,483)	$ (39,495)
Inventory impairments:				
West Coast	$ 132,969	$ 203,192	$ 80,855	$ 202,260
Southwest	102,863	29,323	50,853	29,323
Central	20,539	8,204	3,254	7,904
Southeast	77,900	25,512	18,985	21,731
Total	$ 334,271	$ 266,231	$ 153,947	$ 261,218
Inventory abandonments:				
West Coast	$ 9,186	$ 6,730	$ 9,186	$ 5,035
Southwest	187	103		
Central		1,345		625
Southeast	18,304	1,166	11,240	
Total	$ 27,677	$ 9,344	$ 20,426	$ 5,660
Joint venture impairments:				
West Coast	$ 8,106	$ 3,650	$	$ 3,650
Southwest	4,944			
Central	2,629	750	2,158	750
Southeast	22,835	36,907		36,907
Total	$ 38,514	$ 41,307	$ 2,158	$ 41,307

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3. Segment Information (continued)

	May 31, 2008	November 30, 2007
Assets:		
West Coast	$ 1,267,931	$ 1,542,948
Southwest	653,434	887,361
Central	542,885	643,599
Southeast	677,718	845,679
Corporate and other	1,645,804	1,741,977
Total homebuilding assets	4,787,772	5,661,564
Financial services	53,236	44,392
Total assets	$ 4,841,008	$ 5,705,956
Investments in unconsolidated joint ventures:		
West Coast	$ 77,880	$ 63,450
Southwest	141,558	134,082
Central	2,651	7,230
Southeast	72,415	92,248
Total	$ 294,504	$ 297,010

4. Financial Services

The following table presents financial information related to the Company s financial services reporting segment (in thousands):

	Six Months Ended May 31,		Three Months Ended May 31,	
	2008	2007	2008	2007
Revenues				
Interest income	$ 105	$ 83	$ 58	$ 40
Title services	983	2,639	545	1,222
Insurance commissions	3,799	4,100	1,368	1,903
Escrow coordination fees		589		57
Total	4,887	7,411	1,971	3,222
Expenses				
General and administrative	(2,232)	(2,411)	(1,113)	(1,071)

Operating income	2,655	5,000	858	2,151
Equity in income of unconsolidated joint venture	8,302	10,191	2,154	3,396
Pretax income	$ 10,957	$ 15,191	$ 3,012	$ 5,547

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4. Financial Services (continued)

	May 31, 2008	November 30, 2007
Assets		
Cash and cash equivalents	$ 13,551	$ 18,487
Receivables	789	2,655
Investment in unconsolidated joint venture	38,801	23,140
Other assets	95	110
Total assets	$ 53,236	$ 44,392
Liabilities		
Accounts payable and accrued expenses	$ 17,109	$ 17,796
Total liabilities	$ 17,109	$ 17,796

5. Inventories

Inventories consist of the following (in thousands):

	May 31, 2008	November 30, 2007
Homes, lots and improvements in production	$ 2,156,256	$ 2,473,980
Land under development	452,567	838,440
Total	$ 2,608,823	$ 3,312,420

The Company s interest costs are as follows (in thousands):

	Six Months Ended May 31,		Three Months Ended May 31,	
	2008	2007	2008	2007
Capitalized interest at beginning of period	$ 348,084	$ 333,020	$ 358,010	$ 358,796
Interest incurred	76,905	102,889	38,403	51,340
Interest amortized	(54,898)	(53,598)	(26,322)	(27,825)
Capitalized interest at end of period	$ 370,091	$ 382,311	$ 370,091	$ 382,311

6. Impairments and Abandonments

Each parcel or community in the Company s owned inventory is assessed to determine if indicators of potential impairment exist. If indicators of potential impairment exist for a parcel or community, the identified inventory is evaluated for recoverability in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144). Impairment indicators are assessed separately for each parcel or community on a quarterly basis and include, but are not limited to: significant decreases in sales rates, average selling prices, home delivery volume or gross margins; significant increases in budgeted land development and construction costs or cancellation rates; or projected losses on expected future housing or land sales. When an indicator of potential impairment is identified, the Company tests the asset for recoverability by comparing the carrying amount of the asset to the undiscounted future net cash flows expected to be generated by the asset. The undiscounted future net cash flows are impacted by the Company s expectations related to: market supply and demand, including estimates concerning average selling prices; sales incentives; sales and cancellation rates; and anticipated land development, construction and

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(Unaudited)

6. Impairments and Abandonments (continued)

overhead costs to be incurred. These estimates are specific to each community and may vary among communities.

A real estate asset is considered impaired when its carrying amount is greater than the undiscounted future net cash flows the asset is expected to generate. Impaired real estate assets are written down to fair value, which is primarily based on the estimated future cash flows discounted for inherent risk associated with each asset. These discounted cash flows are impacted by: the risk-free rate of return; expected risk premium based on estimated land development, construction and delivery timelines; market risk from potential future price erosion; cost uncertainty due to development or construction cost increases; and other risks specific to the conditions in the market in which the asset is located at the time an assessment is made. These factors are specific to each community and may vary among communities.

Based on the results of its evaluations, the Company recognized pretax, non-cash inventory impairment charges of $154.0 million in the three months ended May 31, 2008 and $261.2 million in the three months ended May 31, 2007. In the six months ended May 31, 2008 and 2007, the Company recognized pretax, non-cash inventory impairment charges of $334.3 million and $266.2 million, respectively. As of May 31, 2008, the aggregate carrying value of inventory impacted by pretax, non-cash impairment charges was $1.38 billion, representing 156 communities and various other land parcels. As of November 30, 2007, the aggregate carrying value of inventory impacted by pretax, non-cash impairment charges was $1.35 billion, representing 144 communities and various other land parcels.

The Company s optioned inventory is assessed to determine whether it continues to meet the Company s internal investment standards. Assessments are made separately for each optioned parcel on a quarterly basis and are affected by, among other factors: current and/or anticipated sales rates, average selling prices, home delivery volume and gross margins; estimated land development and construction costs; and projected profitability on expected future housing or land sales. When a decision is made to not exercise a land option contract due to market conditions and/or changes in market strategy, the Company writes off the costs, including non-refundable deposits and pre-acquisition costs, related to the abandoned project. The Company recognized abandonment charges associated with land option contracts of $20.4 million in the three months ended May 31, 2008 and $5.7 million in the three months ended May 31, 2007. In the six months ended May 31, 2008 and 2007, the Company recognized abandonment charges of $27.7 million and $9.4 million, respectively. The inventory impairment charges and land option contract abandonment charges are included in construction and land costs in the Company s consolidated statements of operations.

Due to the judgment and assumptions applied in the estimation process with respect to impairments and abandonments, it is possible that actual results could differ from those estimated.

The Company s equity in loss of unconsolidated joint ventures in the three months ended May 31, 2008 and 2007 reflected pretax, non-cash impairment charges of $2.1 million and $41.3 million, respectively, including valuation adjustments related to the Company s investments in certain unconsolidated joint ventures. In the six months ended May 31, 2008 and 2007, the Company s equity in loss of unconsolidated joint ventures reflected pretax, non-cash impairment charges of $38.5 million and $41.3 million, respectively, including valuation adjustments related to the Company s investments in certain unconsolidated joint ventures.

7. Consolidation of Variable Interest Entities

In December 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities (FASB Interpretation No. 46(R)), to clarify the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities, called variable interest entities (VIEs), in which equity investors do not have the characteristics of a controlling interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. Under FASB Interpretation No. 46(R), an enterprise that absorbs a majority of the VIE s expected

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7. Consolidation of Variable Interest Entities (continued)

losses, receives a majority of the VIE s expected residual returns, or both, is considered to be the primary beneficiary of the VIE and must consolidate the entity in its financial statements.

The Company enters into joint ventures from time to time for the purpose of conducting land acquisition, development and other homebuilding activities. Its investments in these joint ventures may create a variable interest in a VIE, depending on the contractual terms of the arrangement. The Company analyzes its joint ventures in accordance with FASB Interpretation No. 46(R) when they are entered into or upon a reconsideration event. All of the Company s joint ventures at May 31, 2008 and November 30, 2007 were determined to be unconsolidated joint ventures because either they were not VIEs, or, if they were VIEs, the Company was not the primary beneficiary of the VIEs.

In the ordinary course of its business, the Company enters into land option contracts in order to procure land for the construction of homes. The use of such option agreements generally allows the Company to reduce the risks associated with direct land ownership and development, reduces the Company s capital and financial commitments, including interest and other carrying costs, and minimizes the amount of the Company s land inventories on its consolidated balance sheet. Under such land option contracts, the Company will pay a specified option deposit or earnest money deposit in consideration for the right to purchase land in the future, usually at a predetermined price. Under the requirements of FASB Interpretation No. 46(R), certain of the Company s land option contracts may create a variable interest for the Company, with the land seller being identified as a VIE.

In compliance with FASB Interpretation No. 46(R), the Company analyzes its land option contracts and other contractual arrangements when they are entered into or upon a reconsideration event, and as a result has consolidated the fair value of certain VIEs from which the Company is purchasing land under option contracts. Although the Company does not have legal title to the optioned land, FASB Interpretation No. 46(R) requires the Company to consolidate the VIE if the Company is determined to be the primary beneficiary. The consolidation of VIEs in which the Company was determined to be the primary beneficiary increased inventories, with a corresponding increase to accrued expenses and other liabilities, on the Company s consolidated balance sheets by $15.5 million at May 31, 2008 and $19.0 million at November 30, 2007. The liabilities related to the Company s consolidation of VIEs from which it is purchasing land under option contracts represents the difference between the purchase price of optioned land not yet purchased and the Company s cash deposits. The Company s cash deposits related to these land option contracts totaled $3.4 million at May 31, 2008 and $4.7 million at November 30, 2007. Creditors, if any, of these VIEs have no recourse against the Company. As of May 31, 2008, excluding consolidated VIEs, the Company had cash deposits totaling $26.3 million, which were associated with land option contracts having an aggregate purchase price of $680.6 million.

The Company also evaluates land option contracts in accordance with Statement of Financial Accounting Standards No. 49, Accounting for Product Financing Arrangements (SFAS No. 49) and, as a result of its evaluations, increased inventories, with a corresponding increase to accrued expenses and other liabilities, on its consolidated balance sheets by $101.0 million at May 31, 2008 and $221.1 million at November 30, 2007.

8. Goodwill

The Company has recorded goodwill in connection with various acquisitions in prior years. Goodwill represents the excess of the purchase price over the fair value of net assets acquired. In accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS No. 142), the Company tests goodwill for potential impairment annually as of November 30 and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

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8. Goodwill (continued)

During the quarter ended May 31, 2008, the Company determined that it was necessary to evaluate goodwill for impairment due to deteriorating conditions in certain housing markets and the significant inventory impairments the Company identified and recognized during the quarter in accordance with SFAS No. 144. The Company evaluates goodwill for impairment using the two-step process prescribed in SFAS No. 142. The first step is to identify potential impairment by comparing the fair value of a reporting unit to the book value, including goodwill. If the fair value of a reporting unit exceeds the book value, goodwill is not considered impaired. If the book value exceeds the fair value, the second step of the process is performed to measure the amount of impairment. In accordance with SFAS No. 142, the Company has determined that its reporting units are the same as its reporting segments.

The Company s goodwill balance at November 30, 2007 totaled $68.0 million. Of this total, $24.6 million related to the Company s Central reporting segment and $43.4 million related to its Southeast reporting segment. Based on the results of its impairment evaluation performed as of April 30, 2008, the Company recorded an impairment charge of $24.6 million in the quarter ended May 31, 2008 related to its Central reporting segment, where all of the goodwill previously recorded was determined to be impaired. The charge was recorded at the Company s corporate level because all goodwill is carried at that level. The Company s goodwill balance of $43.4 million at May 31, 2008 related entirely to its Southeast reporting segment.

The process of evaluating goodwill for impairment involves the determination of the fair value of the Company s reporting units. Inherent in such fair value determinations are certain judgments and estimates relating to future cash flows, including the Company s interpretation of current economic indicators and market valuations, and assumptions about the Company s strategic plans with regard to its operations. To the extent additional information arises, market conditions change or the Company s strategies change, it is possible that its conclusion regarding whether existing goodwill is impaired could change and result in a material effect on the Company s consolidated financial position or results of operations.

9. Commitments and Contingencies

The Company provides a limited warranty on all of its homes. The specific terms and conditions of warranties vary depending upon the market in which the Company does business. The Company generally provides a structural warranty of 10 years, a warranty on electrical, heating, cooling, plumbing and other building systems each varying from two to five years based on geographic market and state law, and a warranty of one year for other components of the home such as appliances. The Company estimates the costs that may be incurred under each limited warranty and records a liability in the amount of such costs at the time the revenue associated with the sale of each home is recognized. Factors that affect the Company s warranty liability include the number of homes delivered, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities, which are included in accrued expenses and other liabilities in the consolidated balance sheets, and adjusts the amounts as necessary based on its assessment.

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9. Commitments and Contingencies (continued)

The changes in the Company s warranty liability are as follows (in thousands):

	Six Months Ended May 31,		Three Months Ended May 31,	
	2008	2007	2008	2007
Balance at beginning of period	$ 151,525	$ 141,060	$ 150,917	$ 139,672
Warranties issued	10,769	26,478	3,834	13,752
Payments and adjustments	(16,244)	(26,863)	(8,701)	(12,749)
Balance at end of period	$ 146,050	$ 140,675	$ 146,050	$ 140,675

In the normal course of its business, the Company issues certain representations, warranties and guarantees related to its home sales and land sales that may be affected by FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. Based on historical evidence, the Company does not believe any of these representations, warranties or guarantees would result in a material effect on its consolidated financial position or results of operations.

The Company has, and requires the majority of its subcontractors to have, general liability insurance (including construction defect coverage) and workers compensation insurance. These insurance policies protect the Company against a portion of its risk of loss from claims related to its homebuilding activities, subject to certain self-insured retentions, deductibles and other coverage limits. The Company self-insures a portion of its overall risk through the use of a captive insurance subsidiary. The Company records expenses and liabilities based on the costs required to cover its self-insured retention and deductible amounts under its insurance policies, and on the estimated costs of potential claims and claim adjustment expenses above its coverage limits or not covered by its policies. These estimated costs are based on an analysis of the Company s historical claims and include an estimate of construction defect claims incurred but not yet reported. The Company s estimated liabilities for such items were $99.3 million at May 31, 2008 and $95.6 million at November 30, 2007, and are included in the consolidated balance sheets as accrued expenses and other liabilities.

The Company is often required to obtain performance bonds and letters of credit in support of its obligations to various municipalities and other government agencies in connection with subdivision improvements such as roads, sewers and water. At May 31, 2008, the Company had approximately $868.7 million of performance bonds and $210.1 million of letters of credit outstanding. In the event any such performance bonds or letters of credit are called, the Company would be obligated to reimburse the issuer of the performance bond or letter of credit. At this time, the Company does not believe that a material amount of any currently outstanding performance bonds or letters of credit will be called. The expiration dates of letters of credit coincide with the expected completion dates of the related projects. If the obligations related to a project are ongoing, annual extensions of the letters of credit are typically granted on a year-to-year basis. Performance bonds do not have stated expiration dates. Rather, the Company is released from the performance bonds as the contractual performance is completed.

Borrowings outstanding and letters of credit issued under the Company s Credit Facility are guaranteed by certain of the Company s subsidiaries (the Guarantor Subsidiaries).

In the ordinary course of business, the Company enters into land option contracts to procure land for the construction of homes. At May 31, 2008, the Company had total deposits of $74.5 million, comprised of cash deposits of $29.7 million and letters of credit of $44.8 million, to purchase land with a total remaining purchase price of $696.1 million. The Company s land option contracts generally do not contain provisions requiring the Company s specific performance.

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9. Commitments and Contingencies (continued)

The Company conducts a portion of its land acquisition, development and other homebuilding activities through participation in unconsolidated joint ventures in which it holds less than a controlling interest. These unconsolidated joint ventures generally operate in certain markets where the Company s consolidated homebuilding operations are located. Through these unconsolidated joint ventures, the Company seeks to reduce and share market and development risks and also reduce the amount of capital it invests in land inventory, while increasing the number of homesites it may own or control. In some instances, participating in unconsolidated joint ventures enables the Company to acquire and develop land that it might not otherwise obtain or have access to due to the project s size, financing needs, duration of improvements or other conditions or circumstances. These unconsolidated joint ventures are typically structured through entities in which ownership is shared with the Company s partners. The Company s partners in these unconsolidated joint ventures are usually unrelated homebuilders, land developers and other real estate entities. While the Company views its participation in unconsolidated joint ventures as beneficial to its homebuilding activities, it does not view such participation as essential.

The Company and/or its unconsolidated joint venture partners typically obtain options or enter into other arrangements to purchase portions of the land held by the unconsolidated joint ventures. The prices for these land options are generally negotiated prices that approximate fair market value. The Company does not include in its income from unconsolidated joint ventures its pro rata share of unconsolidated joint venture earnings resulting from land sales to its homebuilding operations. The Company defers recognition of its share of such unconsolidated joint venture earnings until a home sale is closed and title passes to a homebuyer, at which time it accounts for those earnings as a reduction of the cost of purchasing the land from the unconsolidated joint ventures.

The Company and its unconsolidated joint venture partners make capital contributions to these unconsolidated joint ventures, typically on a pro-rata basis. The obligation to make capital contributions is governed by each unconsolidated joint venture s respective operating agreement. The Company s equity investment in these unconsolidated joint ventures totaled $294.5 million at May 31, 2008 and $297.0 million at November 30, 2007. These unconsolidated joint ventures had total assets of $2.39 billion at May 31, 2008 and $2.51 billion at November 30, 2007. At May 31, 2008, the Company s five largest unconsolidated joint ventures collectively represented approximately 78% of the Company s total investment in unconsolidated joint ventures.

Given the varied nature of the Company s unconsolidated joint ventures projects and the market environments in which they operate, each has distinct funding and liquidity needs. To finance their respective land acquisition and development activities, many of the Company s unconsolidated joint ventures have obtained loans from third-party lenders that are secured by the underlying property and related project assets. Unconsolidated joint ventures had outstanding debt, substantially all of which was secured, of approximately $1.50 billion at May 31, 2008 and $1.54 billion at November 30, 2007.

In certain instances, the Company and the other partners in an unconsolidated joint venture provide guarantees and indemnities to the unconsolidated joint venture s lenders that may include a pro rata share of one or more of the following: (a) the physical completion of improvements for a project and/or the obligation to contribute equity to the unconsolidated joint venture to enable it to fund its completion obligations, which the Company refers to as a completion guaranty; (b) the payment of (i) losses a lender suffers due to certain bad acts or omissions by an unconsolidated joint venture or its partners, such as fraud or misappropriation, or due to environmental liabilities arising with respect to the project, or (ii) outstanding principal and interest and certain other amounts owed to lenders upon the filing by the unconsolidated joint venture of a voluntary bankruptcy petition or the filing of an involuntary bankruptcy petition by creditors of the unconsolidated joint venture in which the unconsolidated joint venture or its partners collude or which the unconsolidated joint venture fails to contest, each of which the Company refers to as a carve-out guaranty; and/or (c) the payment of funds to maintain the value of the unconsolidated joint venture s secured collateral (generally land and improvements) at or above a specific percentage of the outstanding loan balance, which the Company refers to as a loan-to-value maintenance guaranty. In most cases, the extent of each of the Company s and its partners maximum potential exposure to an unconsolidated joint venture s obligations under these guarantees and indemnities is

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9. Commitments and Contingencies (continued)

limited to either a specified maximum amount or an amount equal to their respective pro rata interests in the relevant unconsolidated joint venture. In a few cases, the Company has provided a loan-to-value maintenance guaranty to an unconsolidated joint venture s lenders up to a specified maximum amount and has entered into an agreement with its unconsolidated joint venture partners to be reimbursed for any amounts the Company may pay pursuant to such guaranty above its pro rata interest in the relevant unconsolidated joint venture. If the Company s unconsolidated joint venture partners do not have adequate resources to fulfill their reimbursement obligations, or otherwise fail to do so, the Company may be responsible for more than its pro rata share, up to its maximum exposure under the relevant loan-to-value maintenance guaranty. However, the Company will vigorously pursue all rights and remedies available to it under the applicable agreements, at law or in equity to enforce its reimbursement rights.

The Company s potential exposure under its completion guarantees is limited to the amount, if any, by which an unconsolidated joint venture s outstanding borrowings exceed the value of its assets, though in the aggregate the Company believes its actual exposure under these guarantees will be substantially less than this amount. At this time, the Company has no reason to believe that its carve-out guarantees will be triggered in any material amount. At May 31, 2008, the Company s pro rata share of loan-to-value maintenance guarantees to lenders of unconsolidated joint venture debt totaled approximately $108.2 million. This amount represents the Company s maximum exposure to loss from such loan-to-value maintenance guarantees without regard to the underlying value of the collateral and any defenses that may be available to the Company against any attempted enforcement of such guarantees.

In addition to the above-described guarantees and indemnities, the Company has also provided a several guaranty to the lenders of one of the Company s unconsolidated joint ventures. By its terms, the guaranty purports to guarantee the payment of principal and interest and certain other amounts owed to the unconsolidated joint venture s lenders in the event an involuntary bankruptcy proceeding is commenced against the unconsolidated joint venture that is not dismissed within 60 days or for which an order approving relief under bankruptcy law is entered, even if the unconsolidated joint venture or its partners do not collude in the filing and the unconsolidated joint venture contests the filing. The Company s potential exposure under this guaranty fluctuates with the outstanding balance of the unconsolidated joint venture s debt and with its and its partners respective land purchases from the unconsolidated joint venture. At May 31, 2008, this unconsolidated joint venture had total outstanding indebtedness of approximately $327.9 million and, if this guaranty was enforceable, the Company s potential exposure under the guaranty was approximately $182.7 million. This unconsolidated joint venture has received a series of notices from its lenders administrative agent alleging a number of defaults under its loan agreement. The Company is currently exploring resolutions of the matter with the lenders, the lenders administrative agent and its partners in this unconsolidated joint venture, but there can be no assurance that the Company will reach a satisfactory resolution with all of the parties involved.

Certain of the Company s other unconsolidated joint ventures operating in difficult market conditions are in default of their debt agreements with their lenders or are at risk of defaulting. The Company is carefully managing its investments in these particular unconsolidated joint ventures and is working with the relevant lenders and unconsolidated joint venture partners to reach satisfactory resolutions. However, based on the terms and amounts of the debt involved for these particular unconsolidated joint ventures and the terms of the applicable joint venture operating agreements, the Company does not believe that its exposure related to any defaults by these particular unconsolidated joint ventures is material to the Company s consolidated financial position or results of operations.

10. Legal Matters

Derivative Litigation

On July 10, 2006, a shareholder derivative action, Wildt v. Karatz, et al., was filed in Los Angeles Superior Court. On August 8, 2006, a virtually identical shareholder derivative lawsuit, Davidson v. Karatz, et al., was

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10. Legal Matters (continued)

also filed in Los Angeles Superior Court. These actions, which ostensibly are brought on behalf of the Company, allege, among other things, that defendants (various of the Company s current and former directors and officers) breached their fiduciary duties to the Company by, among other things, backdating grants of stock options to various current and former executives in violation of the Company s shareholder-approved stock option plans, and seek unspecified money damages and injunctive and other equitable relief. Defendants have not yet responded to the complaints. On January 22, 2007, the court entered an order, pursuant to an agreement among the parties and the Company, providing, among other things, that, to preserve the status quo without prejudicing any party s substantive rights, the Company s former Chairman and Chief Executive Officer shall not exercise any of his outstanding options, at any price, during the period in which the order is in effect. Pursuant to further stipulated orders, these terms remain in effect and are now scheduled to expire on September 3, 2008, unless otherwise agreed in writing. The plaintiffs have agreed to stay their cases while the parallel federal court derivative lawsuits discussed below are pursued. A stipulation and order effectuating the parties agreement to stay the state court actions was entered by the court on February 7, 2007. The parties may extend the agreement that options will not be exercised by the Company s former Chairman and Chief Executive Officer beyond the current September 3, 2008 expiration date.

On August 16, 2006, a shareholder derivative lawsuit, Redfield v. Karatz, et al., was filed in the United States District Court for the Central District of California. On August 31, 2006, a virtually identical shareholder derivative lawsuit, Staehr v. Karatz, et al., was also filed in the United States District Court for the Central District of California. These actions, which ostensibly are brought on behalf of the Company, allege, among other things, that defendants (various of the Company s current and former directors and officers) breached their fiduciary duties to the Company by, among other things, backdating grants of stock options to various current and former executives in violation of the Company s shareholder-approved stock option plans and seek unspecified money damages and injunctive and other equitable relief. Unlike Wildt and Davidson, however, these lawsuits also include substantive claims under the federal securities laws. On January 9, 2007, plaintiffs filed a consolidated complaint. All defendants filed motions to dismiss the complaint on April 2, 2007. Subsequently, plaintiffs filed a motion for partial summary judgment against certain of the defendants. Pursuant to stipulated orders, the motions to dismiss and the motion for partial summary judgment remained suspended for several months while the parties engaged in settlement discussions. Although settlement discussions are ongoing, activity in the litigation has recently recommenced. On May 14, 2008, the Court ordered that the partial summary judgment motion shall be taken off calendar, subject to being reset at a future time, following resolution of the pending motions to dismiss. Defendants various motions to dismiss are scheduled to be argued at a hearing on August 18, 2008. Discovery has not commenced. At this time, the Company has not concluded whether any potential outcome of the derivative litigation is likely to be material to its consolidated financial position or results of operations.

Government Investigations

In August 2006, the Company announced that it had received an informal inquiry from the SEC relating to its stock option grant practices. In January 2007, the Company was informed of the SEC s decision to conduct a formal investigation of this matter. The Department of Justice (DOJ) is also looking into these practices but has informed the Company that it is not a target of this investigation. The Company has cooperated with these government agencies and intends to continue to do so. At this time, the Company has not concluded whether an unfavorable outcome of one or both of the government investigations is likely to be material to its consolidated financial position or results of operations.

ERISA Litigation

On March 16, 2007, plaintiffs Reba Bagley and Scott Silver filed an action brought under Section 502 of the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1132, Bagley et al., v. KB Home, et al., in the United States District Court for the Central District of California. The action was brought against the Company, its directors, and certain of its current and former officers. After the Court allowed leave to file an amended complaint, on April 3, 2008, plaintiffs filed an amended complaint adding Tolan Beck and Rod

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10. Legal Matters (continued)

Hughes as additional plaintiffs and dismissing certain individuals as defendants. All four plaintiffs claim to be former employees of KB Home who participated in the KB Home 401(k) Savings Plan (Plan). Plaintiffs allege on behalf of themselves and on behalf of all others similarly situated that all defendants breached fiduciary duties owed to plaintiffs and purported class members under ERISA by failing to disclose information to and providing misleading information to participants in the Plan about alleged prior stock option backdating practices of the Company and by failing to remove the Company s stock as an investment option under the Plan. Plaintiffs allege that this breach of fiduciary duties caused plaintiffs to earn less on their Plan accounts than they would have earned but for defendants alleged breach of duties. Plaintiffs seek unspecified money damages and injunctive and other equitable relief. On May 16, 2008, the Company filed a motion to dismiss on the ground that plaintiffs allegations fail to state a claim against the Company. Plaintiffs filed an opposition to the motion on June 20, 2008. The Company filed its reply in support of the motion on July 7, 2008, and the hearing on the motion is scheduled for August 4, 2008. Because of the pendency of the Company s motion to dismiss (and a separate motion to dismiss filed by the individual defendants), no discovery has been taken in the lawsuit. While the Company believes it has strong defenses to the ERISA claims, it has not concluded whether an unfavorable outcome is likely to be material to its consolidated financial position or results of operations.

Storm Water Matter

In January 2003, the Company received a request for information from the Environmental Protection Agency (EPA) pursuant to Section 308 of the Clean Water Act. Several other public homebuilders received similar requests. The request sought information about storm water pollution control program implementation at certain of the Company s construction sites, and the Company provided information pursuant to the request. In May 2004, on behalf of the EPA, the DOJ asserted that certain regulatory requirements applicable to storm water discharges had been violated on certain occasions at certain of the Company s construction sites, and unspecified civil penalties and injunctive relief might be warranted. The Company explored with the EPA, DOJ and other homebuilders methods of resolving the matter. In May 2008, the Company signed a consent decree with the EPA, DOJ and various states affecting the Company s storm water pollution practices at its construction sites. Other homebuilders also signed similar consent decrees. In June 2008, the DOJ filed suit in the United States District Court for the Eastern District of Virginia (Civil Action No. 1:08CV603) and simultaneously submitted the Company s consent decree for approval by the court, which, if entered, will resolve the issues in the suit. The DOJ also published a notice of lodging of the Company s consent decree in the Federal Register (73 Fed. Reg. 35,711), which triggered the opening of a 30-day public comment period. After the public comment period, the DOJ will ask the court to sign and enter the Company s consent decree as final. The court may require a hearing before signing and entering the consent decree. The Company anticipates that its consent decree will become final during the third fiscal quarter. Under the consent decree, the Company has agreed to pay a civil penalty of $1.2 million and undertake certain storm management practices, among other items. The Company believes that the costs associated with implementing the consent decree are not likely to be material to its consolidated financial position or results of operations.

Other Matters

The Company is also involved in litigation and governmental proceedings incidental to its business. These cases are in various procedural stages and, based on reports of counsel, the Company believes that provisions or reserves made for potential losses are adequate and any liabilities or costs arising out of currently pending litigation should not have a materially adverse effect on its consolidated financial position or results of operations.

11. Stockholders Equity

As of May 31, 2008, the Company was authorized to repurchase four million shares of its common stock under a board-approved stock repurchase program. The Company did not repurchase any of its common stock under this program in the first half of 2008. The Company acquired $.6 million of common stock during the six

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11. Stockholders Equity (continued)

months ended May 31, 2008, which were previously issued shares delivered to the Company by employees to satisfy withholding taxes on the vesting of restricted stock awards. These transactions are not considered repurchases under the share repurchase program.

During the quarter ended February 29, 2008, the Company s board of directors declared a cash dividend of $.25 per share of common stock, which was paid on February 21, 2008 to shareholders of record on February 7, 2008. During the quarter ended May 31, 2008, the Company s board of directors declared a cash dividend of $.25 per share of common stock, which was paid on May 22, 2008 to shareholders of record on May 8, 2008, and declared a cash dividend of $.25 per share of common stock, which is payable on July 24, 2008 to shareholders of record on July 10, 2008.

12. Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157), which provides guidance for using fair value to measure assets and liabilities, defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. In February 2008, the FASB issued FASB Staff Position No. 157-2, Effective Date of FASB Statement No. 157, which delayed for one year the applicability of SFAS No. 157 s fair-value measurements to certain nonfinancial assets and liabilities. The Company adopted SFAS No. 157 in 2008, except as it applies to those nonfinancial assets and liabilities affected by the one-year delay. The partial adoption of SFAS No. 157 did not have a material impact on the Company s consolidated financial position or results of operations. The Company is currently evaluating the potential impact of adopting the remaining provisions of SFAS No. 157 on its consolidated financial position and results of operations.

13. Income Taxes

The Company s income tax expense from continuing operations totaled $.6 million in the second quarter of 2008, compared to an income tax benefit of $117.2 million in the second quarter of 2007. For the six months ended May 31, 2008, the Company s income tax expense from continuing operations totaled $.9 million compared to an income tax benefit of $112.6 million for the six months ended May 31, 2007. These amounts represented effective income tax rates from continuing operations of .2% and 40.2% for the three months ended May 31, 2008 and 2007, respectively, and ..2% and 40.8% for the six months ended May 31, 2008 and 2007, respectively.

The significant change in the Company s effective tax rate in 2008 resulted from no tax benefits being recorded in the three-month or six-month periods as a result of a full valuation allowance related to the Company s current year loss, and the recognition of a liability for unrecognized tax benefits. For the three months ended May 31, 2008, the Company recorded a valuation allowance of $98.9 million. For the six months ended May 31, 2008, the valuation allowance recorded totaled $198.9 million. In accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS No. 109), the Company was unable to record deferred tax benefits that would have reduced its net losses in the three months and six months ended May 31, 2008 due to the uncertainty of realizing such deferred tax assets.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FASB Interpretation No. 48), which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FASB Interpretation No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company implemented the provisions of FASB Interpretation No. 48 effective December 1, 2007. The

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13. Income Taxes (continued)

cumulative effect of the adoption of FASB Interpretation No. 48 was recorded in the first half of 2008 as a $2.5 million reduction to beginning retained earnings. Gross unrecognized tax benefits as of December 1, 2007 totaled $37.8 million. As of the date of its adoption of FASB Interpretation No. 48, the Company s liability for unrecognized tax benefits was $29.0 million, which, if recognized, would affect the Company s effective tax rate.

The Company estimates that within 12 months from the date of its adoption of FASB Interpretation No. 48, $6.0 million of unrecognized federal income tax liability will reverse due to the anticipated expiration of time to assess tax. As of the date of the Company s adoption of FASB Interpretation No. 48, fiscal years 2003 through 2007 remain subject to examination.

Since the Company s adoption of FASB Interpretation No. 48 on December 1, 2007, there have been no material changes to the components of the Company s total unrecognized tax benefit, including the amounts which, if recognized, would affect the Company s effective tax rate. It is reasonably possible that, within the next 12 months, total unrecognized tax benefits may decrease as a result of the potential resolution with the Internal Revenue Service relating to issues stemming from fiscal years 2004 and 2005. However, any such change cannot be estimated at this time.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in its consolidated financial statements as a component of the income tax provision consistent with the Company s historical accounting policy. After the adoption of FASB Interpretation No. 48 on December 1, 2007, the Company s total gross accrued interest and penalties was $16.5 million. At May 31, 2008, its total gross accrued interest and penalties was $17.6 million. The Company s liability for unrecognized tax benefits, combined with accrued interest and penalties, is reflected as a component of accrued expenses and other liabilities in its consolidated balance sheet.

14. Supplemental Disclosure to Statements of Cash Flows

The following are supplemental disclosures to the consolidated statements of cash flows (in thousands):

	Six Months Ended May 31,	
	2008	2007
Summary of cash and cash equivalents:		
Homebuilding	$ 1,305,077	$ 390,573
Financial services	13,551	14,951
Discontinued operations		66,088
Total	$ 1,318,628	$ 471,612
Supplemental disclosures of cash flow information:		
Interest paid, net of amounts capitalized	$ (263)	$ 7,819
Income taxes paid (refunded)	(105,737)	13,670

Supplemental disclosures of noncash activities:		
Cost of inventories acquired through seller financing	$	$ 4,139
Decrease in consolidated inventories not owned	(123,528)	(165,588)

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15. Supplemental Guarantor Information

The Company s obligations to pay principal, premium, if any, and interest under certain debt instruments are guaranteed on a joint and several basis by the Guarantor Subsidiaries. The guarantees are full and unconditional and the Guarantor Subsidiaries are 100% owned by the Company. The Company has determined that separate, full financial statements of the Guarantor Subsidiaries would not be material to investors and, accordingly, supplemental financial information for the Guarantor Subsidiaries is presented.

Condensed Consolidating Statements of Operations
Six Months Ended May 31, 2008 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Revenues	$	$ 1,103,933	$ 329,356	$	$ 1,433,289
Homebuilding:					
Revenues	$	$ 1,103,933	$ 324,469	$	$ 1,428,402
Construction and land costs		(1,274,907)	(393,574)		(1,668,481)
Selling, general and administrative expenses	(37,430)	(141,373)	(67,900)		(246,703)
Goodwill impairment	(24,570)				(24,570)
Operating loss	(62,000)	(312,347)	(137,005)		(511,352)
Interest income (expense), net of amounts capitalized	40,062	(22,454)	(17,608)		
Other, net	20,466	(2,221)	(41,052)		(22,807)
Homebuilding pretax loss	(1,472)	(337,022)	(195,665)		(534,159)
Financial services pretax income			10,957		10,957
Total pretax loss	(1,472)	(337,022)	(184,708)		(523,202)
Income tax expense		(600)	(300)		(900)
Equity in net loss of subsidiaries	(522,630)			522,630	
Net loss	$ (524,102)	$ (337,622)	$ (185,008)	$ 522,630	$ (524,102)

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KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

15. Supplemental Guarantor Information (continued)

Condensed Consolidating Statements of Operations
Six Months Ended May 31, 2007 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Revenues	$	$ 2,081,509	$ 720,537	$	$ 2,802,046
Homebuilding:					
Revenues	$	$ 2,081,509	$ 713,126	$	$ 2,794,635
Construction and land costs		(2,020,276)	(635,408)		(2,655,684)
Selling, general and administrative expenses	(58,734)	(239,512)	(100,561)		(398,807)
Operating loss	(58,734)	(178,279)	(22,843)		(259,856)
Interest income (expense), net of amounts capitalized	96,731	(78,185)	(18,546)		
Other, net	7,006	4,430	(42,868)		(31,432)
Homebuilding pretax income (loss)	45,003	(252,034)	(84,257)		(291,288)
Financial services pretax income			15,191		15,191
Income (loss) from continuing operations before income taxes	45,003	(252,034)	(69,066)		(276,097)
Income tax benefit (expense)	(18,400)	102,800	28,200		112,600
Income (loss) from continuing operations before equity in net income (loss) of subsidiaries	26,603	(149,234)	(40,866)		(163,497)
Income from discontinued operations, net of income taxes			42,348		42,348

Income (loss) before equity in net income (loss) of subsidiaries	26,603	(149,234)	1,482		(121,149)
Equity in net income (loss) of subsidiaries:					
Continuing operations	(190,100)			190,100	
Discontinued operations	42,348			(42,348)	
Net income (loss)	$ (121,149)	$ (149,234)	$ 1,482	$ 147,752	$ (121,149)

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

15. Supplemental Guarantor Information (continued)

Condensed Consolidating Statements of Operations
Three Months Ended May 31, 2008 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Revenues	$	$ 477,483	$ 161,582	$	$ 639,065
Homebuilding:					
Revenues	$	$ 477,483	$ 159,611	$	$ 637,094
Construction and land costs		(589,025)	(166,815)		(755,840)
Selling, general and administrative expenses	(22,737)	(67,142)	(29,186)		(119,065)
Goodwill impairment	(24,570)				(24,570)
Operating loss	(47,307)	(178,684)	(36,390)		(262,381)
Interest income (expense), net of amounts capitalized	21,837	(13,776)	(8,061)		
Other, net	8,584	(728)	(3,817)		4,039
Homebuilding pretax loss	(16,886)	(193,188)	(48,268)		(258,342)
Financial services pretax income			3,012		3,012
Total pretax loss	(16,886)	(193,188)	(45,256)		(255,330)
Income tax expense		(500)	(100)		(600)
Equity in net loss of subsidiaries	(239,044)			239,044	
Net loss	$ (255,930)	$ (193,688)	$ (45,356)	$ 239,044	$ (255,930)

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KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

15. Supplemental Guarantor Information (continued)

Condensed Consolidating Statements of Operations
Three Months Ended May 31, 2007 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Revenues	$	$ 1,063,545	$ 349,663	$	$ 1,413,208
Homebuilding:					
Revenues	$	$ 1,063,545	$ 346,441	$	$ 1,409,986
Construction and land costs		(1,166,530)	(312,875)		(1,479,405)
Selling, general and administrative expenses	(28,767)	(113,353)	(51,465)		(193,585)
Operating loss	(28,767)	(216,338)	(17,899)		(263,004)
Interest income (expense), net of amounts capitalized	50,856	(44,518)	(6,338)		
Other, net	3,805	4,307	(42,007)		(33,895)
Homebuilding pretax income (loss)	25,894	(256,549)	(66,244)		(296,899)
Financial services pretax income			5,547		5,547
Income (loss) from continuing operations before income taxes	25,894	(256,549)	(60,697)		(291,352)
Income tax benefit (expense)	(10,400)	103,200	24,400		117,200
Income (loss) from continuing operations before equity in net income (loss) of subsidiaries	15,494	(153,349)	(36,297)		(174,152)
Income from discontinued operations, net of income taxes			25,466		25,466

Income (loss) before equity in net income (loss) of subsidiaries	15,494	(153,349)	(10,831)		(148,686)
Equity in net income (loss) of subsidiaries:					
Continuing operations	(189,646)			189,646	
Discontinued operations	25,466			(25,466)	
Net loss	$ (148,686)	$ (153,349)	$ (10,831)	$ 164,180	$ (148,686)

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KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

15. Supplemental Guarantor Information (continued)

Condensed Consolidating Balance Sheets
May 31, 2008 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Assets					
Homebuilding:					
Cash and cash equivalents	$ 1,164,661	$ 25,528	$ 114,888	$	$ 1,305,077
Receivables	20,463	139,499	30,048		190,010
Inventories		2,132,660	476,163		2,608,823
Other assets	365,137	241,381	77,344		683,862
	1,550,261	2,539,068	698,443		4,787,772
Financial services			53,236		53,236
Investments in subsidiaries	44,766			(44,766)	
Total assets	$ 1,595,027	$ 2,539,068	$ 751,679	$ (44,766)	$ 4,841,008
Liabilities and stockholders equity					
Homebuilding:					
Accounts payable, accrued expenses and other liabilities	$ 215,832	$ 870,890	$ 301,528	$	$ 1,388,250
Mortgages and notes payable	2,143,415	17,805			2,161,220
	2,359,247	888,695	301,528		3,549,470
Financial services			17,109		17,109
Intercompany	(2,038,649)	1,650,373	388,276		
Stockholders equity	1,274,429		44,766	(44,766)	1,274,429
Total liabilities and stockholders equity	$ 1,595,027	$ 2,539,068	$ 751,679	$ (44,766)	$ 4,841,008

November 30, 2007 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total

Assets					
Homebuilding:					
Cash and cash equivalents	$ 1,104,429	$ 71,519	$ 149,307	$	$ 1,325,255
Receivables	126,531	151,089	18,119		295,739
Inventories		2,670,155	642,265		3,312,420
Other assets	405,306	219,146	103,698		728,150
	1,636,266	3,111,909	913,389		5,661,564
Financial services			44,392		44,392
Investments in subsidiaries	64,148			(64,148)	
Total assets	$ 1,700,414	$ 3,111,909	$ 957,781	$ (64,148)	$ 5,705,956
Liabilities and stockholders equity					
Homebuilding:					
Accounts payable, accrued expenses and other liabilities	$ 210,697	$ 1,130,047	$ 334,935	$	$ 1,675,679
Mortgages and notes payable	2,142,654	19,140			2,161,794
	2,353,351	1,149,187	334,935		3,837,473
Financial services			17,796		17,796
Intercompany	(2,503,624)	1,962,722	540,902		
Stockholders equity	1,850,687		64,148	(64,148)	1,850,687
Total liabilities and stockholders equity	$ 1,700,414	$ 3,111,909	$ 957,781	$ (64,148)	$ 5,705,956

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KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

15. Supplemental Guarantor Information (continued)

Condensed Consolidating Statements of Cash Flows
Six Months Ended May 31, 2008 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Cash flows from operating activities:					
Net loss	$ (524,102)	$ (337,622)	$ (185,008)	$ 522,630	$ (524,102)
Adjustments to reconcile net income to net cash provided (used) by operating activities:					
Inventory and joint venture impairments and land option contract abandonments		266,856	133,606		400,462
Change in assets and liabilities:					
Inventories		157,070	61,051		218,121
Other, net	129,732	(124,104)	5,125		10,753
Net cash provided (used) by operating activities	(394,370)	(37,800)	14,774	522,630	105,234
Cash flows from investing activities:					
Investments in unconsolidated joint ventures		(30,484)	(67,220)		(97,704)
Sales (purchases) of property and equipment, net	5,933	(1,645)	90		4,378
Net cash provided (used) by investing activities	5,933	(32,129)	(67,130)		(93,326)
Cash flows from financing activities:					
Payments of cash dividends	(38,723)				(38,723)
Other, net	3,036	(1,335)			1,701
Intercompany	484,356	25,273	13,001	(522,630)	

Net cash provided (used) by financing activities	448,669	23,938	13,001	(522,630)	(37,022)
Net increase (decrease) in cash and cash equivalents	60,232	(45,991)	(39,355)		(25,114)
Cash and cash equivalents at beginning of period	1,104,429	71,519	167,794		1,343,742
Cash and cash equivalents at end of period	$ 1,164,661	$ 25,528	$ 128,439	$	$ 1,318,628

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KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

15. Supplemental Guarantor Information (continued)

Condensed Consolidated Statements of Cash Flows
Six Months Ended May 31, 2007 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Cash flows from operating activities:					
Net loss	$ (121,149)	$ (149,234)	$ (40,866)	$ 190,100	$ (121,149)
Income from discontinued operations, net of income taxes			(42,348)		(42,348)
Inventory impairments and land option cost write-offs		258,995	57,887		316,882
Other, net	(103,934)	(168,156)	46,428		(225,662)
Net cash provided (used) by operating activities continuing operations	(225,083)	(58,395)	21,101	190,100	(72,277)
Net cash provided by operating activities discontinued operations			188,223		188,223
Net cash provided (used) by operating activities	(225,083)	(58,395)	209,324	190,100	115,946
Cash flows from investing activities:					
Investments in unconsolidated joint ventures		(18,759)	(67,971)		(86,730)
Purchases of property and equipment, net	(233)	(2,603)	(1,055)		(3,891)
Net cash used by investing activities continuing operations	(233)	(21,362)	(69,026)		(90,621)
Net cash used by investing activities discontinued operations			(14,720)		(14,720)

Net cash used by investing activities	(233)	(21,362)	(83,746)		(105,341)
Cash flows from financing activities:					
Payments on mortgages, land contracts and other loans		(91,730)	(21,516)		(113,246)
Payments of cash dividends	(38,533)				(38,533)
Other, net	4,743				4,743
Intercompany	106,806	57,468	25,826	(190,100)	
Net cash provided (used) by financing activities continuing operations	73,016	(34,262)	4,310	(190,100)	(147,036)
Net cash used by financing activities discontinued operations			(196,139)		(196,139)
Net cash provided (used) by financing activities	73,016	(34,262)	(191,829)	(190,100)	(343,175)
Net decrease in cash and cash equivalents	(152,300)	(114,019)	(66,251)		(332,570)
Cash and cash equivalents at beginning of period	447,221	150,829	206,132		804,182
Cash and cash equivalents at end of period	$ 294,921	$ 36,810	$ 139,881	$	$ 471,612

16. Subsequent Event

On June 12, 2008, the Company announced that it would redeem all of its outstanding 7 3/4% senior subordinated notes due 2010 in the aggregate principal amount of $300.0 million. The redemption date is July 14, 2008 and the redemption price is 101.938% of the principal amount plus all accrued interest to the date of redemption. The Company expects to incur a loss on the redemption primarily due to the call premium of $5.8 million.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

OVERVIEW

Revenues are generated from our homebuilding operations and our financial services operations. Discontinued operations are comprised solely of our French construction operations, which we sold on July 10, 2007. The following table presents a summary of our results for the six months and three months ended May 31, 2008 and 2007 (in thousands, except per share amounts):

	Six Months Ended May 31,		Three Months Ended May 31,	
	2008	2007	2008	2007
Revenues:				
Homebuilding	$ 1,428,402	$ 2,794,635	$ 637,094	$ 1,409,986
Financial services	4,887	7,411	1,971	3,222
Total	$ 1,433,289	$ 2,802,046	$ 639,065	$ 1,413,208
Pretax income (loss):				
Homebuilding	$ (534,159)	$ (291,288)	$ (258,342)	$ (296,899)
Financial services	10,957	15,191	3,012	5,547
Loss from continuing operations before income taxes	(523,202)	(276,097)	(255,330)	(291,352)
Income tax benefit (expense)	(900)	112,600	(600)	117,200
Loss from continuing operations	(524,102)	(163,497)	(255,930)	(174,152)
Income from discontinued operations, net of income taxes		42,348		25,466
Net loss	$ (524,102)	$ (121,149)	$ (255,930)	$ (148,686)
Diluted earnings (loss) per share:				
Continuing operations	$ (6.77)	$ (2.12)	$ (3.30)	$ (2.26)
Discontinued operations		.55		.33
Diluted loss per share	$ (6.77)	$ (1.57)	$ (3.30)	$ (1.93)

During the first half of 2008, housing market conditions continued to deteriorate as record high foreclosures in the period exacerbated the oversupply of unsold homes in the marketplace and consumer confidence declined significantly amid signs of weakness in the general economy. The protracted housing supply-demand imbalance combined with ongoing turmoil in consumer mortgage lending and other credit markets further intensified competition for sales and put downward pressure on sales prices during the first half of 2008. These adverse conditions have persisted in varying degrees for the housing industry since the second half of 2006 and their impact is reflected in our results for the three months and six months ended May 31, 2008. Our results for these periods were also substantially affected by strategic actions we have taken over the past several quarters in each of our homebuilding reporting segments to reduce our inventory investments and the number of active communities we operate. We have done so to better align our business operations with today s significantly reduced home sales activity relative to the peak levels of a few years ago and our diminished future sales expectations. In the three months and six months ended May 31, 2008, we operated 37% and 38% fewer active communities, respectively, than in the corresponding year-earlier periods. The reduced community counts were a significant factor in the year-over-year declines in net orders, homes delivered and revenues we experienced in each of our homebuilding reporting segments. We also experienced year-over-year decreases in revenues in each homebuilding reporting segment in the second quarter and first half of 2008 due to targeted sales price reductions and sales concessions we implemented in certain markets or communities in response to competitive pressures, weak consumer demand and heightened supply levels, and our ongoing efforts to enhance the affordability of our homes, particularly in light of tighter consumer mortgage lending standards. As a result of current market conditions and our current strategic initiatives, we expect to report reduced year-over-year net orders, homes delivered and revenues throughout 2008.

Our total revenues of $639.1 million for the three months ended May 31, 2008 decreased 55% from $1.41 billion for the three months ended May 31, 2007 due to lower housing and land sale revenues. Housing revenues of $636.7 million in the second quarter of 2008 declined 51% from $1.30 billion in the year-earlier quarter, reflecting decreases in both the number of homes delivered and the average selling price compared to the year-earlier quarter. We delivered 2,810 homes in the second quarter of 2008, down 41% from the 4,776 homes we delivered in the year-earlier quarter. The overall average selling price of our homes decreased 17% to $226,600 in the second quarter of 2008 from $271,600 in the corresponding period of 2007. We use the term home in this discussion and analysis to refer to a single-family residence, whether it is a single-family home or other type of residential property. Included in our total revenues were financial services revenues of $2.0 million in the three months ended May 31, 2008 and $3.2 million in the three months ended May 31, 2007.

We incurred a net loss of $255.9 million, or $3.30 per diluted share, in the second quarter of 2008, including pretax, non-cash charges of $176.5 million for inventory and joint venture impairments and the abandonment of land option contracts, and $24.6 million for goodwill impairment. The inventory impairments resulted from the combination of increased housing supply and persistently poor demand, which amplified pricing pressures and diminished asset values in many of our markets. Inventory values were also affected by the uncertain time frame for a housing market recovery. The abandonment charges reflect our decisions not to pursue certain land option contracts where potential projects no longer met our internal investment standards. Approximately 90% of the total impairments and abandonments in the second quarter of 2008 were recorded against assets in California, Arizona, Nevada and Florida, states that have been heavily impacted by rising foreclosures and falling housing prices. The goodwill impairment charge related to acquisitions we made in prior years within our Central reporting segment. Our net loss in the second quarter of 2008 also included a charge of $98.9 million to record a valuation allowance against net deferred tax assets generated during the quarter in accordance with SFAS No. 109. In the second quarter of 2007, we posted a net loss of $148.7 million, or $1.93 per diluted share, including a pretax, non-cash charge of $308.2 million for inventory and joint venture impairments and the abandonment of land option contracts, partly offset by after-tax income of $25.5 million, or $.33 per diluted share from the French discontinued operations that we sold in July 2007.

For the six months ended May 31, 2008, our Company-wide revenues totaled $1.43 billion, a decrease of 49% from $2.80 billion for the six months ended May 31, 2007. Included in our total revenues were financial services revenues of $4.9 million in the six months ended May 31, 2008 and $7.4 million in the six months ended May 31, 2007. Our net loss for the first half of 2008 totaled $524.1 million, or $6.77 per diluted share, including pretax, non-cash charges of $400.5 million for inventory and joint venture impairments and the abandonment of land option contracts, and $24.6 million for goodwill impairment. The net loss also reflected a $198.9 million valuation allowance charge against deferred tax assets to fully reserve the tax benefits generated from our pretax loss in the period. For the six months ended May 31, 2007, we reported a net loss of $121.1 million, or $1.57 per diluted share, including pretax, non-cash charges of $316.9 million for inventory and joint venture impairments and land option contract abandonments, and after-tax income of $42.3 million, or $.55 per diluted share from the French discontinued operations.

Given the strength of our cash position, on June 12, 2008, we announced that we would redeem all of our outstanding 7 3/4% senior subordinated notes due 2010 in the aggregate principal amount of $300.0 million. The redemption date is July 14, 2008 and the redemption price is 101.938% of the principal amount plus all accrued interest to the date of redemption. We expect to incur a loss on the redemption primarily due to the call premium of $5.8 million. However, in addition to reducing our total debt, we expect the redemption to generate approximately $16.0 million in annual interest cost savings.

Our backlog at May 31, 2008 consisted of 6,233 homes, representing projected future housing revenues of approximately $1.47 billion. These backlog measures declined 54% and 61%, respectively, from the 13,672 homes, representing approximately $3.74 billion in projected future housing revenues, at May 31, 2007. These backlog level decreases reflected our reduced active community count, the effects of several quarters of negative year-over-year net order results and lower average selling prices. Net orders generated from our homebuilding operations decreased 42% to 4,200 in the second quarter of 2008 from 7,265 net orders in the second quarter of 2007, with year-over-year declines experienced in each of our operating segments largely due to lower active community counts in 2008. However, our second quarter 2008 net orders were nearly triple the 1,449 net orders reported in the first quarter of

2008, in part due to a substantially improved cancellation rate. Our cancellation rate based on gross orders improved to 27% in the second quarter of 2008 from 53% in the first quarter of 2008, 58% in the fourth quarter of 2007 and 34% in the second quarter of 2007.

We continue to take steps to maintain our strong financial position and reposition our operations to align with reduced market demand compared to the record levels of a few years ago. Our cash balance of $1.31 billion and debt balance of $2.16 billion at May 31, 2008 were largely unchanged from the balances at November 30, 2007. We generated positive cash flows from our operations in the first two quarters of 2008, a trend we expect to continue for the remainder of the year. As of May 31, 2008, our ratio of debt to total capital, net of cash, remained at the low end of our targeted range of 40-50%. Our liquidity, including the available capacity under our Credit Facility, was approximately $2.40 billion at May 31, 2008. We have reduced our inventory levels by 50% to $2.61 billion at May 31, 2008 from $5.24 billion at May 31, 2007 and ended the second quarter of 2008 with an attractive, geographically diverse land portfolio of approximately 56,600 lots owned or controlled. We believe our solid financial position and present lot positions give us a distinct competitive advantage relative to other homebuilding companies and should allow us to capitalize on opportunities when the housing market stabilizes.

HOMEBUILDING

We have grouped our homebuilding activities into four reporting segments, which we refer to as West Coast, Southwest, Central and Southeast. As of May 31, 2008, our homebuilding segments consisted of ongoing operations located in the following states: West Coast California; Southwest Arizona and Nevada; Central Colorado and Texas; and Southeast Florida, Georgia, North Carolina and South Carolina.

The following table presents a summary of selected financial and operational data for our homebuilding operations (dollars in thousands, except average selling price):

	Six Months Ended May 31,		Three Months Ended May 31,	
	2008	2007	2008	2007
Revenues:				
Housing	$ 1,363,433	$ 2,670,624	$ 636,719	$ 1,297,366
Land	64,969	124,011	375	112,620
Total	1,428,402	2,794,635	637,094	1,409,986
Costs and expenses:				
Construction and land costs				
Housing	1,520,091	2,508,766	748,098	1,348,306
Land	148,390	146,918	7,742	131,099
Total	1,668,481	2,655,684	755,840	1,479,405
Selling, general and administrative expenses	246,703	398,807	119,065	193,585
Goodwill impairment	24,570		24,570	
Total	1,939,754	3,054,491	899,475	1,672,990