# Toll Brothers
## 2002 ANNUAL REPORT

*Building America's Luxury Homes for Over 35 Years*

*Households with incomes of $100,000 or more (in constant 2001 dollars) have been growing at a pace nearly eight times faster than U.S. households in total over the past twenty years. There were 15.1 million of these affluent households in 2001 compared to 10.9 million five years earlier and 4.6 million twenty years earlier.*

**U.S. Census Bureau, "Money Income in the United States: 2001" • September 2002**

# A Company Profile

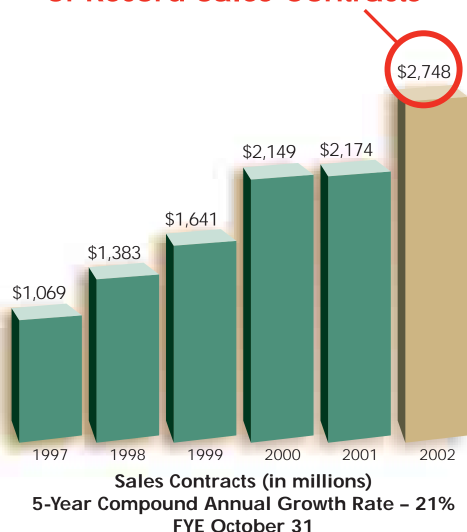
Toll Brothers is the nation's leading builder of luxury homes. A Fortune 1000 company and the eighth largest U.S. home builder by revenues, Toll Brothers was formed in 1967 and has been publicly traded on the New York Stock Exchange (NYSE: TOL) since 1986. The Company serves move-up, empty-nester, active-adult and second-home buyers in 6 regions, 22 states and 43 markets from more than 170 selling communities.

Toll Brothers operates its own architectural, engineering, mortgage, title, land development and land sale, golf course development and management, home security, landscape, cable TV and broadband Internet access subsidiaries. Toll Brothers also maintains its own lumber distribution and house component assembly and manufacturing operations.

Toll Brothers is the only national home building company to have won all three of the industry's highest honors: *America's Best Builder*, the *National Housing Quality Award* and *Builder of the Year.* The Company has won awards for design excellence in all of the regions in which it builds. Toll Brothers' reputation for quality, value and choice has made it the brand name for luxury homes in the United States.

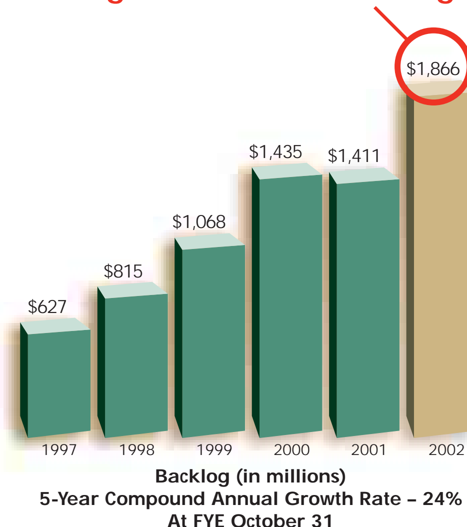
**As the only national home building company focused primarily on the luxury market, Toll Brothers enjoys significant advantages over the small and mid-sized privately owned builders that are its main competitors:**

- A unique home building design and construction system that allows customers to extensively customize their homes while maintaining the efficiencies of high-volume home production.
- Wholly-owned architectural, engineering and house component manufacturing subsidiaries that integrate all phases of the development process, from land planning to house design to construction, into one seamless process.
- National purchasing programs with suppliers of lumber, doors, windows, appliances, carpeting, flooring, plumbing fixtures and dozens of other products that are used in its homes.
- Stockholders' equity of over $1 billion and investment-grade credit ratings from Standard & Poor's, Moody's and Fitch that have enabled Toll Brothers to raise nearly $2 billion in the public and bank capital markets in the past six years at rates and terms more favorable than those attainable by its smaller competitors.
- A land supply of nearly 41,000 home sites owned or controlled and the resources and expertise to secure land approvals and develop sites in an increasingly complex regulatory environment.
- A growing array of ancillary businesses, including mortgage, title, security, cable and Internet delivery and landscaping, that provide additional services and facilitate the home buying process for our customers.
- A brand name reputation and aggressive marketing program that integrates print, Internet, radio, billboard advertising and direct marketing.
- An entrepreneurial management system that places responsibility for all aspects of each community in the hands of a project manager, who oversees sales, marketing, product selection, land development and construction, and has the flexibility of a small custom builder to serve buyers and make key decisions in the field.



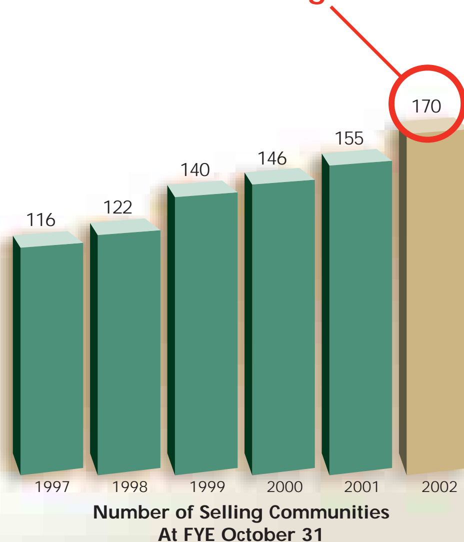
**Sales Contracts (in millions)**
**5-Year Compound Annual Growth Rate – 21%**
**FYE October 31**

**Stockholders' Equity (in millions)**
**5-Year Compound Annual Growth Rate – 24%**
**At FYE October 31**

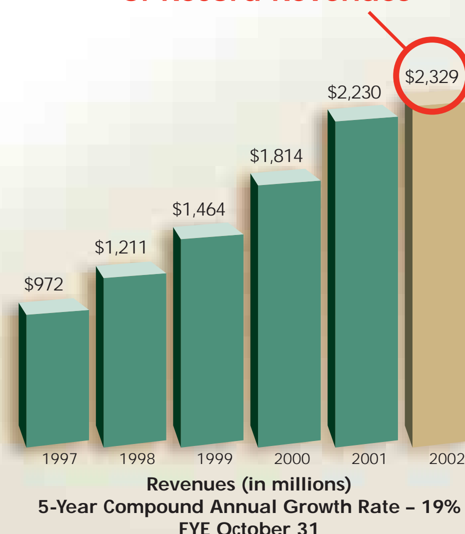


**Backlog (in millions)**
**5-Year Compound Annual Growth Rate – 24%**
**At FYE October 31**

**Earnings Per Share***
**5-Year Compound Annual Growth Rate – 26%**
**FYE October 31**
**Before extraordinary items and change in accounting*



**Number of Selling Communities**
**At FYE October 31**



**Revenues (in millions)**
**5-Year Compound Annual Growth Rate – 19%**
**FYE October 31**

*"Most economists (including Alan Greenspan) argue that [home] price increases rest on a sturdy foundation: low interest rates, strong demographics and a tight supply of homes. Large, publicly traded home builders like Toll Brothers...control a bigger piece of the new-home market than they did in the last recession, and they're better capitalized and better managed than smaller builders, reducing the risks of overbuilding."*

***Newsweek* • August 26, 2002**

# Dear Shareholders,

For a fiscal year that began in the shadow of September 11th, Toll Brothers' performance in 2002 far exceeded our expectations. Despite an economy mired in recession, we produced:

- Our tenth consecutive year of record earnings
- Our eleventh consecutive year of record revenues
- Our twelfth consecutive year of record contracts
- Our highest year-end backlog ever

Heading into the home stretch in fiscal 2002, we continued to gain momentum as we achieved:

- A fourth-quarter record for contracts, up 34% versus 2001
- A fourth-quarter record for backlog, up 32% versus 2001
- The highest earnings and revenues for any quarter in our history

In the face of a faltering stock market, and perhaps partly because of it, demand for our luxury homes remained strong. We believe that poor returns on alternative investments, and very low returns on cash, motivated customers to buy a new home to enhance their lifestyle as well as for a reliable and stable investment.

With home prices continuing to rise, concerns emerged regarding the risk of a "housing bubble." As this notion gained attention, the price of our stock and those of the other public home building companies declined.

We believe that rising home prices in 2002 were not the result of a speculative bubble; rather, they were caused by strong, demographics-driven demand colliding with a shortage of building lots due to no-growth politics and increasing governmental regulatory constraints. Demand in our niche of the luxury market was buoyed by a low 3%* unemployment rate among affluent, white-collar workers and continuing growth of high-earning families: there are now more than 15 million households with incomes of $100,000 or more, in constant 2001 dollars, compared to 8.6 million in 1991.

In contrast to the late 1980s, when our industry could and did overbuild in response to strong demand, home builders have not done so this time. In fact, the supply of available new unsold "spec" homes remains near all-time record lows. One reason is the limit placed on supply by the regulatory process. Another is the increasing dominance of the industry by the major public home building companies: firms with seasoned management teams and sophisticated planning capabilities.

*Left to right:*
Zvi Barzilay, President and COO
Robert I. Toll, Chairman of the Board and CEO
Bruce E. Toll, Vice Chairman of the Board

**Census Bureau unemployment rate for job category: Managerial and Professional Specialty Occupations*

The largest public home building companies have produced excellent results both leading up to and throughout this recession. Even though single-family housing production has remained at near-constant levels for the past ten years, we've continued to grow by gaining market share. With reliable access to public and bank capital markets, the ability to control large quantities of home sites and the skills to navigate complex political and regulatory land approval processes, the large public home building companies have become less cyclical firms.

With this attractive investment profile, we believe the stocks of these companies, which today are trading at six to seven times current-year projected earnings, could be valued at double or triple these price/earnings multiples as the market comes to recognize their reduced cyclicality, greater dependability and excellent growth potential.

Toll Brothers is a prime example: without any major acquisitions, we have produced compound average annual earnings and revenue growth of 20% since going public sixteen years ago. In the last five years alone, we have doubled our revenues and tripled our earnings through a period that has included rising interest rates (in 1999 and 2000), the stock market crash, a recession, the tragedies of September 11th and several international financial crises.

Experts project that the combination of new household formations, demand for new second homes and the need to replace obsolete housing stock will propel demand for new housing nationwide to 1.7 million units per year during this decade. With the growth constraints on supply, we believe home prices will continue to rise and those large building companies that can win approvals and control home sites will continue to gain market share.

Based on trends that show Americans desiring larger and more highly amenitized homes, we believe growing waves of maturing baby boomers reaching their peak earning years and increasing numbers of immigrants seeking to participate in the American dream will increase demand for luxury homes. As the only national home building company focused primarily on the luxury market, Toll Brothers is positioned to prosper as we expand our presence in the luxury market.

In what we believe will be an increasingly lot-constrained environment – particularly in the upscale markets where we build – we have demonstrated our ability to control land, to gain approvals, and to open new communities. In fiscal 2002, we increased the number of lots we own or control to nearly 41,000, which will help us continue to capture greater market share, diversify geographically and expand our move-up, empty-nester, active-adult and second-home product lines.

We enter fiscal 2003 with 170 selling communities, the most in our history, and our largest year-end backlog ever. At $1.87 billion, this backlog equals 82% of FY 2002's home building revenues. We believe this pipeline, totaling nearly 3,400 homes, positions us to produce record home building revenues of at least $2.6 billion (approximately 5,000 home deliveries) in 2003. And with a projected community count of approximately 185 by fiscal year end 2003, we believe we can produce home building revenues of more than $3 billion (approximately 6,000 home deliveries) in 2004, assuming current demand.

Home building has been an oasis of growth in an otherwise weak economy. Although an improved economy would likely lead to higher interest rates, we believe the benefits to our industry of improved consumer confidence and renewed job growth will far outweigh the impact of a rise in rates.

With our land supply, management strength, unique customization systems and high-volume production techniques, we believe we are well prepared for the future. To continue to flourish, we will seek to maintain the balance between caution and opportunity that has enabled us to achieve the industry's highest standards of profitability and quality.

We thank our shareholders and our customers for their ongoing support and our associates, whose diligence and determination are the cornerstones of your Company's success.

| **ROBERT I. TOLL** | **BRUCE E. TOLL** | **ZVI BARZILAY** |
|---|---|---|
| Chairman of the Board and Chief Executive Officer | Vice Chairman of the Board | President and Chief Operating Officer |

*December 12, 2002*

*"We're on our 13th project for Toll Brothers and are pleased to be associated with such a fine firm. They have a reputation for doing one of the best jobs of anybody in the development business, which is pretty darn good!"*

**Arnold Palmer • Golf Course Designer and Golf Legend**

# Creating a Lifestyle Brand

At Toll Brothers, we build more than just beautiful homes...we build luxurious lifestyle communities. Whether our customer is a growing family expanding into a larger home, an empty-nester buying a second residence or an active adult dreaming of living on the 18th hole, we have a community to fit their lifestyle.

Our communities range from small, extensively landscaped sites of 25 to 30 homes, to large, multi-product master plans with golf courses, country clubs and several thousand homes. Throughout 6 regions of the country in 43 markets and 22 states, the Toll Brothers name is becoming synonymous with luxury living. In this time of economic and political uncertainty, with renewed emphasis on hearth and home, the sense of personal and financial security that our homes and communities engender has helped broaden the appeal of our brand.

Our unique project management system affords each of our buyers the individual attention one would expect from a custom home builder. Our trademark customization program enables our buyers to choose from dozens of home designs and hundreds of combinations of structural and designer options such as solariums, guest suites and conservatories. From initial home site selection through closing, our process helps our buyers create beautiful homes that enhance their lifestyles. In this age of choice, our typical buyers add an average of $90,000 in options and lot premiums to their homes.

With our high-volume home building production capabilities and the benefits we derive through our national buying programs, we can provide excellent value to our home buyers that smaller builders find difficult to match. Home quality is ensured through our rigorous, multi-stage, pre-closing inspection process and because we pre-design and pre-budget our homes and options. Through systemization, our goal is to make building a luxury home an enjoyable, stress-free experience for our home buyers.

Our most dramatic communities are our large-scale master plans. We have teamed up with some of the world's great golf course designers to create memorable courses and communities, which typically include country clubs, fitness centers, pools, tennis courts and walking trails. We already have master planned communities open or in development in ten states and plan to introduce these communities throughout the nation.

# CALIFORNIA

## creating the lifestyle brand

With an average delivered home price of over $800,000, California is our highest priced region. Our offerings are diverse, ranging from town homes and condominiums to estate homes, with base prices of $300,000 to over $1 million.

We now build in seven counties in California: Los Angeles, Orange, Riverside and San Diego in Southern California and Alameda, Contra Costa and Marin in Northern California. These markets produced more than 57,000 single-family home permits in 2001. With a rebound in the San Francisco Bay area and steady, solid results in our other California markets, our California backlog grew 70% in 2002. Yet, even with this growth, our market share is less than 1% in these affluent territories which have over 1.5 million $100,000+ income households. This means we have tremendous room for expansion.

The vastness of the state demands different architectural styles in each market. The concept of allowing buyers to choose their home site, then separately design their homes, is an innovation we brought to California, where builders typically obtained their permits with each home and home site already determined.

Our strong capital base and land entitlement capabilities have served us well in California, where we have secured approvals and developed several large sites in lot-constrained locations, including an 1,800-home joint venture with one of California's largest oil producers in Yorba Linda, Orange County, and our nearly 2,000 home Dublin Ranch community adjacent to San Francisco in Contra Costa County.

Country Club Estates at Moorpark is a 216-home community located in the heart of Ventura County's equestrian country, northwest of Los Angeles, in an area with thousands of acres of avocado and citrus groves. This country club setting features panoramic views of hillside orchards and Moorpark Country Club's spectacular 27-hole championship golf course. Many of the home sites are adjacent to the lush fairways and natural landscape. Horizon views of mountain and ocean scenery add to the picturesque surroundings, which feature miles of hiking and biking trails. Moorpark is California living at its finest.

*Moorpark Country Club • Moorpark, CA*

*"Real estate is an incredibly steady investment. Not once since the 1960s...has the nation's median home price declined in a calendar year...overall, home prices have risen an average of 6.3% annually. The median home now sells for 2.8 times the median family income – up from 2.6 in 1990. But this ratio has historically ranged from 2.5 to 3, so the current reading puts housing squarely in the fair-value zone."*

***Time* • August 5, 2002**

# Disputing the Bubble

In the past year, proponents of a "housing bubble" have argued that the recent increase in housing prices mirrors the late 1990s' speculative NASDAQ run-up. We disagree and believe instead that the fundamentals governing supply and demand for new homes remain quite healthy.

For nearly all home buyers, purchasing a new home is a lifestyle decision, not a short-term speculative investment. Unlike stocks, homes cannot be purchased or sold instantaneously, thus igniting the type of frenzied speculation that inflated, then deflated, the NASDAQ so quickly. Home ownership offers many financial advantages, but they generally are long-term advantages that most benefit long-term owners.

According to the National Association of Realtors® (NAR), new home prices have risen in all but two of the past thirty years and the median price of a new home has grown at an average rate of 5.4% per year since 1967. This suggests that recent price increases in most markets are not out of line with historical performances.

New home affordability remains attractive. The NAR's Affordability Index for both new and existing homes is near its highest level since 1993. Similarly, the current relationship between median family income and median new home price (median income divided by median new home price) is above the average level from 1990 to today.

Demand is strong, in part, because of the rapid growth in U.S. households. The U.S. added 32 million people to its population in the 1990s, the largest absolute growth in the past fifty years. The shrinking average size of households, increasing rate of home ownership, and rapid growth in immigration have added fuel to the demand. Increasing affluence and innovative mortgage products that reduce the impact of interest rate volatility have helped make luxury homes affordable to more buyers than ever before.

Despite a larger customer base and attractive affordability, new and existing home inventories remain at near-record low levels based on months' supply available. The increasingly complex regulatory process has lengthened the land approval process in virtually every one of our markets. This has restricted lot supplies, one of the main reasons why the volume of single-family housing starts in the U.S. has been relatively constant over the past ten years, even with strong growth in demand.

*The Orinda ▪ San Ramon, CA*

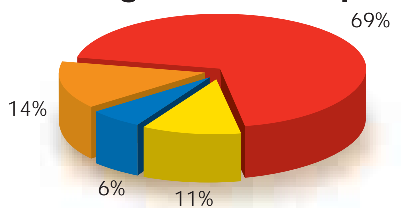
*"Long-term trends in America are to bigger and better homes. The major story of the past two decades is a persistent increase in the quality, size and price of the U.S. housing stock. In fact, the fastest increasing sector is the largest homes of 4,000 square feet and more."*

**Dr. Susan Wachter, Professor of Real Estate and Finance**
**The Wharton School, University of Pennsylvania**

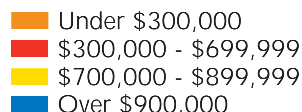
# Platform for Growth

We serve the "sweet spot" in the luxury market – the over 15 million U.S. households with annual net incomes of $100,000 or more. This group has increased eight times more rapidly than U.S. households overall in the past two decades. With the highest rate of home ownership, the most disposable wealth and the greatest financial flexibility among U.S. households, this group offers tremendous opportunity for us to increase our presence in the luxury new home market.

### Serving the "Sweet Spot"



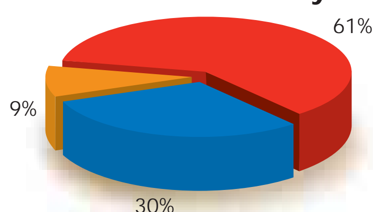

**FYE 2002 Delivered Home Sale Prices**




Avoiding the multimillion-dollar custom home market, we have focused instead on the "nearly custom" niche. In fiscal 2002, the average price of the homes we delivered was $514,000. Over 83% of our homes sold for under $700,000, with nearly 70% between $300,000 and $699,000. At these price points, our products are well within reach of a vast number of buyers.

To serve this expanding customer base, we have steadily diversified our product lines across the luxury spectrum. We now offer move-up, empty-nester, active-adult and second-home communities. New initiatives, such as urban infill communities and six-, eight- and even nineteen-plex attached home communities, are adding to our product lines. Our single-family attached homes range in base price from $166,000 to $622,000 and our single-family detached homes range in base price from $233,000 to $1.5 million. On average, our buyers add 21% to the base price of their homes in options and premiums.

### Product Diversity



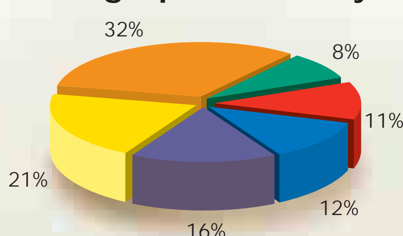

**FYE 2002 Home Contracts by Product Line***

**Approximate, because not all customers complete buyer profiles questionnaires*

We also continue to expand geographically. In 2002, we delivered our first homes in San Antonio, opened our first communities in Denver and acquired our first site in South Carolina's Hilton Head market. We expanded our active-adult product line into suburban Philadelphia and Northern Virginia, and our second-home product line, which is already in Arizona, Florida and California, into Delaware (Bethany Beach), Maryland (Ocean City) and Pennsylvania (the Pocono Mountains).

We believe we still have significant expansion potential. Based on the typical 4% to 10% market share we have in the territories where we are best established, we believe that, over time, in many of our newer markets we can reach, on average, at least a 3% share of new single-family home starts. This equates to approximately 12,000 homes annually – nearly triple our current production. Additionally, we have identified nearly two dozen potential new markets with comparable demographics, where achieving the 3% threshold would yield another 8,000 new home sales annually. Although our ability to achieve these volumes is definitely subject to many variables and uncertainties, the opportunity exists for dramatic growth.

### Geographic Diversity




**FYE 2002 Homebuilding Revenues by Region**

# METRO D.C.

## a platform for growth

The metro Washington, D.C., area of Northern Virginia and Maryland is currently our largest market. We offer homes in 35 communities representing a wide array of move-up, empty-nester, active-adult and country club lifestyles. With 12,220 lots under our control, we have a well-planned future ahead of us. After a decade in the area, we have reached a 3% market share in our metro D.C. territories. Our performance in this region illustrates the success we can achieve with our combination of management, capital, land acquisition, development, design and marketing resources.

In Virginia, our land development and approvals expertise has enabled us to open large communities in unique infill locations. We have the resources to take on large complex projects which may require many years and millions of dollars to win approvals.

This growing area is home to several of our large master planned golf course communities, a 930-home active-adult community and many smaller, empty-nester and move-up communities selling both attached and detached homes to a wide variety of luxury buyers. Toll Brothers Realty Trust, our commercial property affiliate, is completing an 806-unit luxury apartment community in Fairfax County, VA.

Nestled in the shadow of the Bull Run Mountains, Dominion Valley comprises two master planned golf course communities: Dominion Valley Country Club for move-up and empty-nester resort-style living, and Regency at Dominion Valley for active-adult living. Base prices for the nearly 3,000 homes here range from the $200,000s to over $600,000. Resort-style amenities abound. Dominion Valley Country Club showcases a spectacular Arnold Palmer Signature Golf Course; Regency at Dominion Valley adds a challenging course by Palmer Course Design Company. Each private community boasts its own luxurious Clubhouse. Other fabulous amenities include a planned town center, Sports Pavilion, indoor and outdoor swimming pools, tennis courts, ball fields, and miles of recreational trails.

*The Hampton ▪ Haymarket, VA*

*"The home building industry has consolidated. Now it's dominated by big, publicly owned players like Toll Brothers...that are far more conservative than the local builders."*

**Mark Zandi, Economy.com**
***Fortune* • October 28, 2002**

# A Strong Financial Foundation

We believe that the luxury market is the most profitable niche in the home building industry and that our results bear this out. Again in 2002, *Fortune* magazine ranked us the leader for profit margins among the home building companies in the Fortune 1000. Our strong management team, our land acquisition and development expertise, our unique customization systems and our high-volume production capacity all are contributing factors that help us create tremendous value for our shareholders. Since going public in 1986, stockholders' equity has grown at a 27% compound average annual growth rate.

In the past decade, compound annual earnings growth has averaged 29%, revenue growth – 24%, contract growth – 23% and backlog growth – 26%. Based on the demographics of our markets and the communities in our pipeline, we believe we can achieve growth of at least 15% on average, if not higher, in the coming years.

Financially, we continue to strengthen our foundation and increase our liquidity. In the public capital markets, in early fiscal 2002 we raised $150 million through an 8.25% ten-year senior subordinated debt offering. In November of 2002, we entered the investment-grade senior debt market and raised $300 million through a ten-year debt offering priced at 6.875%. We will use a portion of these proceeds to retire our $100 million of 8 3/4% Senior Subordinated Notes due in 2006, thus generating approximately $1.88 million annually in pre-tax interest savings. In the bank capital markets, this summer we added $95 million to our revolving credit and term loan facilities, which now total over $800 million. At fiscal year end, we had $537 million unused and available under our bank revolving credit facility.

We enter 2003 with over $1.1 billion in equity and with investment-grade senior credit ratings from Standard & Poor's (BBB-), Moody's (Baa3) and Fitch (BBB). The average maturity of our debt outstanding is nearly seven years, and we face no significant maturities until 2005. Supported by growing waves of maturing affluent baby boomers, we believe we have the liquidity and capital to expand and take advantage of opportunities in the future.

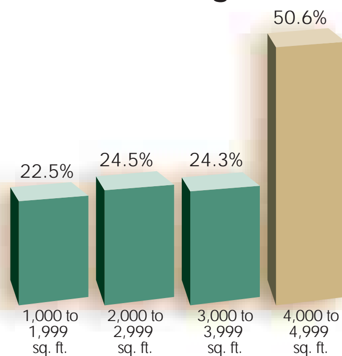
*The Mallorca* ▪ *Palm Beach Gardens, FL*

*"Producing housing for the burgeoning number of U.S. households, together with meeting baby-boomer demand for vacation and retirement homes and replacing units lost from [obsolete housing] stock, calls for average annual construction of 1.7 million new homes and apartments in the decades ahead."*

**Harvard University • The State of the Nation's Housing 2002**

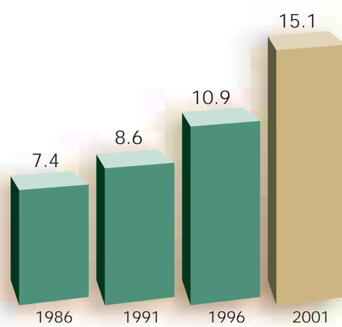
# A Prosperous Decade Ahead

### Demand for Larger Homes



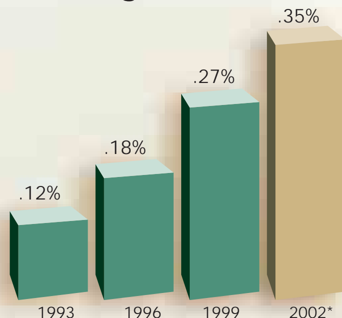

**Change in Number of Homes by Size in U.S. 1985 - 1999**
*Source: American Housing Survey – U.S. Census Bureau*

### Number of Affluent Households




**$100,000+ Income Households (in Millions) (in constant 2001 dollars)**
*Source: U.S. Census Bureau*

### Increasing Market Share




**Toll Brothers' Market Share of U.S. Single-Family Housing Starts**
*Source: NAHB and Company data*
**2002 U.S. housing starts are estimated*

Based on the start of the new millennium and projections of demand for new housing in the future, this should be a tremendous decade for Toll Brothers and the other major public U.S. home building companies.

Experts predict that new households will be forming at the rate of 1.2 million a year for the next two decades, which is comparable to the growth in the 1990s. According to *American Demographics* magazine, the growing appetite for new second homes from maturing baby boomers will require construction of about 300,000 of these homes annually this decade. In addition, with the U.S. housing stock at its oldest average age ever, the need to replace about 300,000 units of obsolete housing each year will further drive demand. In total, experts predict that demand will exist for approximately 1.7 million new units per year this decade. With production having averaged 1.5 million single- and multi-family housing starts over the past ten years, the possibility exists that, going forward, not enough new lots will emerge from the approval process to meet this projected demand.

The largest group of baby boomers, the 4 million people born annually between 1954 and 1964, are now 38 to 48 years of age and in their peak earning years. Their affluence and taste for larger, more highly amenitized and more technologically sophisticated homes, and more than one home in many cases, is a major source of this demand.

Immigration, which brought 7 million people to the U.S. in the 1980s and 9 million in the 1990s, is another major source of demand. Studies show that immigrants, once established, achieve a higher rate of home ownership than their U.S.-born counterparts. Nearly one in four of these working immigrants holds a technical, managerial or professional position, which bodes well for the luxury market.

Affluent households, those earning $100,000 or more annually, are the fastest-growing economic group of home buyers. With the baby boomers in their peak earning years, the empty-nester market already gaining momentum and the active-adult market poised to take off, we are positioned for growth in each of our primary product lines.

Although the top ten publicly traded home building companies have doubled their market share in the past five years alone, their percentage of total housing starts is still under 20%. Toll Brothers' share has nearly tripled in the last decade but still represents only one-third of one percent. In what is still a highly fragmented industry, as the complexity and cost of gaining approvals and meeting regulatory requirements increases, we believe the major public home building companies will gain significant market share at the expense of smaller builders in the decade ahead. We believe the best is yet to come.

# FLORIDA

## a prosperous decade ahead

We build on the southeast and southwest coasts of Florida in some of the most affluent markets in the United States. We entered Florida in 1995 and have grown revenues and contracts each year. In fiscal 2002, we produced $175 million of revenues and $230 million of contracts. With our record backlog of $156 million, up 55% from one year ago, we are poised for another record year of growth in Florida for 2003.

We started in Florida conservatively, by acquiring finished lots in an existing master plan. As we learned the market and built our subcontractor base, we graduated to gaining approvals and acquiring land for our own communities. We then began developing master planned golf course communities in which we now build multiple product lines of move-up and empty-nester homes with tremendous amenities packages. Florida has also been a region of innovation for us as we introduced our first "nineteen-plex" multi-family product and hotel-style suites for guests of our golf course community residents. On the horizon – a luxury high-rise beachfront condominium community near Palm Beach Gardens.

In Florida, the markets in which we build generated 49,000 – or 42% – of the state's 118,000 single-family permits in 2001. With just over 400 deliveries in these markets in fiscal 2002, we have the opportunity to expand our market share significantly within these locations.

Frenchman's Reserve is a golf course community of 443 homes in Palm Beach Gardens, Florida, built around an 18-hole Arnold Palmer Signature Golf Course. We offer homes with base prices from $600,000 to over $1,000,000, a bargain because we are situated amidst other communities whose base prices begin at $2 million. The design of our homes and the exquisite interior decorating of our models earned us a layout in *Architectural Digest* magazine this autumn. The Villa Rosa home pictured here won a Gold Award in Florida's prestigious 2002 PRISM Awards competition, one of nearly fifty awards our Florida communities won in fiscal 2002.

*The Villa Rosa ▪ Palm Beach Gardens, FL*

## THE WEST COAST*

**Los Angeles ▪ Palm Springs ▪ San Diego ▪ San Francisco**

| | |
|---|---|
| Revenues *(in millions)* | $362 |
| Contracts *(in millions)* | $472 |
| Lots Owned or Controlled | 3,842 |
| Year-end Backlog *(in millions)* | $308 |
| Average Delivered Price *(in thousands)* | $818 |

## THE SOUTHWEST*

**Arizona ▪ Colorado ▪ Nevada ▪ Texas**

| | |
|---|---|
| Revenues *(in millions)* | $270 |
| Contracts *(in millions)* | $351 |
| Lots Owned or Controlled | 4,699 |
| Year-end Backlog *(in millions)* | $269 |
| Average Delivered Price *(in thousands)* | $527 |

### MOVE-UP SPOTLIGHT

*Award-winning Monterossa in Las Vegas, which opened in October 2001, was a community one would have expected to suffer after the September 11th tragedies. However, both Monterossa and the Las Vegas market have proven resilient. At Monterossa, which serves growing families in Las Vegas' move-up market, our year-end backlog of over 56 homes averaged $382,500 per home. And we continue to raise prices!*

*Data is for FYE October 31, 2002

**ACTIVE-ADULT SPOTLIGHT**

*From the day it opened in January 2001, Regency at Monroe, in central New Jersey, has redefined our expectations of the possibilities for active-adult communities. Built around a 9-hole golf course by Palmer Course Design Company, its year-end backlog of 96 homes has an average price of over $400,000. Once buyers have finished selecting all their options, some homes have sold for in excess of $550,000.*

## THE MIDWEST*

**Illinois ■ Michigan ■ Ohio**

| | |
|---|---|
| Revenues *(in millions)* | $187 |
| Contracts *(in millions)* | $203 |
| Lots Owned or Controlled | 2,703 |
| Year-end Backlog *(in millions)* | $153 |
| Average Delivered Price *(in thousands)* | $475 |

## THE NORTHEAST*

**Connecticut ■ Massachusetts ■ New Hampshire ■ New Jersey ■ New York ■ Rhode Island**

| | |
|---|---|
| Revenues *(in millions)* | $465 |
| Contracts *(in millions)* | $519 |
| Lots Owned or Controlled | 8,429 |
| Year-end Backlog *(in millions)* | $385 |
| Average Delivered Price *(in thousands)* | $525 |

## THE MID-ATLANTIC*

**Delaware ■ Maryland ■ Pennsylvania ■ Virginia**

| | |
|---|---|
| Revenues *(in millions)* | $735 |
| Contracts *(in millions)* | $890 |
| Lots Owned or Controlled | 17,838 |
| Year-end Backlog *(in millions)* | $547 |
| Average Delivered Price *(in thousands)* | $465 |

## THE SOUTHEAST*

**Florida ■ North Carolina ■ South Carolina ■ Tennessee**

| | |
|---|---|
| Revenues *(in millions)* | $259 |
| Contracts *(in millions)* | $312 |
| Lots Owned or Controlled | 3,333 |
| Year-end Backlog *(in millions)* | $204 |
| Average Delivered Price *(in thousands)* | $422 |

**EMPTY-NESTER SPOTLIGHT**

*In Palma, our empty-nester enclave at Mizner Country Club, in Florida's Boca Raton area, the price of homes in our $14 million backlog average $645,000 including an average of $90,000 in options and lot premiums. Popular upgrades include outdoor kitchen-barbecue-wet bars, marble flooring and our golf cart garage doors to more easily access Mizner's Arnold Palmer Signature Golf Course.*

*The Springfield ▪ Castle Rock, CO*

# Toll Brothers' Eleven-Year Financial Summary

## SUMMARY CONSOLIDATED INCOME STATEMENT DATA *(Amounts in thousands, except per share data)*

| Year Ended October 31 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Revenues | $2,328,972 | $2,229,605 | $1,814,362 | $1,464,115 | $1,210,816 | $ 971,660 | $760,707 | $646,339 | $504,064 | $395,261 | $281,471 |
| Income before income taxes, extraordinary items and change in accounting | $ 347,318 | $ 337,889 | $ 230,966 | $ 162,750 | $ 134,293 | $ 107,646 | $ 85,793 | $ 79,439 | $ 56,840 | $ 43,928 | $ 28,864 |
| Income before extraordinary items and change in accounting | $ 219,887 | $ 213,673 | $ 145,943 | $ 103,027 | $ 85,819 | $ 67,847 | $ 53,744 | $ 49,932 | $ 36,177 | $ 27,419 | $ 17,354 |
| Net income | $ 219,887 | $ 213,673 | $ 145,943 | $ 101,566 | $ 84,704 | $ 65,075 | $ 53,744 | $ 49,932 | $ 36,177 | $ 28,058 | $ 16,538 |
| Income per share | | | | | | | | | | | |
| Basic | | | | | | | | | | | |
| Income before extraordinary items and change in accounting | $ 3.12 | $ 2.98 | $ 2.01 | $ 1.40 | $ 1.18 | $ 0.99 | $ 0.79 | $ 0.75 | $ 0.54 | $ 0.41 | $ 0.26 |
| Net income | $ 3.12 | $ 2.98 | $ 2.01 | $ 1.38 | $ 1.16 | $ 0.95 | $ 0.79 | $ 0.75 | $ 0.54 | $ 0.42 | $ 0.25 |
| Weighted average number of shares | 70,472 | 71,670 | 72,537 | 73,378 | 72,965 | 68,254 | 67,730 | 67,020 | 66,796 | 66,462 | 66,044 |
| Diluted | | | | | | | | | | | |
| Income before extraordinary items and change in accounting | $ 2.91 | $ 2.76 | $ 1.95 | $ 1.38 | $ 1.12 | $ 0.93 | $ 0.75 | $ 0.71 | $ 0.52 | $ 0.41 | $ 0.26 |
| Net income | $ 2.91 | $ 2.76 | $ 1.95 | $ 1.36 | $ 1.11 | $ 0.89 | $ 0.75 | $ 0.71 | $ 0.52 | $ 0.42 | $ 0.25 |
| Weighted average number of shares | 75,480 | 77,367 | 74,825 | 74,872 | 76,721 | 74,525 | 73,758 | 72,720 | 71,310 | 66,934 | 66,468 |

## SUMMARY CONSOLIDATED BALANCE SHEET DATA *(Amounts in thousands, except per share data)*

| At October 31 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Inventory | $2,551,061 | $2,183,541 | $1,712,383 | $1,443,282 | $1,111,223 | $ 921,595 | $772,471 | $623,830 | $506,347 | $402,515 | $287,844 |
| Total assets | $2,895,365 | $2,532,200 | $2,030,254 | $1,668,062 | $1,254,468 | $1,118,626 | $837,926 | $692,457 | $586,893 | $475,998 | $384,836 |
| Debt | | | | | | | | | | | |
| Loans payable | $ 253,194 | $ 362,712 | $ 326,537 | $ 213,317 | $ 182,292 | $ 189,579 | $132,109 | $ 59,057 | $ 17,506 | $ 24,779 | $ 25,756 |
| Subordinated debt | 819,663 | 669,581 | 469,499 | 469,418 | 269,296 | 319,924 | 208,415 | 221,226 | 227,969 | 174,442 | 128,854 |
| Mortgage warehouse loan | 48,996 | 24,754 | | | | | | | | | |
| Collateralized mortgage obligations payable | | | | 1,145 | 1,384 | 2,577 | 2,816 | 3,912 | 4,686 | 10,810 | 24,403 |
| Total | $1,121,853 | $1,057,047 | $ 796,036 | $ 683,880 | $ 452,972 | $ 512,080 | $343,340 | $284,195 | $250,161 | $210,031 | $179,013 |
| Stockholders' equity | $1,129,509 | $ 912,583 | $ 745,145 | $ 616,334 | $ 525,756 | $ 385,252 | $314,677 | $256,659 | $204,176 | $167,006 | $136,412 |
| Number of shares outstanding | 70,216 | 69,556 | 71,790 | 72,907 | 73,871 | 68,551 | 67,837 | 67,276 | 66,846 | 66,638 | 66,174 |
| Book value per share | $ 16.09 | $ 13.12 | $ 10.38 | $ 8.45 | $ 7.12 | $ 5.62 | $ 4.64 | $ 3.82 | $ 3.05 | $ 2.51 | $ 2.06 |
| Return on beginning stockholders' equity | 24.1% | 28.7% | 23.7% | 19.3% | 22.0% | 20.7% | 20.9% | 24.5% | 21.7% | 20.6% | 14.0% |

## HOME DATA

| Year Ended October 31 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Number of homes closed | 4,430 | 4,358 | 3,945 | 3,555 | 3,099 | 2,517 | 2,109 | 1,825 | 1,583 | 1,324 | 1,019 |
| Sales value of homes closed (in thousands) | $2,279,261 | $2,180,469 | $1,762,930 | $1,438,171 | $1,206,290 | $ 968,253 | $759,303 | $643,017 | $501,822 | $392,560 | $279,841 |
| Number of homes contracted | 5,113 | 4,366 | 4,418 | 3,845 | 3,387 | 2,701 | 2,398 | 1,846 | 1,716 | 1,595 | 1,202 |
| Sales value of homes contracted (in thousands) | $2,748,171 | $2,173,938 | $2,149,366 | $1,640,990 | $1,383,093 | $1,069,279 | $884,677 | $660,467 | $586,941 | $490,883 | $342,811 |

| At October 31 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Number of homes in backlog | 3,366 | 2,727 | 2,779 | 2,381 | 1,892 | 1,551 | 1,367 | 1,078 | 1,025 | 892 | 621 |
| Sales value of homes in backlog (in thousands) | $1,866,294 | $1,411,374 | $1,434,946 | $1,067,685 | $ 814,714 | $ 627,220 | $526,194 | $400,820 | $370,560 | $285,441 | $187,118 |
| Number of selling communities | 170 | 155 | 146 | 140 | 122 | 116 | 100 | 97 | 80 | 67 | 62 |
| Home sites | | | | | | | | | | | |
| Owned | 25,822 | 25,981 | 22,275 | 23,163 | 15,578 | 12,820 | 12,065 | 9,542 | 6,779 | 5,744 | 5,633 |
| Optioned | 15,022 | 13,165 | 10,843 | 11,268 | 14,803 | 9,145 | 5,237 | 5,042 | 4,445 | 4,271 | 3,592 |
| Total | 40,844 | 39,146 | 33,118 | 34,431 | 30,381 | 21,965 | 17,302 | 14,584 | 11,224 | 10,015 | 9,225 |

*Note: All share and per share amounts have been adjusted for a 2-for-1 stock split in March 2002.*

# Management's Discussion and Analysis

## CRITICAL ACCOUNTING POLICIES

The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to the recognition of income and expenses, impairment of assets, estimates of future improvement costs, capitalization of costs, provision for litigation, insurance and warranty claims and income taxes. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis of making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates and assumptions or conditions.

We believe the following critical accounting policies reflect the more significant judgments and estimates used in the preparation of our consolidated financial statements.

### Basis of Presentation

Our financial statements include the accounts of Toll Brothers, Inc. and its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. Investments in 20% to 50% owned partnerships and affiliates are accounted for on the equity method. Investments in less than 20% owned entities are accounted for on the cost method.

### Inventory

Inventory is stated at the lower of cost or fair value in accordance with Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of". In addition to direct acquisition, land development and home construction costs, costs include interest, real estate taxes and direct overhead costs related to development and construction, which are capitalized to inventories during the period beginning with the commencement of development and ending with the completion of construction.

It takes approximately four to five years to fully develop, sell and deliver all the homes in one of our typical communities. Longer or shorter time periods are possible depending on the number of home sites in a community. Our master planned communities, consisting of several smaller communities, may take up to 10 years to complete. Since our inventory is considered a long-lived asset under accounting principles generally accepted in the United States, we are required to review the carrying value of each of our communities and writedown the value of those communities for which we believe the values are not recoverable. When the profitability of a current community deteriorates or the sales pace declines significantly or some other factor indicates a possible impairment in the recoverability of the asset, we evaluate the property in accordance with the guidelines of SFAS No. 121. If this evaluation indicates an impairment loss should be recognized, we charge cost of sales for the estimated impairment loss in the period determined.

In addition, we review all the land held for future communities or future sections of current communities, whether owned or under contract, to determine whether or not we expect to proceed with the development of the land. Based upon this review, we decide: (a) as to land that is under a purchase contract but not owned, whether the contract will be terminated or renegotiated; and (b) as to land we own, whether the land can be developed as contemplated, or in an alternative manner, or should be sold. We then further determine which costs that have been capitalized to the property are recoverable and which costs should be written off.

### Income Recognition

Revenue and cost of sales are recorded at the time each home, or lot, is closed and title and possession are transferred to the buyer.

Land, land development and related costs (both incurred and estimated to be incurred in the future) are amortized to the cost of homes closed based upon the total number of homes to be constructed in each community. Any changes to the estimated costs subsequent to the commencement of delivery of homes are allocated to the remaining undelivered homes in the community. Home construction and related costs are charged to the cost of homes closed under the specific identification method.

The estimated land, common area development and related costs of master planned communities (including the cost of golf courses, net of their estimated residual value) are allocated to individual communities within a master planned community on a relative sales value basis. Any change in the estimated costs are allocated to the remaining lots in each of the communities of the master planned community.

### Joint Venture Accounting

We have investments in three joint ventures with independent third parties to develop and sell land that was owned or currently is owned by our venture partners. We recognize our share of earnings from the sale of lots to other builders. We do not recognize earnings from lots we purchase, but instead reduce our cost basis in these lots by our share of the earnings on those lot sales. We have agreed to purchase 180 lots from one of the ventures and have the right to purchase up to 385 lots from the second. The third venture has sold all the land that it owned and is currently in the process of completing the final land improvements which could take 12 months or more to finish. The joint ventures also participate in the profits earned on home sales from the lots sold to other builders above certain agreed upon levels. At October 31, 2002, we had approximately $12.7 million invested in these joint ventures and were committed to contribute additional capital of approximately $30 million if the joint ventures require it.

In addition, we effectively own one-third of Toll Brothers Realty Trust Group (the "Trust"), which was formed with a number of our senior executives and directors and with the Pennsylvania State Employees Retirement System to take advantage of commercial real estate opportunities that may present themselves from time to time. We provide development, finance and management services to the Trust and receive fees under various agreements. At October 31, 2002, our investment in the Trust was $7.5 million. We also entered into a subscription agreement whereby each group of investors agreed to invest an additional $9.3 million if required by the Trust. The original subscription agreement, which was to expire in June 2002, was extended to August 2003. The Trust currently owns and operates several office buildings and an apartment complex, a portion of which is rented and a portion of which remains under construction.

We also own 50% of a joint venture with an unrelated third party that is currently selling and building an active-adult, age-qualified community. At October 31, 2002, our investment was $1.2 million in this joint venture. We do not have any further commitment to contribute additional capital to this joint venture.

We do not currently guarantee any indebtedness of the joint ventures or the Trust. Our total commitment to these entities is not material to our financial condition. These investments are accounted for on the equity method.

## RESULTS OF OPERATIONS

The following table provides a comparison of certain income statement items related to our operations (amounts in millions):

| Year Ended October 31 | 2002 | | 2001 | | 2000 | |
|---|---|---|---|---|---|---|
| | $ | % | $ | % | $ | % |
| Home sales | | | | | | |
| Revenues | 2,279.3 | | 2,180.5 | | 1,762.9 | |
| Costs | 1,655.3 | 72.6 | 1,602.3 | 73.5 | 1,337.1 | 75.8 |
| Land sales | | | | | | |
| Revenues | 36.2 | | 27.5 | | 38.7 | |
| Costs | 25.7 | 70.9 | 21.5 | 78.0 | 29.8 | 77.0 |
| Equity earnings in unconsolidated joint ventures | 1.9 | | 6.8 | | 3.3 | |
| Interest and other | 11.7 | | 14.9 | | 9.5 | |
| Total revenues | 2,329.0 | | 2,229.6 | | 1,814.4 | |
| Selling, general and administrative expenses | 236.1 | 10.1 | 209.7 | 9.4 | 170.4 | 9.4 |
| Interest expense | 64.5 | 2.8 | 58.2 | 2.6 | 46.2 | 2.5 |
| Total costs and expenses | 1,981.7 | 85.1 | 1,891.7 | 84.8 | 1,583.4 | 87.3 |
| Operating income | 347.3 | 14.9 | 337.9 | 15.2 | 231.0 | 12.7 |

*Note: Percentages for selling, general and administrative expenses, interest expense, total costs and expenses and operating income are based on total revenues. Amounts may not add due to rounding.*

## FISCAL 2002 COMPARED TO FISCAL 2001

### Home Sales

Home sales revenues for fiscal 2002 were higher than those for fiscal 2001 by approximately $99 million, or 5%. The revenue increase was attributable to a 2% increase in the number of homes delivered and a 3% increase in the average price of the homes delivered. The increase in the average price of the homes delivered in fiscal 2002 was principally the result of increased base selling prices and an increase in the average value of options and lot premiums our buyers paid. In fiscal 2002, our buyers paid approximately 21% above the base selling price for options and lot premiums.

The slight increase in the number of homes delivered in fiscal 2002 was due primarily to the small increase in the number of delivering communities and a slight decline in the number of homes delivered per community.

We have encountered and continue to encounter delays in the opening of new communities and new sections of existing communities due to increased governmental regulation in many of the markets in which we operate. These delays resulted in a decline in the number of selling communities we had in the later part of fiscal 2000, which did not reverse until the middle of fiscal 2001. In addition, it often takes more than nine months from the signing of an agreement of sale to the delivery of a home to a buyer. Because of the delays in the opening of new communities in fiscal 2000 and 2001 and the long period of time before a new community can start delivering homes once it opens for sale, the increase in the average number of communities delivering homes in fiscal 2002 compared to fiscal 2001 was slight.

The number of homes delivered per community in fiscal 2002 declined slightly compared to fiscal 2001. This decline was primarily due to the decline in backlog at October 31, 2001 as compared to October 31, 2000 and a softness in new contract signings that we encountered in the first portion of the first quarter of fiscal 2002. The decline in backlog at October 31, 2001 and the softness in the first part of the first quarter of fiscal 2002 were due primarily to the slowing economy exacerbated by the tragic events of September 11, 2001.

The value of new sales contracts signed was $2.75 billion (5,113 homes) in fiscal 2002, a 26% increase over the $2.17 billion (4,366 homes) signed in fiscal 2001. This increase is attributable to a 17% increase in the number of homes sold and an 8% increase in the average selling price of the homes (due primarily to the location and size of homes sold and increases in base selling prices). The increase in the number of homes sold is attributable to an increase in the number of communities from which we were selling and the continued demand for our homes. At October 31, 2002, we were selling from 170 communities compared to 155 communities at October 31, 2001.

We believe that the demand for our homes is attributable to an increase in the number of affluent households, the maturation of the baby boom generation, a constricted supply of available new home sites, attractive mortgage rates and the belief on the part of potential customers that the purchase of a home is a stable investment in the current period of economic uncertainty. At October 31, 2002, we had over 40,800 home sites under our control nationwide in markets we consider to be affluent.

At October 31, 2002, our backlog of homes under contract was $1.87 billion (3,366 homes), 32% higher than the $1.41 billion (2,727 homes) backlog at October 31, 2001. The increase in backlog is primarily attributable to the increase in the number of new contracts signed and the increased prices of the homes sold during fiscal 2002 as previously discussed. Based on the size of our current backlog, the continued demand for our homes, the increased number of selling communities from which we are operating and the additional communities we expect to open in the early part of fiscal 2003, we believe that we will deliver approximately 5,000 homes in fiscal 2003 and the average delivered price of those homes will be between $530,000 and $540,000.

Home costs as a percentage of home sales revenues decreased to 72.6% in fiscal 2002 compared to 73.5% in fiscal 2001. The decrease was largely the result of selling prices increasing at a greater rate than costs, lower land and improvement costs, improved operating efficiencies and lower inventory writedowns, offset in part by the cost of increased sales incentives provided to customers in the later part of the fourth quarter of fiscal 2001 and the beginning of the first quarter of fiscal 2002. These incentives were used to help increase new contract signings which were adversely affected by the economic slowdown in the later part of fiscal 2001 and the effect that the tragic events of September 11, 2001 had on new orders. We incurred $6.1 million in write-offs in fiscal 2002 as compared to $13.0 million in fiscal 2001. In fiscal 2003, we expect that home costs will increase slightly as a percentage of home sales revenues due primarily to geographic and product mix changes.

### Land Sales

We are developing several master planned communities in which we sell land to other builders. The amount of land sales will vary from year to year depending upon the scheduled timing of the delivery of the land parcels. Land sales amounted to $36.2 million for fiscal 2002, as compared to $27.5 million for fiscal 2001. In fiscal 2003, land sales are expected to amount to approximately $20 million.

### Equity Earnings in Unconsolidated Joint Ventures

We are a party to several joint ventures and in Toll Brothers Realty Trust Group (the "Trust"). We recognize income for our proportionate share of the earnings from these entities. (See "Critical Accounting Policies – Joint Venture Accounting" for a narrative of our investment in and commitments to these entities.) In fiscal 2002 and 2001, only two of the joint ventures were operating. We recognized $1.9 million of earnings from these entities in fiscal 2002 compared to $6.8 million in fiscal 2001. The decline in earnings was caused by the reduction in the number of lots delivered by one of the joint ventures in fiscal 2002 compared to fiscal 2001. The reduction in fiscal 2002 was the result of fewer lots being available for sale by the joint venture due to the delivery of the last lots owned by it. Earnings from joint ventures will vary significantly from year to year depending on the level of activity of the entities. For fiscal 2003, we expect to realize approximately $4 million of income from our investments in the joint ventures and the Trust.

### Interest and Other Income

Interest and other income decreased $3.2 million in fiscal 2002 compared to fiscal 2001. The decrease was principally due to a decrease in interest income, a decrease in earnings from our ancillary businesses and a non-recurring gain in fiscal 2001 from the sale of an office building constructed by us, offset, in part, by increased income from retained customer deposits.

### Selling, General and Administrative Expenses ("SG&A")

SG&A spending increased by $26.4 million or 12.6% in fiscal 2002 as compared to fiscal 2001 and increased as a percentage of revenues from 9.4% in fiscal 2001 to 10.1% in fiscal 2002. The increased spending was principally due to the costs incurred by the greater number of selling communities that we had during fiscal 2002 as compared to fiscal 2001, costs associated with the continued expansion of the number of new communities and increased insurance costs, offset, in part, by the discontinuance of amortization of goodwill pursuant to our adoption of Statement of Financial Accounting Standards Board No. 142 in November 2001. We expect to open approximately 70 communities in fiscal 2003 as compared to 57 in fiscal 2002. In fiscal 2003, we expect SG&A will increase slightly as a percentage of total revenues compared to 2002.

## FISCAL 2001 COMPARED TO FISCAL 2000

### Home Sales

Home sales revenues for fiscal 2001 were higher than those for fiscal 2000 by approximately $418 million, or 24%. The revenue increase was primarily attributable to a 12% increase in the average price of the homes delivered and a 10% increase in the number of homes delivered. The increase in the average price of the homes delivered was the result of increases in selling prices, a shift in the location of homes delivered to more expensive areas and an increase in the dollar amount of options that our home buyers selected. During fiscal 2001, our home buyers paid approximately 21% above the base selling price of a home for options and lot premiums, compared to 19% in fiscal 2000. The increase in the number of homes delivered was primarily due to the larger backlog of homes to be delivered at the beginning of fiscal 2001 as compared to fiscal 2000.

The value of new sales contracts signed was $2.17 billion (4,366 homes) and $2.15 billion (4,418 homes) for fiscal 2001 and fiscal 2000, respectively. The increase in the value of new contracts signed in fiscal 2001 was primarily attributable to an increase in the average selling price of the homes (due primarily to an increase in base selling prices, a shift in the location of homes sold to more expensive areas and an increase in the dollar amount of options selected by our home buyers), offset, in part, by a decrease in the average number of communities in which we were offering homes for sale and the resulting decrease in the number of homes for which we signed sales contracts. The decrease in the number of communities was the result of increased regulatory requirements that delayed the opening of some new communities and new sections of some existing communities.

At October 31, 2001, the backlog of homes under contract was $1.41 billion (2,727 homes), as compared to the $1.43 billion (2,779 homes) backlog at October 31, 2000.

The terrorist attacks of September 11, 2001 impacted us most severely in the first few weeks immediately after the events as consumer confidence dropped, the stock market declined and our business slowed. In the six-week period following October 31, 2001, the total number of deposits was approximately 12% higher than the same period of fiscal 2000. On a per-community basis, deposits were down approximately 2% over the same period.

Compared to the previous five-year average for the six-week period, deposits were approximately 6% higher on a per-community basis.

Home costs as a percentage of home sales revenues decreased in fiscal 2001 as compared to fiscal 2000. The decrease was largely the result of selling prices increasing at a greater rate than costs, lower land and improvement costs, and improved operating efficiencies, offset, in part, by higher inventory writedowns. We incurred $13.0 million in write-offs in fiscal 2001, as compared to $7.4 million in fiscal 2000.

### Land Sales

In fiscal 2001, we operated a land development and sales operation in our South Riding master planned community located in Loudoun County, Virginia. Land sales amounted to $27.5 million for fiscal 2001 compared to $38.7 million in fiscal 2000. The decrease in land sales in fiscal 2001 as compared to fiscal 2000 was due to fewer lots being available for sale in South Riding in fiscal 2001 than in 2000, offset, in part, by increased sales of lots from several of our other master planned communities.

### Equity Earnings in Unconsolidated Joint Ventures

In fiscal 1998, we entered into a joint venture to develop and sell land owned by our venture partner. Under the terms of the agreement, we have the right to purchase up to a specified number of lots with the majority of the lots to be sold to other builders. In fiscal 2000, the joint venture sold its first group of home sites to other builders and to us. We recognize our share of earnings from the sale of lots to other builders. We do not recognize earnings from lots we purchase; instead, we reduce our cost basis in these lots by our share of the earnings of the joint venture from the sale of these lots.

### Interest and Other Income

Interest and other income increased approximately $5.4 million in fiscal 2001 as compared to fiscal 2000. The increase was principally due to an increase in interest income, the gain from the sale of an office building constructed by us in fiscal 2001, and an increase in earnings from our ancillary businesses, offset in part by reduced management fee income and gains from the sale of miscellaneous assets recognized in fiscal 2000.

### Selling, General and Administrative Expenses ("SG&A")

SG&A spending increased by $39.4 million, or 23%, in fiscal 2001 as compared to fiscal 2000. This increased spending was primarily due to the increase in home revenues in fiscal 2001 over fiscal 2000, and costs related to the development of our master planned communities. SG&A as a percentage of total revenues was the same in fiscal 2001 and fiscal 2000.

## INTEREST EXPENSE

We determine interest expense on a specific lot-by-lot basis for our home building operations and on a parcel-by-parcel basis for land sales.

As a percentage of total revenues, interest expense varies depending on many factors including the period of time that we owned the land, the length of time that the homes delivered during the period were under construction, and the interest rates and the amount of debt carried by us in proportion to the amount of our inventory during those periods. Interest expense as a percentage of revenues was slightly higher in fiscal 2002 as compared to fiscal 2001 and was slightly higher in fiscal 2001 than fiscal 2000.

## INCOME BEFORE INCOME TAXES

Income before income taxes increased 2.8% in fiscal 2002 compared to fiscal 2001 and increased 46.3% in fiscal 2001 compared to fiscal 2000.

## INCOME TAXES

Income taxes for fiscal 2002, 2001 and 2000 were provided at effective rates of 36.7%, 36.8% and 36.8%, respectively.

## CAPITAL RESOURCES AND LIQUIDITY

Funding for our operations has been provided principally by cash flow from operations, unsecured bank borrowings and the public debt markets.

Cash flow from operations, before inventory additions, has improved as operating results have improved. One of the main factors that determines cash flow from operations, before inventory additions, is the level of revenues from the delivery of homes and land sales. We anticipate that cash flow from operations, before inventory additions, will continue to be strong. We have used our cash flow from operations, before inventory additions, bank borrowings and public debt to: acquire additional land for new communities; fund additional expenditures for land development; fund construction costs needed to meet the requirements of our increased backlog and the increasing number of communities in which we are offering homes for sale; repurchase our stock; and repay debt. We expect that our inventory will continue to increase and we are currently negotiating and searching for additional opportunities to obtain control of land for future communities. At October 31, 2002, we had commitments to acquire land of approximately $860 million, of which approximately $65 million had been paid or deposited.

At October 31, 2002, we had a $615 million unsecured revolving credit facility with 19 banks, of which $90 million extends to February 2003 and $525 million extends to March 2006. At October 31, 2002, we had no borrowings against the facility and approximately $77.5 million of letters of credit outstanding under the facility.

In November 2002, we issued $300 million of 6.875% Senior Notes pursuant to Rule 144A of the Securities Act of 1933, as amended. We intend to use the proceeds to repay all of the $100 million outstanding of our 8 3/4% Senior Subordinated Notes due 2006, repay bank debt and for general corporate purposes. We called for redemption all of the $100 million outstanding 8 3/4% Senior Subordinated Notes effective December 27, 2002 at a price of 102.917% of the principal amount. We will recognize a pretax charge of approximately $4 million in the first quarter of fiscal 2003 representing the premium paid on redemption and the write-off of unamortized bond issuance costs.

We believe that we will be able to continue to fund our activities through a combination of existing cash resources, cash flow from operations and existing sources of credit, including the public debt markets.

## INFLATION

The long-term impact of inflation on us is manifested in increased costs for land, land development, construction and overhead, as well as in increased sales prices. We generally contract for land significantly before development and sales efforts begin. Accordingly, to the extent land acquisition costs are fixed, increases or decreases in the sales prices of homes may affect our profits. Since the sales prices of homes are fixed at the time a buyer enters into a contract to acquire a home and we generally contract to sell a home before commencement of construction, any inflation of costs in excess of those anticipated may result in lower gross margins. We generally attempt to minimize that effect by entering into fixed-price contracts with our subcontractors and material suppliers for specified periods of time, which generally do not exceed one year.

In general, housing demand is adversely affected by increases in interest costs, as well as in housing costs. Interest rates, the length of time that land remains in inventory and the proportion of inventory that is financed affect our interest costs. If we are unable to raise sales prices enough to compensate for higher costs, or if mortgage interest rates increase significantly, affecting prospective buyers' ability to adequately finance home purchases, our revenues, gross margins and net income would be adversely affected. Increases in sales prices, whether the result of inflation or demand, may affect the ability of prospective buyers to afford new homes.

## QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk primarily due to fluctuations in interest rates. We utilize both fixed rate and variable rate debt. For fixed rated debt, changes in interest rates generally affect the fair market value of the debt instrument, but not our earnings or cash flow. Conversely, for variable rate debt, changes in interest rates generally do not impact the fair market value of the debt instrument. We do not have the obligation to prepay fixed rate debt prior to maturity, and, as a result, interest rate risk and changes in fair market value should not have a significant impact on such debt until we are required to refinance such debt.

The table below sets forth, as of October 31, 2002, our long-term debt obligations, principal cash flows by scheduled maturity, weighted-average interest rates and estimated fair value (amounts in thousands):

| | Fixed Rate Debt (3) | | Variable Rate Debt (1) (2) | |
|---|---|---|---|---|
| Fiscal Year of Expected Maturity | Amount | Weighted Average Interest Rate | Amount | Weighted Average Interest Rate |
| 2003 | $ 20,511 | 6.91% | $53,796 | 3.42% |
| 2004 | 2,659 | 6.61 | 4,800 | 4.01 |
| 2005 | 208,359 | 7.74 | 2,870 | 3.97 |
| 2006 | 4,885 | 8.51 | 150 | 1.99 |
| 2007 | 200,000 | 8.25 | 150 | 1.92 |
| Thereafter | 620,000 | 8.18 | 4,010 | 1.92 |
| Total | $1,056,414 | 8.05% | $65,776 | 3.39% |
| Fair value at October 31, 2002 | $1,067,210 | | $65,776 | |

(1) We have a $615 million revolving credit facility with 19 banks of which $525 million extends through March 2006 and $90 million extends through February 2003. Interest is payable on borrowings under this facility at 0.90% (this rate will vary based upon our corporate debt rating and leverage ratios) above the Eurodollar rate or at other specified variable rates as selected by us from time to time. We had no borrowings against this facility at October 31, 2002.

(2) One of our subsidiaries has a $50 million line of credit with a bank to fund mortgage originations. The line is due within 90 days of demand by the bank and bears interest at the bank's overnight rate plus an agreed upon margin. At October 31, 2002 the subsidiary had $49.0 million outstanding under the line at an average interest rate of 3.36%. Borrowing under this line is included in the 2003 fiscal year maturities.

(3) In November 2002, we issued $300 million of 6.875% Senior Notes due 2012. We intend to use a portion of the proceeds from the notes to redeem all of the $100 million of our outstanding 8 3/4% Senior Subordinated Notes due 2006. We expect to complete this redemption in December 2002. The 8 3/4% notes are included in the fiscal 2007 maturities.

Based upon the amount of variable rate debt outstanding at October 31, 2002 and holding the variable rate debt balance constant, each one percentage point increase in interest rates would increase the interest incurred by us by approximately $660,000 per year.

## STATEMENT ON FORWARD-LOOKING INFORMATION

Certain information included herein and in other Company reports, SEC filings, statements and presentations is forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995, including, but not limited to, statements concerning anticipated operating results, financial resources, changes in revenues, changes in profitability, interest expense, growth and expansion, anticipated income to be realized from investments in joint ventures and the Toll Brothers Realty Trust Group, the ability to acquire land, the ability to gain approvals and to open new communities, the ability to sell homes and properties, the ability to deliver homes from backlog, the ability to secure materials and subcontractors, the ability to produce the liquidity and capital to expand and take advantage of opportunities in the future, and stock market valuations. Such forward-looking information involves important risks and uncertainties that could significantly affect actual results and cause them to differ materially from expectations expressed herein and in other Company reports, SEC filings, statements and presentations. These risks and uncertainties include local, regional and national economic conditions; the demand for homes; domestic and international political events; the effects of governmental regulation; the competitive environment in which the Company operates; fluctuations in interest rates; changes in home prices; the availability and cost of land for future growth; the availability of capital; uncertainties and fluctuations in capital and securities markets; the availability and cost of labor and materials; and weather conditions.

# Financial Statements

## CONSOLIDATED STATEMENTS OF INCOME

*(Amounts in thousands, except per share data)*

| Year Ended October 31 | 2002 | 2001 | 2000 |
|---|---|---|---|
| **Revenues** | | | |
| Home sales | $2,279,261 | $2,180,469 | $1,762,930 |
| Land sales | 36,183 | 27,530 | 38,730 |
| Equity earnings in unconsolidated joint ventures | 1,870 | 6,756 | 3,250 |
| Interest and other | 11,658 | 14,850 | 9,452 |
| | 2,328,972 | 2,229,605 | 1,814,362 |
| **Costs and expenses** | | | |
| Home sales | 1,655,331 | 1,602,276 | 1,337,060 |
| Land sales | 25,671 | 21,464 | 29,809 |
| Selling, general and administrative | 236,123 | 209,729 | 170,358 |
| Interest | 64,529 | 58,247 | 46,169 |
| | 1,981,654 | 1,891,716 | 1,583,396 |
| Income before income taxes | 347,318 | 337,889 | 230,966 |
| Income taxes | 127,431 | 124,216 | 85,023 |
| Net income | $ 219,887 | $ 213,673 | $ 145,943 |
| **Earnings per share** | | | |
| Basic | $ 3.12 | $ 2.98 | $ 2.01 |
| Diluted | $ 2.91 | $ 2.76 | $ 1.95 |
| Weighted average number of shares | | | |
| Basic | 70,472 | 71,670 | 72,537 |
| Diluted | 75,480 | 77,367 | 74,825 |

*See accompanying notes.*

## CONSOLIDATED BALANCE SHEETS

*(Amounts in thousands)*

| At October 31 | 2002 | 2001 |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | $ 102,337 | $ 182,840 |
| Inventory | 2,551,061 | 2,183,541 |
| Property, construction and office equipment, net | 38,496 | 33,095 |
| Receivables, prepaid expenses and other assets | 95,065 | 74,481 |
| Mortgage loans receivable | 63,949 | 26,758 |
| Customer deposits held in escrow | 23,019 | 17,303 |
| Investments in unconsolidated entities | 21,438 | 14,182 |
| | $2,895,365 | $2,532,200 |
| **Liabilities and Stockholders' Equity** | | |
| **Liabilities** | | |
| Loans payable | $ 253,194 | $ 362,712 |
| Subordinated notes | 819,663 | 669,581 |
| Mortgage company warehouse loan | 48,996 | 24,754 |
| Customer deposits | 134,707 | 101,778 |
| Accounts payable | 126,391 | 132,970 |
| Accrued expenses | 281,275 | 229,671 |
| Income taxes payable | 101,630 | 98,151 |
| Total liabilities | 1,765,856 | 1,619,617 |
| **Stockholders' Equity** | | |
| Preferred stock, none issued | | |
| Common stock, 74,002 shares and 74,029 issued at October 31, 2002 and 2001, respectively | 740 | 369 |
| Additional paid-in capital | 102,600 | 107,014 |
| Retained earnings | 1,101,799 | 882,281 |
| Treasury stock, at cost - 3,785 shares and 4,473 shares at October 31, 2002 and 2001, respectively | (75,630) | (77,081) |
| Total stockholders' equity | 1,129,509 | 912,583 |
| | $2,895,365 | $2,532,200 |

*See accompanying notes.*

## CONSOLIDATED STATEMENTS OF CASH FLOWS

*(Amounts in thousands)*

| Year Ended October 31 | 2002 | 2001 | 2000 |
|---|---|---|---|
| **Cash flow from operating activities** | | | |
| Net income | $219,887 | $213,673 | $145,943 |
| Adjustments to reconcile net income to net cash used in operating activities: | | | |
| Depreciation and amortization | 10,495 | 9,356 | 8,528 |
| Equity earnings in unconsolidated joint ventures | (1,870) | (6,756) | (3,250) |
| Deferred tax provision | 1,831 | 7,323 | 5,191 |
| Provision for inventory writedowns | 6,081 | 13,035 | 7,448 |
| Changes in operating assets and liabilities: | | | |
| Increase in inventory | (360,409) | (456,922) | (271,751) |
| Origination of mortgage loans | (412,431) | (199,102) | |
| Sale of mortgage loans | 376,764 | 183,449 | |
| (Increase) decrease in receivables, prepaid expenses and other assets | (29,185) | 10,793 | (28,025) |
| Increase (decrease) in customer deposits on sales contracts | 32,929 | (3,146) | 22,429 |
| Increase in accounts payable and accrued expenses | 52,761 | 71,776 | 71,492 |
| Increase in current income taxes payable | 9,042 | 8,142 | 25,132 |
| Net cash used in operating activities | (94,105) | (148,379) | (16,863) |
| **Cash flow from investing activities** | | | |
| Purchase of property and equipment, net | (14,170) | (15,020) | (9,415) |
| Investment in unconsolidated entities | (9,526) | | |
| Distribution from unconsolidated entities | 4,200 | 15,750 | 13,589 |
| Net cash (used in) provided by investing activities | (19,496) | 730 | 4,174 |
| **Cash flow from financing activities** | | | |
| Proceeds from loans payable | 528,710 | 208,628 | 559,843 |
| Principal payments of loans payable | (627,270) | (180,094) | (460,482) |
| Net proceeds from issuance of senior subordinated notes | 149,748 | 196,930 | |
| Proceeds from stock-based benefit plans | 12,997 | 14,932 | 11,936 |
| Purchase of treasury stock | (31,087) | (71,767) | (33,232) |
| Net cash provided by financing activities | 33,098 | 168,629 | 78,065 |
| Net (decrease) increase in cash and cash equivalents | (80,503) | 20,980 | 65,376 |
| Cash and cash equivalents, beginning of year | 182,840 | 161,860 | 96,484 |
| Cash and cash equivalents, end of year | $102,337 | $182,840 | $161,860 |

*See accompanying notes.*

# Notes to Consolidated Financial Statements

## NOTE 1: SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation

The accompanying consolidated financial statements include the accounts of Toll Brothers, Inc. (the "Company"), a Delaware corporation, and its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. Investments in 20% to 50% owned partnerships and affiliates are accounted for on the equity method. Investments in less than 20% owned entities are accounted for on the cost method.

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

### Income Recognition

The Company is primarily engaged in the development, construction and sale of residential homes. Revenues and cost of sales are recorded at the time each home sale is closed and title and possession have been transferred to the buyer. Closing normally occurs shortly after construction is substantially completed.

Land, land development and related costs (both incurred and estimated to be incurred in the future) are amortized to the cost of homes closed based upon the total number of homes the Company expects to construct in each community. Any changes resulting from a change in the estimated number of homes to be constructed or a change in estimated costs subsequent to the commencement of delivery of homes are allocated to the remaining undelivered homes in the community. Home construction and related costs are charged to the cost of homes closed under the specific identification method.

The estimated land, common area development and related costs of master planned communities (including the cost of golf courses, net of their estimated residual value) are allocated to individual communities within a master planned community on a relative sales value basis. Any changes resulting from a change in the estimated number of homes to be constructed or a change in estimated costs are allocated to the remaining lots in each of the communities of the master planned community.

Land sales revenue and cost of sales are recorded at the time that title and possession of the property have been transferred to the buyer.

### Cash and Cash Equivalents

Liquid investments or investments with original maturities of three months or less are classified as cash equivalents. The carrying value of these investments approximates their fair value.

### Property, Construction and Office Equipment

Property, construction and office equipment are recorded at cost and are stated net of accumulated depreciation of $44.5 million and $35.8 million at October 31, 2002 and 2001, respectively. Depreciation is recorded by using the straight-line method over the estimated useful lives of the assets.

### Inventory

Inventory is stated at the lower of cost or fair value in accordance with Statement of Financial Accounting Standards, No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." In addition to direct land acquisition, land development and home construction costs, costs include interest, real estate taxes and direct overhead costs related to development and construction, which are capitalized to inventories during the period beginning with the commencement of development and ending with the completion of construction.

It takes approximately four to five years to fully develop, sell and deliver all the homes in one of the Company's typical communities. Longer or shorter time periods are possible depending on the number of home sites in a community. The Company's master planned communities, consisting of several smaller communities, may take up to 10 years to complete. Since the Company's inventory is considered a long-lived asset under accounting principles generally accepted in the United States, the Company is required to review the carrying value of each of its communities and writedown the value of those communities for which it believes the values are not recoverable. When the profitability of a current community deteriorates or the sales pace declines significantly or some other factor indicates a possible impairment in the recoverability of the asset, the Company evaluates the property in accordance with the guidelines of SFAS No. 121. If this evaluation indicates an impairment loss should be recognized, the Company charges cost of sales for the estimated impairment loss in the period determined.

In addition, the Company reviews all the land held for future communities or future sections of current communities, whether owned or under contract, to determine whether or not it expects to proceed with the development of the land, and, if so, whether it will be developed in the manner originally contemplated. Based upon this review, the Company decides: (a) as to land that is under a purchase contract but not owned, whether the contract will be terminated or renegotiated; and (b) as to land the Company owns, whether the land can be developed as contemplated or in an alternative manner, or should be sold. The Company then further determines which costs that have been capitalized to the property are recoverable and which costs should be written off.

The Company capitalizes certain project marketing costs and charges them against income as homes are closed.

### Joint Venture Accounting

The Company is party to three joint ventures with independent third parties to develop and sell land that was owned or is currently owned by its venture partners. The Company recognizes its share of the earnings from the sale of lots to other builders. The Company does not recognize earnings from the lots it purchases from these ventures, but reduces its cost basis in the lots by its share of the earnings from those lots.

The Company effectively owns one-third of Toll Brothers Realty Trust Group and 50% of a joint venture that is selling and building an active-adult, age-qualified community. The Company recognizes its share of the earnings from these entities.

### Treasury Stock

Treasury stock is recorded at cost. Issuance of treasury shares is accounted for on a first-in, first-out basis. Differences between the cost of treasury shares and the re-issuance proceeds are charged to additional paid-in capital.

### Advertising Costs

The Company expenses advertising costs as incurred.

### Warranty Costs

The Company accrues for expected warranty costs at the time each home is closed and title and possession have been transferred to the buyer. Costs are accrued based upon historical experience.

### Insurance Costs

The Company accrues for the expected costs associated with the deductibles and self-insured retentions on its various insurance policies.

### Segment Reporting

Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures about Segments of an Enterprise and Related Information," establishes standards for the manner in which public enterprises report information about operating segments. The Company has determined that its operations primarily involve one reportable segment, home building.

### Goodwill and Other Intangible Assets

SFAS No. 142, "Goodwill and Other Intangible Assets," provides guidance on accounting for intangible assets and eliminates the amortization of goodwill and certain other intangible assets. Intangible assets, including goodwill, that are not subject to amortization are required to be tested for impairment and possible writedown on an annual basis. The Company adopted SFAS No. 142 as of November 1, 2001, the first day of its 2002 fiscal year. The adoption of SFAS No. 142 did not have a material impact on the Company's fiscal 2002 financial statements. The Company had $9.4 million of unamortized goodwill as of November 1, 2001. The Company amortized $1.1 million (net of $674,000 of income taxes) and $1.1 million (net of $665,000 of income taxes) in fiscal 2001 and 2000, respectively. Had the Company not amortized goodwill during fiscal 2001, net income, diluted earnings per share and basic earnings per share would have been $214.8 million, $2.78 and $3.00, respectively. Had the Company not amortized goodwill during fiscal 2000, net income, diluted earnings per share and basic earnings per share would have been $147.1 million, $1.97 and $2.03, respectively.

### New Accounting Pronouncements

SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," provides guidance on financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of", and the accounting and reporting provisions of Accounting Principles Bulletin Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, Extraordinary, Unusual and Infrequently Occurring Events and Transactions." The Company is required to adopt SFAS No. 144 for its 2003 fiscal year. The Company's adoption of SFAS No. 144 will not have a material impact on its financial condition or results of operations.

SFAS No. 145, "Rescission of SFAS Nos. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections", requires all gains and losses from extinguishment of debt to be included as an item of income from continuing operations. The provisions of SFAS No. 145 relating to the rescission of SFAS No. 4 will become effective for the Company's fiscal year 2003.

### Stock Split

On March 4, 2002, the Company's Board of Directors declared a two-for-one split of the Company's common stock in the form of a stock dividend to stockholders of record on March 14, 2002. The additional shares were distributed on March 28, 2002. All share and per share amounts have been restated to reflect the split.

### Reclassification

Certain prior year amounts have been reclassified to conform with the fiscal 2002 presentation.

## NOTE 2: INVENTORY

Inventory consisted of the following (amounts in thousands):

| At October 31 | 2002 | 2001 |
|---|---|---|
| Land and land development costs | $ 772,796 | $ 833,386 |
| Construction in progress | 1,491,108 | 1,146,485 |
| Sample homes and sales offices | 163,722 | 107,744 |
| Land deposits and costs of future development | 114,212 | 89,360 |
| Other | 9,223 | 6,566 |
| | $2,551,061 | $2,183,541 |

Construction in progress includes the cost of homes under construction, land and land development costs and the carrying cost of home sites that have been substantially improved.

The Company provided for inventory writedowns and the expensing of costs which it believed not to be recoverable of $6.1 million in fiscal 2002, $13.0 million in fiscal 2001 and $7.4 million in fiscal 2000. Of these amounts, $2.5 million, $3.8 million and $1.6 million were applicable to future communities in fiscal 2002, fiscal 2001 and fiscal 2000, respectively.

Interest capitalized in inventories is charged to interest expense when the related inventory is delivered. Changes in capitalized interest for the three years ended October 31, 2002 were as follows (amounts in thousands):

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Interest capitalized, beginning of year | $ 98,650 | $78,443 | $64,984 |
| Interest incurred | 90,313 | 79,209 | 60,236 |
| Interest expensed | (64,529) | (58,247) | (46,169) |
| Write-off to cost and expenses | (797) | (755) | (608) |
| Interest capitalized, end of year | $123,637 | $98,650 | $78,443 |

## NOTE 3: LOANS PAYABLE AND SUBORDINATED NOTES

Loans payable at October 31, 2002 and 2001 consisted of the following (amounts in thousands):

| | 2002 | 2001 |
|---|---|---|
| Term loan due July 2005 | $207,500 | $192,500 |
| Revolving credit facility | - | 80,000 |
| Term loan due March 2002 | - | 50,000 |
| Other | 45,694 | 40,212 |
| | $253,194 | $362,712 |

The Company has a $615 million unsecured revolving credit facility with 19 banks of which $525 million extends through March 2006 and $90 million extends through February 2003. Interest is payable on borrowings under the facility at 0.90% (subject to adjustment based upon the Company's debt rating and leverage ratios) above the Eurodollar rate or at other specified variable rates as selected by the Company from time to time. The Company had no outstanding borrowings against the facility at October 31, 2002. At October 31, 2002, letters of credit and obligations under escrow agreements of approximately $77.5 million were outstanding under the facility. The revolving credit agreement contains various covenants, including financial covenants related to consolidated stockholders' equity, indebtedness and inventory. The agreement requires the Company to maintain a minimum consolidated stockholders' equity which would restrict the payment of cash dividends and the repurchase of Company stock to approximately $350 million at October 31, 2002.

The Company has borrowed $207.5 million from nine banks at a weighted-average interest rate of 7.76% repayable in July 2005. This term loan is unsecured and the agreement contains financial covenants that are less restrictive than the covenants contained in the Company's revolving credit agreement.

At October 31, 2002, the aggregate estimated fair value of the Company's loans payable was approximately $275.6 million. The fair value of loans was estimated based upon the interest rates at October 31, 2002 that the Company believed were available to it for loans with similar terms and remaining maturities.

At October 31, 2002 and 2001, the Company's senior subordinated notes consisted of the following (amounts in thousands):

| | 2002 | 2001 |
|---|---|---|
| 8 3/4% Senior Subordinated Notes due November 15, 2006 | $100,000 | $100,000 |
| 7 3/4% Senior Subordinated Notes due September 15, 2007 | 100,000 | 100,000 |
| 8 1/8% Senior Subordinated Notes due February 1, 2009 | 170,000 | 170,000 |
| 8% Senior Subordinated Notes due May 1, 2009 | 100,000 | 100,000 |
| 8 1/4% Senior Subordinated Notes due February 1, 2011 | 200,000 | 200,000 |
| 8.25% Senior Subordinated Notes due December 1, 2011 | 150,000 | - |
| Bond discount | (337) | (419) |
| | $819,663 | $669,581 |

All issues of senior subordinated notes are subordinated to all senior indebtedness of the Company. The indentures restrict certain payments by the Company including cash dividends and the repurchase of Company stock. The notes are redeemable in whole or in part at the option of the Company at various prices on or after the fifth anniversary of each issue's date of issuance.

At October 31, 2002, the aggregate fair value of all the outstanding subordinated notes, based upon their indicated market prices, was approximately $808.3 million.

A subsidiary of the Company has a $50 million bank line of credit to fund mortgage originations. The line of credit is collateralized by all the assets of the subsidiary. At October 31, 2002, the subsidiary had borrowed $49.0 million under the line of credit at an average rate of 3.36% and had assets of approximately $65 million.

The annual aggregate maturities of the Company's loans and notes during each of the next five fiscal years are: 2003 - $74.3 million; 2004 - $7.5 million; 2005 - $211.2 million; 2006 - $5.0 million; and 2007 - $200.2 million. The Company called for redemption its 8 3/4% Senior Subordinated Notes due 2006 on December 27, 2002. These notes are included in fiscal 2007 maturities. See footnote 12 for additional information related to the redemption.

## NOTE 4: INCOME TAXES

The Company's estimated combined federal and state tax rate before providing for the effect of permanent book-tax differences ("Base Rate") was 37% in 2002, 2001 and 2000. The effective tax rate in 2002, 2001, and 2000 was 36.7%, 36.8% and 36.8%, respectively. The primary difference between the Company's Base Rate and effective tax rate was tax-free income.

The provision for income taxes for each of the three years ended October 31, 2002, 2001 and 2000 was as follows (amounts in thousands):

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Federal | $117,233 | $114,131 | $ 78,105 |
| State | 10,198 | 10,085 | 6,918 |
| | $127,431 | $124,216 | $ 85,023 |
| Current | $125,600 | $116,893 | $ 79,832 |
| Deferred | 1,831 | 7,323 | 5,191 |
| | $127,431 | $124,216 | $ 85,023 |

The components of income taxes payable at October 31, 2002 and 2001 consisted of the following (amounts in thousands):

| | 2002 | 2001 |
|---|---|---|
| Current | $ 68,170 | $ 66,522 |
| Deferred | 33,460 | 31,629 |
| | $101,630 | $ 98,151 |

The components of net deferred taxes payable at October 31, 2002 and 2001 consisted of the following (amounts in thousands):

| | 2002 | 2001 |
|---|---|---|
| **Deferred tax liabilities** | | |
| Capitalized interest | $38,783 | $32,789 |
| Deferred expense | 22,192 | 17,755 |
| Total | 60,975 | 50,544 |
| **Deferred tax assets** | | |
| Accrued expenses deductible when paid | 16,723 | 7,040 |
| Inventory valuation differences | 2,204 | 2,581 |
| Deferred income | 431 | 2,329 |
| Other | 8,157 | 6,965 |
| Total | 27,515 | 18,915 |
| Net deferred tax liability | $33,460 | $31,629 |

## NOTE 5: STOCKHOLDERS' EQUITY

The Company's authorized capital stock consists of 100,000,000 shares of Common Stock, $.01 par value per share, and 1,000,000 shares of Preferred Stock, $.01 par value per share. The Board of Directors is authorized to amend the Company's Certificate of Incorporation to increase the number of authorized shares of Common Stock to 200,000,000 shares and the number of shares of authorized Preferred Stock to 15,000,000 shares.

Changes in stockholders' equity for the three years ended October 31, 2002 were as follows (amounts in thousands):

| | Common Stock | | Additional Paid-In Capital | Retained Earnings | Treasury Stock | Total |
|---|---|---|---|---|---|---|
| | Shares | Amount | | | | |
| Balance, November 1, 1999 | 72,908 | $369 | $105,239 | $ 522,665 | $(11,939) | $ 616,334 |
| Net income | | | | 145,943 | | 145,943 |
| Purchase of treasury stock | (2,710) | | | | (33,232) | (33,232) |
| Exercise of stock options | 1,344 | | 588 | | 13,352 | 13,940 |
| Executive bonus award | 160 | | (225) | | 1,621 | 1,396 |
| Employee benefit plan issuances | 88 | | (148) | | 912 | 764 |
| Balance, October 31, 2000 | 71,790 | 369 | 105,454 | 668,608 | (29,286) | 745,145 |
| Net income | | | | 213,673 | | 213,673 |
| Purchase of treasury stock | (4,122) | | | | (71,767) | (71,767) |
| Exercise of stock options | 1,562 | | (336) | | 20,452 | 20,116 |
| Executive bonus award | 272 | | 1,678 | | 2,735 | 4,413 |
| Employee benefit plan issuances | 52 | | 218 | | 785 | 1,003 |
| Balance, October 31, 2001 | 69,554 | 369 | 107,014 | 882,281 | (77,081) | 912,583 |
| Net income | | | | 219,887 | | 219,887 |
| Purchase of treasury stock | (1,238) | | | | (31,087) | ( 31,087) |
| Exercise of stock options | 1,411 | | (4,137) | | 24,192 | 20,055 |
| Executive bonus award | 440 | | (647) | | 7,502 | 6,855 |
| Two-for-one stock split | | 371 | (2) | (369) | | |
| Employee benefit plan issuances | 50 | | 372 | | 844 | 1,216 |
| Balance, October 31, 2002 | 70,217 | $740 | $102,600 | $1,101,799 | $(75,630) | $1,129,509 |

### Redemption of Common Stock

To help provide for an orderly market in the Company's Common Stock in the event of the death of either Robert I. Toll or Bruce E. Toll (the "Tolls"), or both of them, the Company and the Tolls have entered into agreements in which the Company has agreed to purchase from the estate of each of the Tolls, $10 million of the Company's Common Stock (or a lesser amount under certain circumstances) at a price equal to the greater of fair market value (as defined) or book value (as defined). Further, the Tolls have agreed to allow the Company to purchase $10 million of life insurance on each of their lives. In addition, the Tolls have granted the Company an option to purchase up to an additional $30 million (or a lesser amount under certain circumstances) of the Company's Common Stock from each of their estates. The agreements expire in October 2005.

In December 2000, the Company's Board of Directors authorized the repurchase of up to 10,000,000 shares of its Common Stock, par value $.01, from time to time, in open market transactions or otherwise, for the purpose of providing shares for its various employee benefit plans. At October 31, 2002, the Company had repurchased approximately 5,360,000 shares under the authorization.

### Stockholder Rights Plan

Shares of the Company's Common Stock outstanding are subject to stock purchase rights. The rights, which are exercisable only under certain conditions, entitle the holder, other than an acquiring person (and certain related parties of an acquiring person), as defined in the plan, to purchase common shares at prices specified in the rights agreement. Unless earlier redeemed, the rights will expire on July 11, 2007. The rights were not exercisable at October 31, 2002.

## NOTE 6: STOCK-BASED BENEFIT PLANS

### Stock-Based Compensation Plans

The Company accounts for its stock option plans according to Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Accordingly, no compensation costs are recognized upon issuance or exercise of stock options.

SFAS No. 123, "Accounting for Stock-Based Compensation," requires the disclosure of the estimated value of employee option grants and their impact on net income using option pricing models that are designed to estimate the value of options that, unlike employee stock options, can be traded at any time and are transferable. In addition to restrictions on trading, employee stock options may include other restrictions such as vesting periods. Further, such models require the input of highly subjective assumptions, including the expected volatility of the stock price. Therefore, in management's opinion, the existing models do not provide a reliable single measure of the value of employee stock options.

For the purposes of providing the pro forma disclosures, the fair value of options granted was estimated using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in each of the three fiscal years ended October 31, 2002:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Risk-free interest rate | 5.02% | 4.01% | 5.80% |
| Expected life (years) | 7.50 | 7.31 | 7.70 |
| Volatility | 41.30% | 37.40% | 35.70% |
| Dividends | none | none | none |

At October 31, 2002, the Company's stock-based compensation plans consisted of its four stock option plans. Net income and net income per share as reported in these consolidated financial statements and on a pro forma basis, as if the fair value-based method described in SFAS No. 123 had been adopted, were as follows (in thousands, except per share amounts):

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Net income: | | | |
| As reported | $219,887 | $213,673 | $145,943 |
| Pro forma | $205,314 | $202,597 | $136,622 |
| Basic net income per share: | | | |
| As reported | $ 3.12 | $ 2.98 | $ 2.01 |
| Pro forma | $ 2.91 | $ 2.83 | $ 1.88 |
| Diluted net income per share: | | | |
| As reported | $ 2.91 | $ 2.76 | $ 1.95 |
| Pro forma | $ 2.72 | $ 2.62 | $ 1.83 |
| Weighted average grant date fair value per share of options granted | $ 11.17 | $ 8.93 | $ 4.52 |

### Stock Option Plans

The Company's four stock option plans for employees, officers and directors provide for the granting of incentive stock options and non-statutory options with a term of up to ten years at a price not less than the market price of the stock at the date of grant.

On December 12, 2002, the Compensation Committee of the Company's Board of Directors, the committee that administers the stock option plans, voted to eliminate any options currently available for grant and future increases in options available for grant under the Company's Stock Option and Incentive Stock Plan (1995). Options available for grant at October 31, 2002 under the 1995 plan were 2,269,032.

The Company's Stock Incentive Plan (1998) provides for automatic increases each November 1 in the number of shares available for grant by 2.5% of the number of shares issued (including treasury shares). The 1998 Plan restricts the number of shares available for grant in a year to a maximum of 5,000,000 shares .

No additional options may be granted under the Company's Stock Option Plan (1986) and the Company's Stock Option and Incentive Stock Plan (1995).

The following table summarizes stock option activity for the four plans during the three years ended October 31, 2002:

| | Number of Options (in 000's) | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, November 1, 1999 | 11,783 | $10.20 |
| Granted | 3,760 | 8.77 |
| Exercised | (1,357) | 8.84 |
| Cancelled | (179) | 10.48 |
| Outstanding, October 31, 2000 | 14,007 | $ 9.94 |
| Granted | 2,299 | 19.31 |
| Exercised | (1,590) | 9.59 |
| Cancelled | (230) | 11.51 |
| Outstanding, October 31, 2001 | 14,486 | $11.44 |
| Granted | 2,586 | 21.76 |
| Exercised | (1,530) | 9.98 |
| Cancelled | (221) | 17.68 |
| Outstanding, October 31, 2002 | 15,321 | $13.24 |

Options exercisable and their weighted average exercise price at October 31, 2002, 2001 and 2000 were 9,780,881 shares and $10.64; 9,275,756 shares and $9.96; and 7,748,446 shares and $9.96, respectively.

Options available for grant at October 31, 2002, 2001 and 2000 under all the plans were 3,498,000 (after the elimination of 2,269,032 options available for grant under the 1995 plan), 5,618,728 and 4,626,502, respectively.

The following table summarizes information about stock options outstanding and exercisable at October 31, 2002:

| | Options Outstanding | | |
|---|---|---|---|
| Range of Exercise Prices | Number Outstanding (in 000's) | Weighted-Average Remaining Contractual Life (in years) | Weighted-Average Exercise Price |
| $ 4.35 – $ 8.70 | 1,405 | 2.6 | $ 6.15 |
| 8.71 – 10.88 | 5,117 | 5.8 | 9.13 |
| 10.89 – 13.06 | 2,845 | 5.8 | 11.86 |
| 13.07 – 15.23 | 1,395 | 5.2 | 14.01 |
| 17.41 – 21.76 | 4,559 | 8.7 | 20.65 |
| $ 4.35 – $21.76 | 15,321 | 6.3 | $13.24 |

| | Options Exercisable | |
|---|---|---|
| Range of Exercise Prices | Number Exercisable (in 000's) | Weighted-Average Exercise Price |
| $ 4.35 – $ 8.70 | 1,405 | $ 6.15 |
| 8.71 – 10.88 | 4,106 | 9.22 |
| 10.89 – 13.06 | 2,377 | 11.95 |
| 13.07 – 15.23 | 1,395 | 14.01 |
| 17.41 – 21.76 | 498 | 19.31 |
| $ 4.35 – $21.76 | 9,781 | $10.64 |

### Bonus Award Shares

Under the terms of the Company's Cash Bonus Plan covering Robert I. Toll, Mr. Toll is entitled to receive cash bonus awards based upon the pre-tax earnings and stockholders' equity of the Company. In December 1998, Mr. Toll and the Board of Directors agreed that any bonus payable for each of the three fiscal years ended October 31, 2001 would be made (except for specific conditions) in shares of the Company's Common Stock using the value of the stock as of the date of the agreement ($12.125 per share). The stockholders approved the plan at the Company's 1999 Annual Meeting. The Company recognized compensation expense in 2001 and 2000 of $6.9 million and $4.4 million, respectively, which represented the fair market value of the shares issued to Mr. Toll (440,002 shares in 2001 and 271,584 shares in 2000).

In December 2000, Mr. Toll and the Board of Directors agreed that any bonus payable for each of the three fiscal years ended October 31, 2004 would be made (except for specific conditions) in shares of the Company's Common Stock using the value of the stock as of the date of the agreement ($19.3125 per share). The stockholders approved the plan at the Company's 2001 Annual Meeting. The Company recognized compensation expense in 2002 of $9.6 million, which represented the fair market value of shares issued to Mr. Toll (471,099 shares).

On October 31, 2002, 2001 and 2000, the closing price of the Company's Common Stock on the New York Stock Exchange was $20.48, $15.58 and $16.25, respectively.

Under the Company's deferred compensation plan, Mr. Toll can elect to defer receipt of his bonus until a future date. Mr. Toll elected to defer receipt of his bonus for fiscal 2002 and 2001.

### Employee Stock Purchase Plan

The Company's Employee Stock Purchase Plan enables substantially all employees to purchase the Company's Common Stock for 95% of the market price of the stock on specified offering dates or at 85% of the market price of the stock on specified offering dates subject to restrictions. The plan, which terminates in December 2007, provides that 600,000 shares be reserved for purchase. As of October 31, 2002, a total of 448,276 shares were available for issuance.

The number of shares and the average prices per share issued under this plan during each of the three fiscal years ended October 31, 2002, 2001 and 2000 were 15,672 shares and $21.24; 12,536 shares and $15.24; and 12,618 shares and $9.71, respectively. No compensation expense was recognized by the Company under this plan.

## NOTE 7: EARNINGS PER SHARE INFORMATION

Information pertaining to the calculation of earnings per share for each of the three years ended October 31, 2002 is as follows (amounts in thousands):

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Basic weighted average shares | 70,472 | 71,670 | 72,537 |
| Assumed conversion of dilutive stock options | 5,008 | 5,697 | 2,288 |
| Diluted weighted average shares | 75,480 | 77,367 | 74,825 |

## NOTE 8: EMPLOYEE RETIREMENT PLAN

The Company maintains a salary deferral savings plan covering substantially all employees. The plan provides for Company contributions totaling 2% of all eligible compensation, plus 2% of eligible compensation above the social security wage base, plus matching contributions of up to 2% of eligible compensation of employees electing to contribute via salary deferrals. Company contributions with respect to the plan totaled $3.5 million, $3.1 million, and $2.6 million, for the years ended October 31, 2002, 2001 and 2000, respectively.

## NOTE 9: COMMITMENTS AND CONTINGENCIES

At October 31, 2002 the Company had agreements to purchase land and improved home sites for future development with purchase prices aggregating approximately $860 million, of which $64 million had been paid or deposited. Purchase of the properties is contingent upon satisfaction of certain requirements by the Company and the sellers.

At October 31, 2002, the Company had outstanding surety bonds amounting to approximately $587.6 million related primarily to its obligations to various governmental entities to construct improvements in the Company's various communities. The Company estimates that approximately $265 million of work remains on these improvements. The Company has an additional $41.5 million of surety bonds outstanding which guarantee other obligations of the Company. The Company does not believe that any outstanding bonds will likely be drawn upon.

At October 31, 2002, the Company had agreements of sale outstanding to deliver 3,366 homes with an aggregate sales value of approximately $1.87 billion.

At October 31, 2002, the Company was committed to make approximately $364 million of mortgage loans to its home buyers and to others. All loans with committed interest rates are covered by take-out commitments from third-party lenders, which minimizes the Company's interest rate risk. The Company also arranges a variety of mortgage programs that are offered to its home buyers through outside mortgage lenders.

The Company is involved in various claims and litigation arising in the ordinary course of business. The Company believes that the disposition of these matters will not have a material effect on the business or on the financial condition of the Company.

## NOTE 10: RELATED PARTY TRANSACTIONS

To take advantage of commercial real estate opportunities that may present themselves from time to time, the Company formed Toll Brothers Realty Trust Group (the "Trust"), a venture that is effectively owned one-third by the Company; one-third by a number of senior executives and/or directors, including Robert I. Toll, Bruce E. Toll (and certain family members), Zvi Barzilay (and certain family members), and Joel H. Rassman; and one-third by the Pennsylvania State Employees Retirement System (collectively, the "Shareholders").

The Shareholders entered into a subscription agreement whereby each group has agreed to invest additional capital in an amount not to exceed $9.3 million if required by the Trust. The original subscription agreement, which was to expire in June 2002, was extended until August 2003.

At October 31, 2002, the Company had an investment of $7.5 million in the Trust. This investment is accounted for on the equity method.

The Company provides development, finance and management services to the Trust and received fees under the terms of various agreements in the amounts of $1.2 million, $1.7 million and $1.4 million in fiscal 2002, 2001 and 2000, respectively.

During fiscal 2000, the Company repurchased 500,000 shares of its Common Stock from Bruce E. Toll at $15 per share, a price that was within the trading range of the Company's Common Stock on the dates of the transactions.

## NOTE 11: SUPPLEMENTAL DISCLOSURE TO STATEMENTS OF CASH FLOWS

The following are supplemental disclosures to the statements of cash flows for each of the three years ended October 31, 2002 (amounts in thousands):

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Cash flow information | | | |
| Interest paid, net of amount capitalized | $ 29,867 | $ 26,985 | $21,548 |
| Income taxes paid | $116,558 | $108,750 | $54,700 |
| Non-cash activity | | | |
| Cost of inventory acquired through seller financing | $ 13,993 | $ 34,662 | $ 8,321 |
| Investment in unconsolidated subsidiary acquired through seller financing | - | - | $ 4,500 |
| Income tax benefit related to exercise of employee stock options | $ 7,394 | $ 5,396 | $ 2,128 |
| Stock bonus awards | $ 6,855 | $ 4,413 | $ 1,395 |
| Contributions to employee retirement plan | $ 883 | $ 791 | $ 641 |

## NOTE 12: SUBSEQUENT EVENT

In November 2002, Toll Brothers Finance Corp., a wholly-owned subsidiary of the Company, issued $300 million of 6.875% Senior Notes due 2012. The notes were issued in a private placement under Rule 144A of the Securities Act of 1933, as amended. The Company has agreed to file a registration statement enabling the noteholders to exchange the notes for publicly registered notes. The Company intends to use the proceeds from the offering to redeem $100 million of its 8 3/4% Senior Subordinated Notes due 2006, repay bank debt and for general corporate purposes.

The Company called for redemption its 8 3/4% Senior Subordinated Notes due 2006 at 102.917% of principal amount on December 27, 2002. The redemption will result in a pretax charge in the Company's first quarter of fiscal 2003 of approximately $4 million.

## REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Toll Brothers, Inc.

We have audited the accompanying consolidated balance sheets of Toll Brothers, Inc. and subsidiaries as of October 31, 2002 and 2001, and the related consolidated statements of income and cash flows for each of the three years in the period ended October 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Toll Brothers, Inc. and subsidiaries at October 31, 2002 and 2001, and the consolidated results of their operations and their cash flows for each of the three years in the period ended October 31, 2002, in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

Philadelphia, Pennsylvania
December 12, 2002

## SUMMARY CONSOLIDATED QUARTERLY FINANCIAL DATA (UNAUDITED)

*(Amounts in thousands, except per share data)*

| Fiscal 2002<br>Three Months Ended | Oct. 31 | July 31 | April 30 | Jan. 31 |
|---|---|---|---|---|
| Revenue | $705,590 | $580,707 | $550,496 | $492,179 |
| Gross profit | $192,433 | $162,103 | $156,897 | $136,537 |
| Income before income taxes | $109,905 | $ 84,603 | $ 82,826 | $ 69,984 |
| Net income | $ 69,383 | $ 53,500 | $ 52,510 | $ 44,494 |
| Earnings per share* | | | | |
| Basic | $ 0.99 | $ 0.76 | $ 0.74 | $ 0.63 |
| Diluted | $ 0.93 | $ 0.70 | $ 0.69 | $ 0.60 |
| Weighted average number of shares* | | | | |
| Basic | 70,204 | 70,835 | 70,849 | 70,001 |
| Diluted | 74,752 | 76,685 | 76,237 | 74,244 |

| Fiscal 2001<br>Three Months Ended | Oct. 31 | July 31 | April 30 | Jan. 31 |
|---|---|---|---|---|
| Revenue | $655,752 | $584,068 | $514,524 | $475,261 |
| Gross profit | $182,759 | $164,239 | $136,959 | $121,908 |
| Income before income taxes | $108,183 | $ 94,160 | $ 72,351 | $ 63,195 |
| Net income | $ 68,526 | $ 59,444 | $ 45,778 | $ 39,925 |
| Earnings per share* | | | | |
| Basic | $ 0.98 | $ 0.83 | $ 0.63 | $ 0.55 |
| Diluted | $ 0.92 | $ 0.77 | $ 0.58 | $ 0.51 |
| Weighted average number of shares* | | | | |
| Basic | 69,820 | 71,677 | 72,857 | 72,326 |
| Diluted | 74,661 | 77,413 | 78,564 | 78,830 |

** Due to rounding, the sum of the quarterly earnings per share may not equal the reported earnings per share for the year. Share and per share amounts have been adjusted for a two-for-one stock split.*

# Corporate Information

## Board of Directors and Executive Officers

| | |
|---|---|
| Robert I. Toll* | *Chairman of the Board and Chief Executive Officer* |
| Bruce E. Toll | *Vice Chairman of the Board* |
| Zvi Barzilay* | *President and Chief Operating Officer* |
| Robert S. Blank | *Partner - Whitcom Partners, a media company* |
| Edward G. Boehne | *Retired President - Federal Reserve Bank of Philadelphia* |
| Richard J. Braemer | *Partner - Ballard, Spahr, Andrews & Ingersoll, LLP, Attorneys at Law* |
| Roger S. Hillas | *Retired Chairman - Meritor Savings Bank* |
| Carl B. Marbach | *President - Internetwork Publishing Corp., an electronic publisher* |
| Stephen A. Novick | *Vice Chairman and Chief Creative Officer - Grey Global Group, an advertising agency* |
| Joel H. Rassman* | *Executive Vice President, Treasurer and Chief Financial Officer* |
| Paul E. Shapiro | *Executive Vice President and Chief Administrative Officer - Revlon, Inc.* |

*Executive Officer of the Company*

## Officers

*First Senior Vice President*
Wayne S. Patterson

*Senior Vice President and General Counsel*
Kenneth J. Gary

*Senior Vice Presidents*

Thomas A. Argyris, Jr.
James W. Boyd
Barry A. Depew
G. Cory DeSpain
Richard T. Hartman
Werner Thiessen
Edward D. Weber
Douglas C. Yearley, Jr.

*Vice Presidents - Operations*

Peter Alles
Keith L. Anderson
Thomas J. Anhut
William J. Bestimt
Ronald Blum
Charles W. Bowie
Roger A. Brush
Scott L. Coleman
Perry J. Devlin
Michael J. Donnelly
Kevin D. Duermit
John P. Elcano
Alan E. Euvrard
Augustine P. Flores
Raymond P. Gamble
William J. Gilligan
John D. Harris
Douglas C. Heppe
Benjamin D. Jogodnik
Gregory Kamedulski
Gregory S. Kelleher
Webb A. Koschene
B. Mitchell Kotler
Gary Lemon
James Majewski, Jr.
John G. Mangano
Gary M. Mayo
Marc F. McAlpine
Richard C. McCormick
Thomas J. Murray
Daniel J. O'Brien
Robert Parahus
Jon Paynter
William D. Perry
William C. Reilly
Ralph E. Reinert
Douglas C. Shipe
James A. Smith

*Vice Presidents - Administration*

| | |
|---|---|
| Paul Brukardt | *Acquisitions* |
| Frederick N. Cooper | *Finance* |
| Jonathan C. Downs | *Human Resources* |
| Evan G. Ernest | *Taxation* |
| Eric Finkelberg | *Land Acquisitions* |
| Robert B. Fuller | *Land Approvals* |
| Bette-Jo Heilner | *Information Systems* |
| Allan R. Irwin | *Country Club/Golf Course Operations* |
| Manfred P. Marotta | *Toll Integrated Systems* |
| Kira McCarron | *Marketing* |
| Robert N. McCarron | *Land Development* |
| Kevin J. McMaster | *Controller* |
| Charles E. Moscony | *Westminster Title* |
| Joseph J. Palka | *Land Development* |
| Joseph R. Sicree | *Chief Accounting Officer* |
| Michael I. Snyder | *Corporate Planning and Corporate Secretary* |
| Ronnie E. Snyder | *Land Development* |
| Michael J. Sosinski | *Eastern States Engineering* |
| Steven A. Turbyfill | *Product Development* |
| Phillip M. Turner | *Land Development* |
| Mark J. Warshauer | *Counsel* |

*Subsidiary Operations*

| | |
|---|---|
| Wayne S. Patterson | *President, Westminster Security Company* |
| Charles E. Moscony | *President, Westminster Title Company* |
| Donald L. Salmon | *President, Westminster Mortgage Corporation* |
| Michael J. Zammit | *Managing Director, Advanced Broadband* |

Employee listings are as of 11/1/02.

## Employees
As of October 31, 2002, the Company had 2,960 full-time employees.

## Shareholders
As of October 31, 2002, the Company had 744 shareholders of record.

## Stock Listing
The Common Stock of Toll Brothers, Inc. is traded on the New York Stock Exchange and Pacific Exchange (symbol "TOL").

## Investor Relations - Information Requests
The Company's Form 10-K Annual Report, Form 10-Q Quarterly Reports and other Company information are available on our Web site, www.tollbrothers.com, or upon request from Frederick N. Cooper (fcooper@tollbrothersinc.com) or Joseph R. Sicree (jsicree@tollbrothersinc.com), Co-Directors of Investor Relations, at the Corporate Office.

## Common Stock Price Range - New York Stock Exchange
*(adjusted for 2-for-1 stock split in March 2002)*
*Quarter Ended*

| 2002 | High | Low | 2001 | High | Low |
|---|---|---|---|---|---|
| October 31 | $27.20 | $17.76 | October 31 | $20.12 | $12.93 |
| July 31 | $31.80 | $20.81 | July 31 | $22.07 | $15.20 |
| April 30 | $30.20 | $20.93 | April 30 | $19.85 | $16.20 |
| January 31 | $23.20 | $15.42 | January 31 | $22.63 | $15.60 |

## Corporate Office
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Huntingdon Valley, Pennsylvania 19006
(215) 938-8000
www.tollbrothers.com

## Transfer Agent and Registrar
American Stock Transfer and Trust Company
New York, New York
1-800-937-5449
www.amstock.com

## Independent Auditors
Ernst & Young LLP
Philadelphia, Pennsylvania

## Securities Counsel
Wolf, Block, Schorr and Solis-Cohen LLP
Philadelphia, Pennsylvania

**Demographic data:**
The sources for the demographic data included in this annual report are Claritas; International Strategy & Investment Group; The Joint Center for Housing Studies of Harvard University; Merrill Lynch; National Association of Home Builders; National Association of Realtors; Raymond James & Associates, Inc.; U.S. Census Bureau; U.S. Department of Labor; and U.S. Immigration and Naturalization Service

**Photography:**
James B. Abbott, Jeffrey Aron, Mark Boisclair, Rob Brown, Chris Burkhalter, Mert Carpenter, Greg Cava, Craig Cozart, Barry Grossman, Rob Ikeler, Barry Kinsella, Robb Miller, Vic Moss, Rob Muir, Kim Sargent, Bob Shimer, Bill Taylor, George Wilkins, Jim Wilson

**Photos:**
**Cover photo:** The Mirador, Gilbert, AZ
**Inside front cover:** The Grande Clubhouse at Mizner Country Club, Boca Raton area, FL
**Pg. 3:** The Columbia Lexington, Novi, MI
**Pg. 4:** The Sienna, Palm Springs, CA
**Pg. 8:** The Vasari backyard, Las Vegas, NV
**Pg. 14:** The Monterey, Las Colinas, TX
**Center Spread:** (clockwise from top left) The Menlo Manor, San Ramon, CA; The Carlsbad foyer, Yorba Linda, CA; The Capistrano backyard, Yorba Linda, CA; The Malvern Heritage, Novi, MI; The Turnberry living room, Monroe Township, NJ; The Langley Federal, Ashburn, VA; The Hampton Georgian, Raleigh, NC; The Segovia master bath, Boca Raton area, FL; The Strathmore Mediterranean, San Antonio, TX; The Chatsworth backyard, Las Vegas, NV; View of the Austin from the 3rd hole, Castle Rock, CO
**Pg. 26:** The Columbia, Buckingham, PA
**Pg. 27:** The Hampton, Raleigh, NC
**Pg. 28:** The Stratford Heritage, Ann Arbor, MI
**Pg. 29:** The Casa del Sol, Palm Beach Gardens, FL
**Pg. 31:** The Terraza, Gilbert, AZ
**Pg. 34:** The Grande Clubhouse at Naples Lakes Country Club, Naples, FL
**Back cover photo:** The Viana, Palm City, FL

**Quote Sources:**
**Inside front cover:** U.S. Census Bureau - Money Income in the United States: 2001 - Report P60-218, issued Sept. 2002
**Pg. 2:** Newsweek, Aug. 26, 2002, "Real Estate" - Betting Against a Housing Bust by Daniel McGinn
**Pg. 8:** Time, Aug. 5, 2002, "Economy & Business", What Housing Bubble? by Daniel Kadlec
**Pg. 10:** Dr. Susan Wachter, Nov. 19, 2002, "Nationwide Trends and the American Luxury Home Market"
**Pg. 12:** Fortune, Oct. 28, 2002, "Is Real Estate Next?" by Shawn Tully
**Pg. 14:** Joint Center for Housing Studies of Harvard University, The State of the Nation's Housing 2002

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