

# KBH Earnings Call Transcript

**Date: 2025-12-18**

**Quarter: 4**

Operator: Good afternoon. My name is John, and I will be your conference operator today. I would like to welcome everyone to the KB Home 2025 Fourth Quarter Conference Call. All participants are in a listen-only mode. Following the company's opening remarks, we will open the lines for questions. This conference call is being recorded, and a replay will be accessible on the KB Home website until January 18, 2026. I will now turn the call over to Jill Peters, Senior Vice President, Investor Relations. Thank you, Jill. You may now begin.

Jill Peters: Good afternoon, everyone, and thank you for joining us today to review our results for the fourth quarter and full year of fiscal 2025. On the call are Jeff Mezger, Chairman and Chief Executive Officer; Rob McGibney, President and Chief Operating Officer; Rob Dillard, Executive Vice President and Chief Financial Officer; Bill Hollinger, Senior Vice President and Chief Accounting Officer; and Thad Johnson, Senior Vice President and Treasurer. During this call, items will be discussed that are considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future results, and the company does not undertake any obligation to update them. Due to various factors, including those detailed in today's press release and in our filings with the Securities and Exchange Commission, actual results could be materially different from those stated or implied in the forward-looking statements. In addition, an explanation and/or reconciliation of the non-GAAP measures of adjusted housing gross profit margin, adjusted net income, and adjusted diluted earnings per share, as well as any other non-GAAP measure referenced during today's discussion, to its most directly comparable GAAP measure, can be found in today's press release and/or on the Investor Relations page of our website at kbhome.com. And finally, please note all figures are based on our fiscal November 30 year-end, and all comparisons are on a year-over-year basis unless otherwise stated. And with that, here is Jeff Mezger.

Jeff Mezger: Thank you, Jill, and good afternoon, everyone. We are pleased to share our results for our 2025 fourth quarter and fiscal year. It was a year that tested consumers' resilience as they faced various economic and geopolitical issues. Yet through it all, they continue to demonstrate a desire to own a home. We helped nearly 13,000 individuals and families achieve the dream of homeownership while maintaining our industry-leading customer satisfaction ratings. With total revenues of over \$6.2 billion and nearly \$430 million in net income, we produced a 10% increase in our book value per share. We further strengthened our financial flexibility with the recent expansion of our new \$1.2 billion revolving credit facility and the extension of our term loan. Through our balanced approach to capital allocation, we rewarded our shareholders with a healthy return of capital totaling more than \$600 million in fiscal 2025, including dividends. We continue to lead our peer group in the cumulative amount of capital returned to our shareholders over the past four and a half years as a percentage of market capitalization. In 2025, we repurchased 13% of our outstanding shares at an average price below our current book value. We believe this is an excellent use of our cash and accretive to both our earnings and book value per share. As for the details of our fourth quarter results, we produced total revenues of just under \$1.7 billion and adjusted diluted earnings per share of \$1.92. We returned about \$115 million in cash to our shareholders, including the repurchase of 1.6 million shares. We remain optimistic about the housing market, as we believe favorable demographics will be a key driver supporting higher demand over time, together with the structural undersupply of homes. Near-term conditions continue to

reflect underlying demand for homes supported by population household formation, job, and wage growth. However, low consumer confidence, affordability concerns, and elevated mortgage rates continue to constrain the pool of actionable buyers. Consumers are demonstrating their interest in buying a home, reflected in our website visits, leads, and traffic to our communities. They're just taking much longer to make their home buying decisions. We produced 2,414 net orders in the fourth quarter, maintaining a consistent approach to pricing by offering transparent and affordable prices rather than inflated prices masked by heavy incentives. This remains the foundation of our competitive position, as it allows us to advertise our compelling pricing directly on our website. It is also how we build trust with our customers. We were disciplined in not taking overly aggressive steps to capture sales during the seasonally slower fourth quarter. By doing so, we believe we are positioned to achieve better margins on these sales in our 2026 first quarter than we would otherwise have produced. Before I turn the call over to Rob McGibney, I will make a comment on the approach we are taking with respect to our guidance for fiscal 2026. As detailed in today's press release, we are providing our outlook for fiscal 2026 deliveries and housing revenues. We expect to have greater visibility on both operating and gross margins as we get into the spring selling season and plan to provide our projections for these metrics when we report our 2026 first quarter results in March. Let me pause here for a moment and ask Rob to provide more details on our sales, as well as an operational update.

Rob McGibney: Thank you, Jeff. Consistent with our operational success throughout fiscal 2025, our divisions continued to execute well in the fourth quarter, maintaining high customer satisfaction levels, further improving build times, lowering direct costs, and balancing pace and price to optimize each asset. Traffic in our communities was steady during the fourth quarter, and at 18%, our cancellation rate was stable, supporting net orders at an average absorption pace of three per month per community. This pace was in line with our average fourth-quarter pace of the past two years. As we look ahead to the full year 2026, although we begin the year with a lower backlog than we have carried in some time, the fundamentals of our operating model and the improvements we have made over the last few years provide a clear and, we believe, achievable path to meeting our delivery objectives. Our beginning backlog represents 27% of the midpoint of our full-year delivery target, compared to 34% at the start of 2025. While this is a smaller starting position, it must be viewed in the context of our significantly faster build times and our expectation of expanding our community count with new community openings. We have become more efficient in building homes, with build times improving roughly 20% year over year in the fourth quarter. We achieved our company-wide target of 120 days or better from home start to completion on built-to-order homes during the quarter, with several divisions averaging fewer than 100 days in November. Our faster build times allow us to extend sales much deeper into the year and still achieve delivery of the home. At quarter-end, we had 271 active communities, up 5% as compared to the prior year period. In our 2026 first quarter, we are planning to open between 35 and 40 new communities and expect to hit a high watermark for community count during our second quarter, at the height of the spring selling season. With this broader base of communities, we are very well positioned to capture the typical seasonal lift in demand during this period. Our new communities typically generate strong early demand, benefiting from the newness and excitement of grand openings and supported by our disciplined community opening process. Importantly, these new communities are expected to generate favorable gross margins supported by a sales mix that is predominantly built to order. As we have discussed, we are focused on returning our built-to-order homes to a higher percentage of our total deliveries, from 57% in Q4 2025 to our historical 70% or higher. While we always have some inventory homes available for those buyers that need a quicker move-in date, the superior margins we generate on BTO homes will allow us to realize greater value from our communities. Our gross margins on BTO homes are trending three to five percentage points higher than on inventory sales, and we began to see a shift toward more BTO sales during November, an encouraging trend that has continued into December. We remain focused on selling our BTO homes, and as these sales become deliveries over the course of fiscal 2026, we expect to achieve a favorable trajectory in our gross margins. We are aligning our starts with our BTO sales and started 1,827 homes in our fourth quarter. Our divisions, together with our national purchasing team, are doing an outstanding job in driving costs lower. These efforts, combined with our value engineering and studio simplification initiatives, contributed to direct costs that were about 4% lower sequentially and

6% lower year over year on our homes started during the fourth quarter, helping to offset the impact of higher land costs. Before I wrap up, I will review the credit profile of our buyers who finance their mortgage through our joint venture, KBHS Home Loans. Our capture rate was high, with 80% of our buyers who financed their homes in the fourth quarter using KBHS. Higher capture rates help us manage our backlog more effectively and provide more certainty in closing dates, which benefits our company as well as our buyers. In addition, we see higher customer satisfaction levels from buyers who use our joint venture versus other lenders. The average cash down payment moved up slightly, both sequentially and year over year, to 17%, equating to nearly \$80,000. On average, the household income of customers who use KBHS was about \$130,000, and they had a FICO score of 743. Even with over one-half of our customers purchasing their first home, we are still attracting buyers with strong credit profiles who can qualify for their mortgage while making a significant down payment or paying in cash. 10% of our deliveries in the fourth quarter were to all-cash buyers. In conclusion, we remain firmly committed to delivering high customer satisfaction and strong operational execution to drive our results. We believe our portfolio of communities, products, and pricing are well aligned with the needs of today's buyers, and with improved build times, an expanded community footprint, and stronger operational consistency, we are confident in our ability to achieve our fiscal 2026 delivery objectives. With that, I will turn the call back over to Jeff.

Jeff Mezger: Thanks, Rob. With respect to our lot position, we owned or controlled roughly 65,000 lots at year-end, 43% of which were controlled. Our footprint is focused on markets that we believe are positioned for long-term economic and demographic growth. As our newest divisions in Seattle, Boise, and Charlotte continue to mature, their contribution to our results is becoming more meaningful. In addition, we see an opportunity to expand our share in all of our core markets over time. We remain selective with our land positions across our business, and as part of our regular review of land purchases in our pipeline, we canceled contracts to purchase approximately 3,500 lots, representing about 20 communities, in the fourth quarter, which no longer met our underwriting criteria. Our lot pipeline is healthy, providing us with the flexibility to be patient in adding to our controlled lot count until we find opportunities with better terms that will provide higher returns. One of the key benefits of our build-to-order approach is that it provides visibility into the need and timing for replacement communities based on each community's sales pace, local market dynamics, and expected sellout date, which is beneficial in our effort to be capital efficient. We're also developing lots in smaller phases wherever possible and balancing development with our starts pace to manage our inventory of finished lots. Our business generates healthy cash flow, and we remain consistent in our balanced approach toward allocating it. We are achieving our priorities of positioning our business for future growth, managing our leverage within our targeted range, and rewarding our shareholders through share repurchases and our quarterly cash dividend. We are maintaining our land investments at a level that will support our current growth projections, investing \$665 million in land acquisition and development in the fourth quarter, with about two-thirds of our investment going toward developing the land we already own. With nearly \$430 million in net income generated for the year, lower land acquisition and development spend, and the improvement in our build times unlocking cash, we returned more than \$600 million in capital to our shareholders in fiscal 2025. This includes approximately \$540 million in share repurchases at an average price of \$57.37 per share. At these levels, the repurchases are an excellent use of capital and will enhance both our future earnings per share and our return on equity. In closing, I want to thank the entire KB Home team for their commitment to serving our homebuyers. We believe we have the most talented and experienced operators in the business, who are driven to produce results. Our divisions executed well this past year despite challenging market conditions and controlled the controllable, achieving a significant reduction in build times, lowering direct costs, and opening a meaningful number of new communities. In fiscal 2025, we returned the highest level of capital to our shareholders in a single year in our company's history. We plan to continue our share repurchase program in fiscal 2026, with between \$50 million and \$100 million of repurchases planned for our first quarter. As we begin the new year, we do so with a balance sheet that is stronger than it has ever been and with added financial flexibility. We believe we are well positioned for the spring selling season with our expected community count growth and have confidence that our renewed focus on built-to-order sales will generate higher margins as the year progresses. Our objectives for fiscal

2026 are centered on continuing to deliver outstanding service to our homebuyers, driving higher shareholder value, and we look forward to updating you as the year unfolds. Now I will turn the call over to Rob Dillard for the financial review.

Rob Dillard: Thanks, Jeff. I'm pleased to report on the fourth quarter and full year 2025 results. As Jeff and Rob said, we continue to manage the business with discipline, with a focus on optimizing every asset by pricing to the market, maintaining a healthy pace, and delivering our built-to-order advantage. This strategy has led to relatively consistent results in a constrained market in 2025. In 2025, we exceeded the midpoint of our guidance range, with total revenues of \$1.69 billion and housing revenues of \$1.68 billion, a 15% decrease. We delivered 3,619 homes, which exceeded the midpoint of our implied guidance, largely due to reduced average build times in our 268 average communities for the quarter. The average selling price declined 7% to \$466,000 due to regional and product mix and general market conditions. Housing gross profit margin was 17%, and adjusted housing gross profit margin, which excluded \$13.7 million of inventory-related charges, was 17.8%. Adjusted housing gross profit margin was 310 basis points lower due to pricing pressure, negative operating leverage, higher relative land costs, regional mix, and product mix, which was pronounced due to the age and price of incremental volume versus guidance. This margin pressure was again partially offset by lower direct construction costs per unit. SG&A expense as a percent of housing revenues was 10%. The SG&A expense ratio was 9.1% when adjusted for the \$16 million of accelerated equity-based compensation expense. This expense reflects a change in policy for the vesting of certain long-term incentive awards. This affected only the timing of expense recognition, and there was not an increase in the total compensation cost of these rewards. Homebuilding operating income for the fourth quarter decreased to \$117 million, or 6.9% of homebuilding revenues, and homebuilding operating income excluding the inventory-related charges and the accelerated equity-based compensation expense was \$147 million, or 8.7% of homebuilding revenues. Net income was \$102 million, or \$1.55 per diluted share, benefiting from a 13% reduction in our weighted average diluted shares outstanding. Adjusted net income, which excludes the inventory-related charges, the accelerated equity-based compensation expense, and approximately \$1 million for early extinguishment of debt, was \$126 million, or \$1.92 per diluted share. For the full year 2025, we delivered 12,902 homes and generated \$6.24 billion of total revenues. Housing revenues were down 10% to \$6.21 billion. Diluted earnings per share was \$6.15, and book value per share increased 10% to \$61.75. Turning now to our guidance. Our guidance for the first quarter and full year 2026 is based on our belief that we're well positioned for the present operating environment through our strategy of providing customers the best buying experience and the best value by delivering a personalized built-to-order home. In 2026, we expect to generate housing revenues between \$1.05 billion and \$1.15 billion based on expected deliveries of between 2,300 and 2,500 homes. Housing gross profit margin, assuming no inventory-related charges, is expected to be between 15.4% and 16% for 2026. Margins are expected to be affected primarily by negative operating leverage and typical seasonality in the quarter, but we also expect continued margin trend impacts of pricing pressure and higher lot costs, as well as some regional mix. We expect to continue to partially offset this margin pressure with lower direct construction costs per unit. We expect margins to improve throughout 2026 due to positive operating leverage and typical seasonality, as well as our strategy to shift the mix of homes sold and delivered to favorable built-to-order homes. We believe that we are well positioned to execute this mix shift in 2026, as we start the year with 271 communities, and we expect a considerable number of new community openings in the first half of 2026. The first quarter 2026 SG&A ratio is expected to be between 12.2% and 12.8%, due mainly to expected reduced operating leverage despite cost controls. This is our highest seasonal SG&A quarter, compared to 11% in 2025. We had solid results reducing both fixed costs and direct costs throughout 2025, and we expect this to continue in 2026. Our effective tax rate for the first quarter is expected to be approximately 19%. It's notable that we expect the tax rate to be lower only in 2026. We expect the tax rate to increase and end the year with an average of between 24% and 26% due to reduced energy credits, given the end of 45L credits in 2026. For the full year 2026, we expect housing revenues of between \$5.1 billion and \$6.1 billion based on between 11,000 and 12,500 deliveries. This full year's guidance is based on current market conditions and will be expanded to include our customary components as we gain an understanding of spring selling season market dynamics. Turning now to the balance sheet. We believe that we're well

positioned with over \$5.7 billion in inventory at the end of 2025. We owned or controlled over 64,000 lots, including 27,000 lots that we have the option to purchase. Our option lot position is 27% lower than a year ago due to our continued focus on only allocating capital to positions that align with our strategy and return expectations. We continue to invest selectively to augment our land position, and we invested over \$665 million in land development and fees during the fourth quarter and over \$2.6 billion in 2025. During the fourth quarter, we entered into a new credit facility to increase liquidity and improve covenants, and we amended our \$360 million term loan to extend its maturity to 2029. We now have no debt maturities until June 2027. At quarter-end, we had total liquidity of \$1.43 billion due to \$229 million in cash and no cash borrowings on our \$1.2 billion revolving credit facility. We continue to target a total debt-to-capital ratio in the neighborhood of 30% to support our strong BB positive credit rating, and we are pleased with our current 30.3% ratio. This strong balance sheet enables us to provide shareholders with a healthy dividend, which currently has an approximately 1.6% yield, as well as return capital to shareholders in the form of share repurchases. In the fourth quarter, we repurchased 1.6 million shares for a return of capital of \$100 million. In 2025, we repurchased approximately 9.4 million shares, or 13% of our outstanding shares at the beginning of the year. We have now repurchased nearly 36% of our outstanding common stock since implementing our share buyback program in late 2021. Over the past four and a half years, we have returned over \$1.9 billion to shareholders in the form of dividends and share repurchases. In the fourth quarter, our Board of Directors approved a new \$1 billion share repurchase authorization to support our capital return strategy. We ended the year with \$900 million available under this authorization. We expect to repurchase between \$50 million and \$100 million of our common stock in the first quarter. As we look ahead, our strategy is to enhance our results through continued discipline and a focus on higher-margin built-to-order homes. We believe that this operating strategy, when combined with our shareholder-focused capital strategy, will maximize shareholder value over the long term. With that, I'll now take your questions. John, would you please open the lines?

Operator: Yes. Thank you. We will now conduct a question and answer session. If you would like to ask a question, please press star then 1 on your telephone keypad. You may press star 2 to remove yourself from the queue. For anyone using speaker equipment, we ask that you please pick up your handset to provide optimum sound quality. We ask that you please limit yourself to one question and one follow-up. Thank you. One moment, please, while we poll for questions. And the first question comes from the line of John Lovallo with UBS. Please proceed with your question.

John Lovallo: Guys, thank you for taking my questions tonight. The first one is maybe just a little bit more philosophical. I mean, I understand the changes in the way you're providing the outlook relating to the full year deliveries and the gross margin, but there also seems to be a bit of conservatism, particularly in the gross margin guide, that maybe wasn't always the case. I mean, can you help me understand if there's been some change there and maybe instilling a little bit more conservatism into the outlook? And also, is there a chunk of spec that's going to be delivered in the first quarter that's going to negatively impact that margin?

Rob Dillard: John, I can make a few comments and then pass it over to Rob Dillard. There is still some inventory that we have to clear as part of our transition to more built-to-order sales, and we have factored that into the guidance that we provided. One of the things that we touched on in our comments is that some of this inventory is aged in that it was built at much higher build costs. And as we've reacted to the market, we're lowering our costs on new deliveries, but we have to clear these older specs that have a higher cost basis. So it is impacting the margin. It's a short-term thing, but it's something we have to power through. But within our guide, I would say that it's just a guide. It's not conservative. It's not aggressive. It's just realistic. And if you think about it, one of the real drivers of the lesser margin in the quarter is the lost leverage because our revenue is down. And it's a fairly significant move sequentially from Q4 to Q1 due to the loss in revenue leverage. You got any other color, Rob, you wanna add?

Rob Dillard: Yeah, those are the two main points there, John. I think that it's you can't express enough how important in Q1 the seasonality and the leverage is having an impact on that Q1 margin expectation. Typically, that's 100 to 150 basis points, and we think that we'll be near the top end of that, if not above it. There is a real opportunity for leverage as we get through the year, as Jeff said, and that the leverage in Q1, given kind of our conservatism on the delivery number, is creating some

conservatism as you see it through the cycle of that guide. There also, as Jeff said, some with some product mix as we shift through some of the older specs that haven't had the benefit of the direct cost reductions. And we saw a bit of that also in Q4 as well, which I think was really the incremental units versus guide and a big part of the margin compression versus where we thought we were going to be. So we think that there's real opportunity as we go through the year, but we're really pegging where we expect to be in Q1 on those factors.

John Lovallo: Okay. Yeah. That's really helpful. And maybe sticking to a similar topic, I don't recall you guys ever giving an adjusted EPS number before. And I'm curious about the thought process behind excluding the accelerated stock comp if it's really just timing-related and seemingly future quarters could benefit from less stock comp if the total amount is changing? And also, it seems a little bit unusual to exclude impairments from adjusted EPS. So just maybe your thoughts on that would be very helpful.

Rob Dillard: Yeah, John. We just wanted to give you a like-for-like number because the timing on the equity expense is where it was. It was significant enough that we wanted to give you a like-for-like number that was relevant so that you could make comparisons and so that you could also make a comparison versus our guide.

Operator: Thank you. And the next question comes from the line of Stephen Kim with Evercore ISI. Please proceed with your question.

Stephen Kim: Yeah. Thanks a lot, guys. Just to start off with, if we could, could we get the spec numbers, the finish, and the under-construction specs at the end of the quarter and also a clarification on your community count comment? You said 2Q was going to be the high watermark. Just want to make sure that we're clear that you're saying that the community count will actually be highest in 2Q, and then it will descend from there.

Rob McGibney: In my community account, cadence and color? Okay. So, yeah, Steve, you know, as we're looking at the setup for the year, I mentioned in my prepared remarks, ended the quarter with 271. We're on an upward trajectory for that. We do expect to hit the peak for community count for the year, kinda right in the heart of the spring selling season, right in the middle of Q2, and be up from that 271. We're not pinpointing a number, but we think we'll be up, you know, somewhere between nine to 13 communities from that number by the time. And by the time we get right into the middle of that second quarter. So that's driving some of our assumptions and projections on the deliveries for the year. As far as the inventory levels, we've got about 1,700 homes in inventory right now across the company, and those are inventory that we're expecting to cover here over the next few months.

Stephen Kim: Okay. That's total. Right? Total inventory, not necessarily finished inventory. Is that right? Like, just trying to get a sense of how much is finished and how much is under construction.

Rob McGibney: Well, since we haven't been starting specs, you know, we've seen some of that shift out of the under-construction. So of the 1,700, we've got a little over a thousand that are at or near the finish stage.

Stephen Kim: Okay. Gotcha. That's helpful. And then a general question about your community, I'm sorry, your shift to BTO. What you're describing is that you have a number of new communities that are going to be opening up, and that will really facilitate your transition to more BTO sales, which are also higher margin. And I guess, would it be helpful for me to understand what is it about a new community that necessarily makes it easier for you to make a shift in your BTO strategy? Because, you know, to a degree, I would think that most of your pretty much all of your communities initially designed around the BTO concept. And sort of market reality sort of kind of pushed you to do a little bit more spec than you would normally like. So that's my perception. Is that an incorrect perception? Do you actually have communities that, you know, you kinda just earmarked to be kinda spec communities and you're just not doing any of those as we go forward? Just if you can help me understand how the transition is facilitated by a new community opening up.

Rob McGibney: Yeah. Let me go back up top and start with, you know, when we got into starting specs, it was largely driven by the supply chain crunch that we had in our cycle times that expanded big time, and it just made it difficult for a lot of reasons to sell BTO when it was taking, you know, 220 days, 240 days to deliver that home. So, yeah, that combined with virtually no inventory in the market, and then as we've worked through, you know, this process, it's been difficult to get off of that, and we drew a hard

line in the sand earlier this year or in 2025. And, you know, as I look at it, I think a core strength of our company is the ability to sell the advantage of the built-to-order model. And frankly, we created an internal conflict with ourselves with those specs that we started. And, you know, in a lot of ways, we've been competing with ourselves to some extent. And with our BTO program, with our build times, we're now building in less than 120 days. So that competes much better with the timeline for resales and spec homes. And we're giving our customers the ability to lock the loan and leverage the one-time float down in the event that mortgage rates decline. So, you know, it's really what's driving the improvement is sharper alignment around our built-to-order model and just driving that discipline and consistency in how our teams position our value with a great base price and transparency and the ability to personalize. And, you know, our focus is really reinforcing the importance of selling the home through the customer's eyes, helping them understand the trade-offs and the cost certainty and the long-term value of getting what they want rather than, you know, pushing that spec solution. So, you know, I would characterize this as less of a change in strategy, just more stronger execution against a proven business model that we've operated with for a long time. And when our sales teams fully believe in and consistently sell the benefits of that built-to-order, the results follow. And with these new communities, we don't have specs to compete with at all, and we're quickly working through the specs in our existing communities where it's creating that competition.

Operator: Thank you. Our next question comes from the line of Alan Ratner with Zelman and Associates. Please proceed with your question.

Alan Ratner: Guys. Good afternoon. Thanks for all the detail. I wanted to follow up on the comments you made last quarter about trying to get towards more of a base price model as opposed to the kitchen sink incentive model that a lot of your competitors are operating with. And it seems like since then, if anything, the incentive environment has gotten even more competitive. I mean, we're seeing rate buy-downs advertised on a lot of builder websites, you know, 2%, 3%. So I'm just curious, you know, a, how has it been competing in this environment with your new strategy? And b, do you have an update on kind of what the actual base price adjustments that you've seen up to this point and what the expectation is going forward? Thank you.

Rob McGibney: Yeah. So, you know, there's really not much to report on the price change front. I mean, overall, it was a relatively stable quarter for us in terms of pricing. And as Jeff said in the beginning, and we said last quarter, we've been disciplined and didn't chase volume during what was typically a lower demand environment and more inelastic. So, you know, not a lot of change on the price front. I, you know, expect that you've seen recently too, is that a function of maybe the overall inventory environment kind of improving across the industry? You know, we've heard from a lot of your spec-focused peers, like, they pulled back a lot on starts over the last handful of months. So are you actually seeing a little bit of relief on the spec competition side, or is it more, you know, something you're doing internally that's driven that recent mix shift?

Jeff Mezger: Yeah. Alan, one of the things that got blurred with what Rob walked through on the supply chain crunch and then the inventory that we put in and others put in is you lose sight of the value in the build-to-order approach. And don't underestimate the benefit of many of our divisions now building in less than 100 days. Would you rather have a completed spec with a lot of incentives to move it, or do you want to build your own home and create your own value and close 30 days later or 45 days later? So what we're seeing is with our build times coming down, the value proposition of the personalized home at an attractive price is more compelling. So we don't think that our customers are competing with the specs. We focus on resale, and we offer a brand new home that's within range of the resale median. And they really value the personalization. So it's naturally coming back to us because we're prioritizing it and focusing on it much better than we did the last couple of years.

Operator: Thank you. Our next question comes from the line of Rafe Jadrosich with Bank of America. Please proceed with your question.

Rafe Jadrosich: Hi. Good evening. Thanks for taking my question. I just wanted to kind of follow up on some of the comments about BTO mix. I think you said 57% of deliveries were BTO in the fourth quarter. How should how are what are you expecting for the fiscal first quarter? And then what would that be for the full year kind of at the midpoint of guidance? Wondering sort of where the exit rate will be for the year compared to that 70% target you have?

Rob McGibney: Yeah. That's a good question. I mean, in the first quarter, I expect that we are going to continue covering some of that inventory. So the ratio is going to be tilted more so towards probably that 57% to 60% range. Yeah. The exit rate, I think, is what's more important. And we're very focused on getting back to at least a 70/30 ratio. And we see that a great opportunity to drive that change with the new communities we've got coming with the onset of the spring selling season as we work the built-to-order model. And, you know, could go that route. We expect that we'll exit at that rate it'll be kind of a gradual progression to get there through the first couple of quarters of the year.

Rafe Jadrosich: Great. So similar mix in fiscal first quarter versus the fourth quarter?

Rob McGibney: Most likely, yes.

Rafe Jadrosich: Right. And then just the fiscal the first quarter gross margin, the quarter-over-quarter decline, you spoke about the fixed cost deleverage and the amount that you're getting pressured there. But the decline is sort of greater than that. What are the other pieces to sort of bridge us to the first quarter decline?

Rob McGibney: It's, you know, outside of the leverage piece, it's just largely driven by regional and product mix within our cities combined with some pricing pressure on moving the inventory. Yes. Jeff mentioned, we've got this tail of inventory that we're working through that has higher direct cost and a lower margin, and that's gonna, you know, that bled into the deliveries, and we'll continue in the short term. And overall, with the higher margin BTO sales becoming a large percentage of our deliveries and the improved leverage that we'll get on fixed as we move throughout 2026, we expect Q1 to be the bottom in margins, and we're gonna go up from there.

Operator: Thank you. Our next question comes from the line of Mike Dahl with RBC Capital Markets. Please proceed with your question.

Mike Dahl: Hi, thanks for taking my questions. One more on the BTO dynamic. I guess, look, if you halt your spec starts, it's pretty easy to mathematically move your mix of BTO up. So I'm trying to understand, you know, in context, your order pace was light. So as you go into next year, you know, you have a view that you can kind of manage this transition and the demand will be there. What are you willing to tolerate on pace to force the issue versus just if you get into the spring selling season, the demand response isn't there, kind of pivoting back to spec, I guess. And anything you can give us on aside from just percentage mix. Maybe, like, some sales pace stats on, you know, on some of the newer communities that are more BTO versus some of the spec communities. Just looking for a little more color there.

Jeff Mezger: Yeah. Mike, there's a few factors in the response. One, every community is a different story. And while Rob was sharing the mix shift we're seeing to BTO, it's not just on the brand new community. Some communities had little inventory and have sustained the mix, and others had more than they should have. We're slowly working through that. But it's working across the system. And I've shared on past calls with we keep walking through the optimize the asset approach. And for our company, it seems to you get the best returns if doing at least four a month on average per community. Our sales pace in the fourth quarter would seasonally adjust to four a month. So we were on the four a month pace in the quarter. As we look ahead into the spring selling season, our intent is to support our sales rate with built-to-order sales more so than forcing the inventory. And in part, we like it because we know what the margin is when we start the home. You can fool yourself with a spec start into thinking you're gonna make this margin, and then lo and behold, five months later, it's down four or five points. So we would rather pull the levers on a built-to-order approach in the spring per community and ensure that we hold to that four-month pace.

Mike Dahl: Okay. Thanks, Jeff. My second question, look, I appreciate the dynamics at play with the margin between seasonality and the spec dynamic that you expect to work past as the year goes on. If we look at the 1Q operating margin guidance, it is low single digits, which if we think about normal distribution, there would presumably be some healthy number of communities that were kinda breakeven or below. So my question is really around your impairment process and testing. And I know there's a component that's probably duration and your projections about BTO. But, hypothetically, if you were to sustain these types of margins and kind of the mid-teens, what are the set of assumptions that would be required to make the charge? I mean, 14 million in charge is still kinda nominal this quarter.

What would lead you to take kind of, I guess, for lack of a better word, much larger charges because it seems like this is getting closer to where some land might be impaired.

Jeff Mezger: Mike, I'll say a few things and hand it to Rob Dillard. We've already shared the first quarter margins are the low watermark, and we expect improvement quarter over quarter as the year progresses from there. And it's a combination of better leverage as we grow revenue back and better margins as our community mix rotates around. I can say we've had the same impairment process for years and years. It's very rigorous. Every community is analyzed every quarter. And it starts with what's the margin in the community, and do you have a positive margin or not? And even at today's margin, there's a significant gap before any kind of major impairments would get triggered. And when you threw out that number on impairments, keep in mind half of it was abandonments on communities we elected not to go forward with. So it's not a reflection of a margin. It's a reflection of a community we decided not to close on. Don't you wanna say anything else?

Rob Dillard: Yeah. I mean, just to concur with what Jeff said, I mean, the impairment process is incredibly rigorous, and it is community by community, and it's pretty much a constant process that we're evaluating these communities and understanding what the trends are within the communities and the returns and profitability of the communities. We have a certain number of communities that kind of hit excess scrutiny, and that list of communities is actually relatively limited. We did decide to take an impairment on two communities, one of which was relatively small as it was about to close out, and then the other one was a community in our central division, you know, in Colorado, which was associated with the same issue, which is a change in some of the requirements on housing, which changed the cost profile of those houses and led us to an impairment on those products. So we think that that's fully behind us now. So as we evaluate these impairments, there would have to be some kind of meaningful shift or a trigger that would change our perception of the community's profitability over time. And right now, we haven't seen that. And so I would also say that all of these profitability measures are fully loaded with, you know, corporate and everything else in there. And so that has an impact, and those are also costs that we're evaluating as we go forward.

Operator: And the next question comes from the line of Trevor Allinson with Wolfe Research. Please proceed with your question.

Trevor Allinson: Hi, good evening. Thank you for taking my questions. First question on the ASP implied by the midpoint of your 2026 revenue deliveries guidance. I believe the midpoint in '26 is above your 4Q '25 ASP. Is the expectation to be able to increase prices in fiscal '26? Or are there mix impacts driving that just trying to understand what should the base case be for pricing to move higher versus where it wasn't? In April?

Jeff Mezger: Trevor, we're not assuming price. That is totally mixed. We have some very high-end communities and very good locations in California that are opening soon. In fact, one's already open. And they'll be delivering a pretty sizable number of homes in the third and fourth quarters. So our mix shift is gonna trigger a higher ASP as these higher-priced communities hit volume.

Trevor Allinson: Okay. Makes sense. And then the second one is on returning cash to shareholders in 2026. You gave the guide for 1Q. Typically, it's a smaller quarter for you guys. So should we think that you continue to return capital to shareholders at a similar \$50 million to \$100 million rate post 1Q? Or how are you thinking about that beyond the first quarter? Thanks.

Rob Dillard: Well, we've demonstrated with our activity that we're programmatic now with the share buyback program. And we typically are a little lighter in the first quarter because of the cash position we're in at the end of the year. And we wanna, you know, evaluate it as the spring comes. And it's a few factors that we evaluate, not just our cash and balance sheet, but is the stock price, and do we have a lot of opportunity to grow the company? And that's one of the key areas that we wanna continue to pursue as well. But I would say that as the quarters roll by, the \$50 to \$100 million a quarter is reasonable.

Operator: Thank you. And our next question comes from the line of Jade Rahmani with KBW. Please proceed with your question.

Jade Rahmani: Thank you very much. You mentioned transparency on price and emphasizing pricing over incentives. Are you seeing other builders follow suit in cutting price, and are you worried at all that this could lead to price wars in many locations?

Rob McGibney: I really haven't seen it. I mean, most of what we see is that those are trying to cover their spec inventory that they've got, and it's kind of the same game. You've got inventory. You've designed it, and it's out there. And it may not be exactly what people want, so they're just discounting that product and giving rate buy-downs and everything else. We see very little with our built-to-order focus, especially in the first-time buyer space.

Jade Rahmani: And then on the option walk-away charges, you identified a pool of communities that you may not exercise additional options, and do you anticipate further charges through this year, 2026?

Rob Dillard: You know, that's just a normal part of our land procurement process that we have, you know, options which are really just payments, you know, earnest money or what have you as we go through the process and execute due diligence, and sometimes we decide to proceed and sometimes we don't, and I think that we're holding the line with really stringent underwriting standards, and we're ensuring that we're sticking to our strategy. And that's kind of led to maybe what is more than typical kind of abandonment, but it's not something that's indicative of, you know, us of a low quality or anything like that. We're pretty pleased with how that's progressing and think that that's it's not a normal way thing that we expect to see in a really fulsome market, but it's a characteristic of this market.

Operator: Our next question comes from the line of Sam Reid with Wells Fargo.

Sam Reid: Yes. Thanks so much. Just curious where incentive loads landed in the fourth quarter as a percent of revenues? And any sense as to what's embedded in the first quarter? And then kind of a knock-on to that is talk through how you're incentivizing some of this aged inventory that you're selling through.

Rob McGibney: So, yeah, I'm not sure I have a perfect answer for you on the incentive piece on Q4. I know that if any mortgage concessions that we did, it was right around 1%. When we look at our book of business and the inventory that we've got, that's really one of the few places where we're applying any of those incentives at all. So most of that's coming through that side of it. As we look out through the balance of the year, we projected we're gonna get even further away from that, and incentive usage should come down even more.

Rob Dillard: Yeah. There's no, like, unusual incentives. Like, what you would read through our incentive disclosure is really more just the normal way incentive that we give, which is like closing cost assistance. And things like that. There's nothing unusual when that equates to just, you know, one or 2%. Typically. That helps.

Sam Reid: And then this is perhaps more of a follow-up to some of the prior questions. But when you look at your range of delivery volume outcomes in '26, it's pretty wide. The question really is, is there a different assumption for spec versus build-to-order embedded at the high end of that delivery volume range versus the low end? And then, I mean, would it be fair to assume that the low end of that range is just a scenario where build-to-order doesn't come in as planned? We just love some context on that.

Rob McGibney: Yeah. We're really focused on driving the built-to-order sales as we said. And the range is driven by, you know, we're in December right now. We've got the spring selling season in front of us. We've got a lot of communities open, but just don't have great visibility into what the spring might be. I'd say that the 2025 spring selling season was a disappointment, and we've baked our or we've made our prepared our plan and our strategy for the year around what I would consider a normal spring selling season with that community count growth maybe even slightly below average. You know, as we piece it all together, we're only counting on needing to drive about just slightly over four built-to-order sales per community in the first half of the year. And as we look at the past years, to get us to the midpoint of our delivery range. And when we look at past years, you know, it seems like that would be relatively easy to do. If we do better than that and we have a spring selling season like we saw a couple of years ago, then we'll probably hit the high end, but we just don't know yet.

Operator: Thank you. And our final question comes from the line of Michael Rehaut with JPMorgan. Please proceed with your question.

Andrew Azzi: Hi, guys. You have Andrew Azzi here on for Mike. Just wanted to drill down. I believe you guys said traffic was relatively stable within the quarter. Was there any meaningful difference in sales trends month to month, or is it more of the same?

Rob McGibney: Well, month to month, I mean, September was our strongest month, and we see that

almost every year. And then it ticks down in October and November. So this year followed that typical seasonal pattern that we did, that we saw. Traffic's held steady, and our conversion is actually improved a little. So we're focused on driving more traffic. It's just, you know, challenging to do in November and December.

Andrew Azzi: Okay. I appreciate that. And then, you know, maybe within one Q's gross margin and even as we go throughout the year, are kind of your assumptions for construction costs and lot costs within your guide in 1Q and maybe your outlook for the year?

Rob Dillard: Yeah. I mean, we're not expecting a meaningful change in construction or lot costs. I mean, we do feel really good that we've kind of bent the curve a little bit on unit costs. In the sense that direct construction costs and material costs we've been able to offset the lot cost inflation. And sequentially, the year-over-year change in lot cost has gone down pretty meaningfully from the third quarter to the fourth quarter. And so we feel like we're getting to a better position there in terms of being able to draw profitability off of our cost savings initiatives. But we don't have, like, a specific guide on lot cost change that we would give you at this point. Yeah. It's baked in.

Operator: Thank you. Ladies and gentlemen, that does conclude the question and answer session. And that also concludes today's teleconference. We thank you for your participation. You may disconnect your lines at this time.