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HEARD ON THE STREET

Home-Building Stocks Show Weakness After Strong Run

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Investors and homebuyers alike may be getting ready to slam the door on the strong recent stock performances of the home-building sector, amid signs of deterioration in the long-strong housing market.

Since October, big builders such as **Centex** Corp., **D.R. Horton** Inc., **KB Home**, **Lennar** Corp., **Pulte Homes** Inc. and **Toll Brothers** Inc. have seen their share prices outperform the market as they continued to post record-breaking earnings. Taking advantage of the lowest interest rates in decades, homebuyers have flocked to buy new homes and townhouses built by these firms.

But in what could be a sign that the good times are coming to an end, the Commerce Department Thursday reported that new home sales fell 15% in January, the largest percentage drop in nine years. That data comes on the back of concerns expressed by some analysts that lenders are beginning to tighten underwriting standards for mortgages, particularly for lower-income and first-time buyers.

"The market is skeptical of the sustainability of the earnings," says Barbara Allen, senior housing analyst at New York investment bank Natexis Bleichroeder. "Investors are paying less and less, on the fear that earnings will go down."

That has become clear during the past few weeks as the shares of

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COMPANIES

Dow Jones, Reuters

Centex Corp. (CTX)

PRICE	55.28
CHANGE	-0.28
U.S. dollars	2/28

D.R. Horton Inc. (DHI)

PRICE	18.31
CHANGE	-0.19
U.S. dollars	2/28

KB Home (KBH)

PRICE	46.90
CHANGE	-0.45
U.S. dollars	2/28

Lennar Corp. (LEN)

PRICE	53.99
CHANGE	-0.09
U.S. dollars	2/28

Pulte Homes Inc. (PHM)

PRICE	50.83
CHANGE	-0.29
U.S. dollars	2/28

homebuilders have come off of 52-week highs they set in the first half of 2002. During the past several years, even with a few ups and downs, the sector has been a rare bright spot in a gloomy stock market. But some souring sentiment surfaced for several companies. In December analysts downgraded KB Home and on Wednesday, Pulte was also downgraded. The two companies rank within the top five builders in terms of numbers of homes built.

Toll Brothers Inc. (TOL)

PRICE	19.37
CHANGE	-0.10
U.S. dollars	2/28

Beazer Homes USA Inc. (BZH)

PRICE	58.36
CHANGE	0.36
U.S. dollars	2/28

* At Market Close

In the case of KB, Banc of America Securities and JMP Securities brought the Los Angeles builder down to "neutral" and "market outperform," respectively. The worry: Although KB was able to sell homes for higher prices, the number of new homes it was able to sell remained relatively flat. In the case of Pulte, Salomon Smith Barney earlier this week downgraded the shares to "in line" from "outperform," citing little further upside in an already high stock price.

For now at least, most brokerage analysts are focused more on whether the stocks are overpriced relative to their earnings than on any fundamental meltdown in the sector. As a group, the home builders price-to-earnings trading ratio hit a peak back in May 2002, when it traded at 9.9 times trailing 12-month earnings. That ratio has now slipped to 6.6, which has prompted the builders themselves to argue their shares are cheap. Meanwhile, the group's price-to-book-value ratio, an indicator favored by industry analysts, has fallen to 1.29 from 1.97 during the same period.

J.P. Morgan Securities analyst Michael Rehaut thinks the builders are overly optimistic about their prospects. In a January report, he said that decelerating housing starts, slowing order growth and rising inventory levels translate into a tougher pricing environment for the companies. As a result, homebuilders will resort increasingly to special incentives and discounting.

Mr. Rehaut doesn't see gains in the builders' share prices until the price-to-book-value ratio falls below one, which he points out is consistent with what has happened each time home builders have fallen out of favor with investors. Some builders are already there; **Beazer Homes USA** Inc. is at about 91% of book value even though it has been posting record earnings just like the other big home developers.

Analysts and some investors say they already are seeing signs of builders resorting to tricks to lure in buyers. No-downpayment programs are becoming more prevalent. Some builders are offering upgrades like better-quality kitchen cabinetry and appliances at no additional costs.

All the major builders are using so-called "gifting" programs in softer markets such as Denver, Texas and Arizona. Such programs allow buyers to purchase homes without a down payment, which in turn is provided by nonprofit organizations supported by the builders. The large homebuilders report that an average of 3% of their sales are covered by such programs, though in the case of KB Home the number is closer to 13%.

Then there is the question of tighter credit standards by lenders. In the fourth quarter, a Federal Reserve survey of bank-lending practices showed a growing number of banks tightening their lending policies in the face of record high defaults and foreclosures. Like many other businesses, some homebuilders have gotten into the lending game themselves. Dallas-based Centex, for instance, provides loans to some homebuyers with spotty credit histories.

In a recent conference call with investors, Jay Bray, the chief financial officer of Centex Home Equity Company, a subsidiary of the homebuilder, assured investors that the company goes above and beyond to ensure the quality of its loans. Centex "deals primarily in the prime of sub-prime business," he stressed.

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