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# Toll Brothers, Inc. (TOL)

Q2 2019 Earnings Call

## CORPORATE PARTICIPANTS

**Douglas C. Yearley, Jr.**  
*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

**Gregg L. Ziegler**  
*Treasurer & Senior Vice President, Toll Brothers, Inc.*

**Martin P. Connor**  
*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

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## OTHER PARTICIPANTS

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**Michael Eisen**  
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**Scott Schrier**  
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*Analyst, Keefe, Bruyette & Woods, Inc.*

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*Analyst, Susquehanna International Group, LLP (SIG)*

**Michael Rehaut**  
*Analyst, JPMorgan Securities LLC*

**Megan McGrath**  
*Analyst, The Buckingham Research Group, Inc.*

**John Lovallo**  
*Analyst, Bank of America Merrill Lynch*

**Carl E. Reichardt**  
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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning and welcome to the Toll Brothers Second Quarter Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference over to Doug Yearley, Chairman and Chief Executive Officer. Please go ahead.

**Douglas C. Yearley, Jr.**

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

Thank you, Chad. Welcome and thank you for joining us. I'm Doug Yearley, Chairman and CEO. With me today are Bob Toll, Chairman Emeritus; Rick Hartman, President and COO; Marty Connor, Chief Financial Officer; Fred Cooper, Senior VP of Finance and Investor Relations; Kira Sterling, Chief Marketing Officer; Gregg Ziegler, Senior VP and Treasurer; and Don Salmon, President of TBI Mortgage Company.

Before I begin, I ask you to read the statement on forward-looking information in yesterday's release and on our website. I caution you that many statements on this call are forward-looking based on assumptions about the economy, world events, housing and financial markets and many other factors beyond our control that could significantly affect future results. Those listening on the Web can e-mail questions to [investorrelations@tollbrothers.com](mailto:investorrelations@tollbrothers.com).

Fiscal year 2019 second quarter results were strong, with earnings per share of \$0.87, up 21%; pre-tax earnings up 16% (sic) [15%]; and home sales revenue up 7%; and adjusted home sales gross margin improving 100 basis points compared to one year ago. Fiscal year 2019's second quarter net income and earnings per share were the highest second quarter in over a decade.

Our second quarter contracts were down 16% in dollars and 9% in units. We attribute this decline in part to the industry-wide slowdown that began in the second half of 2018 and to a challenging year-over-year comparison.

We are encouraged that demand improved as our second quarter progressed. April contracts were better than March, which were better than February. While February and March contracts were down versus 2018's same months, 2019's April contracts surpassed last year's April on both a growth and per community basis.

Although, the spring selling season bloomed late, it built momentum. In fact, it was the best April on a gross and per community basis for contracts since 2006. Traffic and deposits this May have also been encouraging. We view this as a positive sign for the overall health of the housing market.

According to recent reports, builder sentiment in May rose to a seven-month high and single-family housing starts in April were up 6.2% versus March. The industry is being buoyed by low interest rates, a strong employment picture and continued aging of the existing housing stock, and a still limited supply of new homes in many markets.

Last week, we learned that we moved up 52 spots on the Fortune 500 to number 428. We continue to look for opportunities to grow and leverage our industry-leading brand, as we expand our geographic footprint, product line and price points.

On Monday, we announced our entry into the metro Atlanta market with the acquisition of Sharp Residential. The acquisition of Sharp brings us into the largest U.S. housing market where we did not operate. This quarter, we opened our first communities in Salt Lake City and Portland, Oregon, where we are already seeing healthy buyer demand. We also acquired our first West Coast City Living Urban condominium sites in Los Angeles and Seattle.

We continue to look to broaden our product line and price points beyond our traditional move-up and baby boomer active-adult buyers. About one-third of our for-sale communities now offer some homes with base prices under \$500,000. This enables us to serve millennials and other customers who want our luxurious quality and our brand, but may seek a lower price point and a quicker more streamlined home buying process. We are particularly proud of our Crossings at Meridian community in Phoenix, where we have sold 53 homes at an average price in the mid to upper \$300,000s since opening just seven months ago. We are also serving urban and suburban renters.

For Toll Brothers Apartment Living, we currently have a pipeline of 18,600 units under development across the country. Recently, the National Multifamily Housing Council named us the fastest-growing and 14th largest apartment developer in the country. We are excited with the growth and potential of this business. We are also investing in the single-family build to rent sector. This is another business we believe has great potential.

This quarter, we formed a joint venture with BB Living, an established build to rent developer and a large financial partner in a \$400 million joint venture to purpose build and operate single-family rental communities. We are initially targeting the Phoenix, Denver, Las Vegas, Jacksonville, Dallas, Houston and Boise markets. While Toll Brothers has committed a relatively modest \$60 million to this partnership, we believe this investment will produce strong returns over time. With a positive macroeconomic backdrop, record low unemployment, continued wage growth, and solid consumer confidence, we are optimistic about the opportunities ahead.

Now, let me turn it over to Marty.

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## Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

Thanks, Doug. Before I address the specifics of this quarter, I do want to note that a reconciliation of the non-GAAP measures referenced during today's discussion to their comparable GAAP measures can be found in the back of yesterday's release.

Our homebuilding operations teams had a great quarter. We exceeded our guidance and our pre-tax income rose 15% on a home sale revenue increase of just 7%. Adjusted home sale gross margin came in 100 basis points better than a year ago, driven primarily by solid operations and favorable mix and the positive impact from collection of a brownfield credit. Our cancellation rate during the quarter returned to historical norms versus the slightly elevated level of 2019's first quarter. We believe this reflects a more confident consumer and an improved market.

Interest expense through cost of sales was 2.6% of home sales revenues, down 20 basis points compared to a year ago. In fiscal year 2019 second quarter, we had an SG&A margin of 10.4%, which is in line with fiscal year 2018's second quarter. This was better than our guidance due to our strong home sale revenues.

We remain focused on maintaining our conservative balance sheet with ample liquidity, low leverage and a long-dated debt maturity portfolio. We ended fiscal year 2019 second quarter with a debt-to-capital ratio of 42.5% on a gross basis and a net debt-to-capital ratio of 34.6% compared to 44.6% and 40.4% respectively at fiscal year

2018's second quarter end. We had more than \$2 billion of untapped cash and available credit facilities at quarter end.

As announced Monday, we used some of this liquidity to acquired Sharp Residential, and we are well positioned and remain active in pursuit of additional attractive land and builder opportunities. We also remain committed to prudent capital management. Share repurchases will continue to be part of our capital allocation strategy. Our weighted average debt maturity is five years. Our weighted average interest rate is 4.65%, and we only have \$250 million of maturities due in the next 33 months.

Last week, Standard & Poor's acknowledged the strength of our operations and balance sheet by moving our outlook from stable to positive. Our book-value per share at fiscal year 2019 second quarter end was \$33.84, our highest ever, and a jump from \$33.04 last quarter. At almost \$34 per share, we have grown our book value per share at a compound annual rate of 16% since our going public in 1986.

Due to the lack of visibility in the consumer demand the past few quarters, we had not previously provided second half and fiscal year 2019 guidance. Now, based on our backlog and other factors, we are providing our initial forward-looking income statement guidance for the second half of fiscal year 2019. We expect third quarter deliveries of between 1,800 and 2,000 units with an average delivered price of between \$855,000 and \$880,000.

We expect fiscal year 2019 deliveries of between 7,700 and 8,100 units with an average delivered price of between \$855,000 and \$880,000, the same as the third quarter. We expect third quarter adjusted home sale gross margin of approximately 22.5% and SG&A as a percentage of third quarter home sales revenues of approximately 10.7%. We expect fiscal year 2019 adjusted home sale gross margin of approximately 23% and SG&A as a percentage of fiscal year 2019 home sale revenues of approximately 10.4%.

Our third quarter and fiscal year 2019 guidance are tempered slightly by the impact of weather that will delay some home closings in certain of our Northern California communities, including our high density Metro Crossing project in Fremont.

Northern California had an unusually long rainy season this year that lasted from October until May, disrupting land development activity and home production. This is significant as our Northern California division with projected margins higher than the company average has 630 units in backlog, representing \$920 million of future revenue.

Our guidance for adjusted home sales gross margin during the balance of the fiscal year also reflects the slower demand and rising incentives associated with the challenging sales environment of last fall and winter, as well as normal changes in mix. Additionally, impacting our margin guidance is a 10 basis point to 20 basis point impact from purchase accounting associated with our acquisition of Sharp Residential and a fewer higher-priced units in New York City projected to close in the balance of the year at low margins.

We expect third quarter other income, income from unconsolidated entities, and land sales gross profit of approximately \$13 million in total and we expect the tax rate of approximately 27.5%. We expect fiscal year 2019 other income, income from unconsolidated entities, and land sales gross profit of approximately \$100 million in total, and we expect the tax rate of approximately 27.5%.

Lastly, we expect interest expense to cost of sales to be approximately 2.7% of home sales revenue for the balance of the year and our weighted average share count to be approximately 148 million shares for the third

quarter and year. We are pleased that our community count grew from 283 a year ago to 311 at the second quarter end. The Sharp acquisition will add 10 more communities to this total.

Now, let me turn it back to Doug.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

Thank you, Marty. Chad, we're all set for questions.

## QUESTION AND ANSWER SECTION

**Operator:** Sounds good. Thank you. We will now begin the question-and-answer session. [Operator Instructions] The first question comes from Stephen Kim with Evercore ISI. Please go ahead.

Trey Morrish

*Analyst, Evercore ISI*

Q

Hey, guys. It's actually Trey on for Steve. Thanks for taking some time for questions. First, I want to talk about the April contracts. You said it clearly got better. And looking at the geographic spread, it looks like that California was clear an area of weakness in the quarter. I was wondering if that might have been the driver for why April wasn't so much better than the first two months, or if it was just a holistic better improvement across the entire portfolio.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

It was more holistic across the entire portfolio. To give the numbers, because I know they'll be asked, February was down 22% over February of 2018 in units. March was down 19% over March of 2018 in units. And April was up 11% over April of 2018 in units. It was spread around the country, the improvement in April. Some highlights: New Jersey, Pennsylvania, Florida, Texas, Michigan, Arizona, Nevada and California.

Trey Morrish

*Analyst, Evercore ISI*

Q

Okay. Got it. That's helpful. And then, looking at your guidance, is there any way you could potentially quantify the margin impact or at least give us a ballpark of the margin impact from the disruption from the Northern California developments?

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

We expect approximately 100 units fewer than we might have projected at the beginning of the year or than backlog conversion factors might project for the third quarter. And we only project to make up about half of those in the fourth quarter.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

But as we mentioned, the backlog in Northern Cal is significant. It is higher margin than the company average. And those homes are sold and will be delivered. They have just been delayed a little bit because of a really bad fall, winter and spring rainy season in San Francisco.

Trey Morrish

*Analyst, Evercore ISI*

Q

Okay. Got it. Thank you very much, guys.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Trey, I think one of the other things kind of worth noting is that those buildings in the Fremont area are generally attached multi-family condo buildings. So, they have a tendency to settle in a lumpy manner, or be accelerated, or be delayed in a lumpy manner. So, there's a little variability in these projections associated with the specific timing of closings for those buildings at a time, if you will.

Trey Morrish

*Analyst, Evercore ISI*

Q

All right. Thank you.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

You see the entire building...

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Right.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

...at about the same time.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Or you don't.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Correct.

**Operator:** Our next question will be from Stephen East with Wells Fargo. Please go ahead.

Paul Przybylski

*Analyst, Wells Fargo Securities LLC*

Q

Thanks. Actually, this is Paul Przybylski on for Stephen. I guess, first off, your orders were a little bit lower than what we were expecting in California. I was wondering if you could add any color on that market between

Northern and Southern and how incentives trended in California in 2Q versus what we saw last fall. And then, also if you're seeing either markets of Las Vegas, Reno and Boise seeing any negative impacts as California is cool?

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Sure, Paul. Let me start with the comp. It was a difficult comp. The second quarter of 2018 in California was up 45% in units and 52% in dollars over Q2 of 2017. So we faced that. We also have a lack of current inventory in some locations in California because we had some openings last year that had a lot of pent-up demand and sold very rapidly in the early month of their opening. And now we're more in the middle innings of those communities where demand is good, but it's not benefiting from the early on pent-up demand. Layered onto that as we've talked about the severe weather up Northern Cal. It certainly had a bigger impact on land development and construction, but we also believe it had some impact on sales. I just heard this past weekend was another washout weekend, which we think certainly dampens some of the sales activity.

But just to put it into perspective, last year I'm looking at Metro Crossing, Tassajara Hills, and Gale Ranch in Northern Cal, which are three of our bigger communities, and Altair and Robertson Ranch in Southern Cal, they combined at 332 contracts in the second quarter of last year compared to 127 this year.

Now, part of that is slower demand this spring versus the last spring, but the much bigger part is what I first described with the lack of inventory, the middle innings, and some weather-related issues particularly in the north. So, one part of your question was north versus south. I think it's been fairly similar in both markets. I will say that what we've seen in April and the first three weeks of May is very encouraging.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Northern California and Southern California were our top two markets for the bulk of last year and probably the year before that, and they're still top 10 markets for us.

Paul Przybylski

*Analyst, Wells Fargo Securities LLC*

Q

Okay. Great. And then could you add some color around the Sharp acquisition? Maybe how it came about, what you'll be doing product-wise and your growth expectations and how that profitability compares to the total gross margin? And then any other opportunities for M&A in the southeast of Florida?

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Sure. So, we've had our eye on Atlanta for a number of years, as I mentioned, the largest market that we're not in. And we have an M&A team that is in action all the time, everywhere looking for opportunities. We met Tom Sharp. We were very impressed with his leadership, his company, and his land, which I personally toured and I'm very impressed with. And we're able to put the deal together.

I think it's a good fit and price point. He goes from about \$300,000 to \$900,000, and we're going offer homes throughout that range. There's a number of opportunities he showed me that frankly with his capital structure he was unable to buy, but now we can step in and hopefully take advantage.



And so I look for significant growth in Atlanta. I'm excited by the opportunity. Beyond Atlanta, M&A is active right now. We're very engaged in studying a number of opportunities nationwide, some are existing markets, some are new markets, and that team is working overtime.

Paul Przybylski  
*Analyst, Wells Fargo Securities LLC*

Q

Great. I appreciate the color.

Martin P. Connor  
*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

And Paul, as you know, in purchase accounting, units you acquired that are in backlog, you write up the inventory and deliver at a lower gross margin in the 5% to 10% range in the way we account for it. And so that'll have a 10 to 20 basis point dampening impact in our third and fourth quarter of fiscal year 2019. The impact will be much less moving forward from there. And you asked about the gross margins from the Sharp acquisition. As we've modeled them on a run rate basis without any expectations of synergies or improvements, we think they'll be maybe 100 basis points below our company average, but we bought that at Shapell and we bought that at Coleman and we bought at CamWest and we were positively wrong, because they got better than the company average. And we expect a pretty high return on our investment here in an IRR and recoupment of our investment over the next three to four years.

Paul Przybylski  
*Analyst, Wells Fargo Securities LLC*

Q

Great. Thank you. I appreciate it.

Douglas C. Yearley, Jr.  
*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Thanks, Paul.

**Operator:** Our next question comes from Nishu Sood with Deutsche Bank. Please go ahead.

Timothy Daley  
*Analyst, Deutsche Bank Securities, Inc.*

Q

Hi. This is actually Tim Daley on for Nishu. So my first question is just to follow on the acquisition. So it was at the lower end of the spectrum that you guys have typically operated in. And then, I know that, Doug, you did mention a few times that you are kind of trying target that millennial a bit more and maybe outside of the traditional active-adult and move-up markets.

So, just curious as how should we interpret this deal and then those comments with the longer-term strategy of Toll Brothers? And are you guys looking to organically expand this entry-level footprint outside of Atlanta? Yeah, if you could just provide some color on the strategy, and if there's any sort of shift there we should be thinking about.

Douglas C. Yearley, Jr.  
*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Sure. Yeah. I wouldn't read anything into the \$300,000 to \$900,000 price range, and average price of \$500,000 for Sharp. And we bought Coleman Homes in Boise now three years ago, three-and-a-half years ago and their price was in the low-300s.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

\$280,000 actually.

A

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

And we built it. We do 500 homes a year plus or minus in Boise with nice margins, very high ROE at a lower price point. And we have operations around the country. As I mentioned in my prepared comments, one-third of our communities now offer at least one home on the price sheet with a base price under \$500,000.

A

So this is not some profound shift. We recognize that the millennial generation is a large generation. We are not going to sit back for a decade and wait for them to buy the traditional second or third move-up home from Toll Brothers. They are buying homes later. They are, therefore, wealthier. And there is a huge opportunity for us to sell in the 3s, 4s, 5s in existing markets and in possibly some new markets to that crowd.

I highlighted one community in Phoenix. Historically, Phoenix for us had an average price of \$900,000, selling primarily to the affluent empty nester. We opened Crossings at Meridian in the mid-3s and have 53 sales in seven months with good margins, very high ROE.

I'm very proud of how we're going about it. We are doing more and more of that organically in our existing markets, and we will also look to do that through acquisition, if the right builder comes along, whether it be an existing market or a new market.

Timothy Daley

*Analyst, Deutsche Bank Securities, Inc.*

Great. Appreciate those details. And then, I guess, second one is more for Marty. So, Marty, you did note that share repurchases will continue to be a part of the capital allocation strategy going forward, but this quarter and even the last quarter, the buybacks were a bit lighter that they've been trending over the last couple of years despite the stock kind of trading around a similar tangible book value multiple.

Q

So just curious as to how should we kind of balance the commentary that you provided on the continuation of buybacks along with the kind of lower run rate that we're currently trending at for this year. And should we maybe think that we're going to get back to that \$200 million, \$300 million a year annual run rate over – that we've seen since 2015 basically or maybe a bit more subdued pace as you guys look to allocate capital somewhere else similar to commentary around the acquisitions, etcetera? So, yeah, some detail there, we'd be grateful as well.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

Sure. Thanks, Tim. We kind of caution against reading too much into our limited stock repurchases this quarter. Repurchases remain a key part of our capital allocation strategy. We've balanced the deployment of our capital into our stock with our upcoming maturities of debt. The land and builder acquisition opportunities we see in the near-term, I might emphasize those. The price of the stock and, obviously, the time periods where we can buy the stock back, based on blackout rules. The past few quarters were also impacted by some conservatism in capital

A

spend, driven by the uncertain demand environment of last fall and the winter, and as Doug mentioned, continuing into February and March for us this year.

Timothy Daley

*Analyst, Deutsche Bank Securities, Inc.*

Great. Thanks for the details and the time.

Q

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

You're welcome.

A

**Operator:** Our next question will be from Ken Zener with KeyBanc. Please go ahead.

Kenneth Zener

*Analyst, KeyBanc Capital Markets, Inc.*

Good morning, gentlemen.

Q

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

Hi, Ken.

A

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

Good morning, Ken.

A

Kenneth Zener

*Analyst, KeyBanc Capital Markets, Inc.*

Marty, that was great data. I think you said – I might have got it wrong, but 630 units were Northern California backlog, was that correct? Did I hear you say that?

Q

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

Yes.

A

Kenneth Zener

*Analyst, KeyBanc Capital Markets, Inc.*

So that's just about just under 60% of your total California backlog. Was that similar to kind of where we were last year? I don't think Northern California was greater than Southern California. Was that a big shift year-over-year?

Q

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

Go ahead, Gregg. You're looking at really small numbers on the page that I can't see.

A

Gregg L. Ziegler

*Treasurer & Senior Vice President, Toll Brothers, Inc.*

A

No worries, even though we're only a year apart. Ken, California North does have 630 units in backlog, California South has just a little bit under 400. So that – for today, you can see a little bit of a delta in the backlog.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

But the question was last year; when compared to last year's, Gregg, yeah.

Gregg L. Ziegler

*Treasurer & Senior Vice President, Toll Brothers, Inc.*

A

Oh, a year ago? Okay. So as we go a year ago...

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Metro Crossing and Northern.

Gregg L. Ziegler

*Treasurer & Senior Vice President, Toll Brothers, Inc.*

A

Yeah.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

I would suspect Northern California is a higher percentage because of the...

Gregg L. Ziegler

*Treasurer & Senior Vice President, Toll Brothers, Inc.*

A

Complex units.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

...units there and – complex units.

Gregg L. Ziegler

*Treasurer & Senior Vice President, Toll Brothers, Inc.*

A

Yeah. We had approximately 600 units in backlog a year ago in the north, and in the south, we had a little over 700.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

There you go.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Yeah. So it did shift from the south to the north this year.

Gregg L. Ziegler

*Treasurer & Senior Vice President, Toll Brothers, Inc.*

A

Yes.

Kenneth Zener

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Great. I appreciate that detail. And the only reason I asked is can you maybe update us, I know Southern California and Orange County and stuff had more of the before national buyer. Have you seen any change there in terms of change in this case being stability, which could be a good thing? And because we are seeing inflecting data on the existing sales side that's actually can be interpreted as being positive. So I'm trying to see have you seen any of that type of stability. Thank you very much.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

We are encouraged by the improving sequential order trend month to month to month through the spring. And so yes, it's stable and getting better, which makes us feel pretty good.

Kenneth Zener

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Thank you.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

You're welcome.

**Operator:** The next question will be from Michael Rehaut with JPMorgan Securities. Please go ahead.

Michael Rehaut

*Analyst, JPMorgan Securities LLC*

Q

Thanks. Good morning, everyone.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Good morning, Mike.

Michael Rehaut

*Analyst, JPMorgan Securities LLC*

Q

First question I had was on the sales pace trajectory. Obviously, good to hear that April orders up 11% year-over-year and you said sales pace was up year-over-year as well. If kind of looking at the back half of the year, specifically even the third quarter. I mean, last year, you did a sales pace of around 2.6, slightly better than the average sales pace that you did this second quarter. And actually that 2.6 I think was the highest it's been in quite some time certainly over the last several years.

So just thinking about as many companies have talked to so far this year, trends kind of being consistent with normal seasonality, notwithstanding the April sales pace up year-over-year, should we expect as you go into the back half of the year for there to be that normal sequential declines? I mean, historically, you've done anywhere from 15% to 20% down sequentially into the third quarter from the second, and obviously, a further 10%-ish or so fall-off in the fourth quarter. Does anything – as you look at the demand trends today and obviously you kind of talked to April and May being encouraging, does anything point you in the direction that 3Q and 4Q wouldn't adhere to that normal type of seasonality?

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Well, I don't see – and Doug you can jump – any reason for it not to follow the normal seasonality of years and years. But we are up pretty significantly in a number of communities and the comps for us quarter-over-quarter get quite a bit easier in the third quarter and the fourth quarter.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Right. That was exactly my answer.

Michael Rehaut

*Analyst, JPMorgan Securities LLC*

Q

Okay. And community count is obviously a separate driver, but just focused on sales pace, I think what you said would make sense and just wanted to confirm that. So thanks for that. Secondly, just some housekeeping items, if I could. You had mentioned, Marty, that the second quarter gross margin was driven by a few factors. One of them being a credit. I was just hoping to get the number there, the dollar or basis point impact. And of the...

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

It was around \$5 million.

Michael Rehaut

*Analyst, JPMorgan Securities LLC*

Q

All right. Perfect. And then, the community count, as part of your guidance, towards the end of your guidance for 3Q and fiscal 2019, right at the end after share count, you had mentioned something around community count expectations for the next quarter or two. I missed that. I apologize.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

I don't think we really gave any particular guidance at the end. So, you didn't miss anything. We ended Q2 with 311. We're going to add 10 from the Sharp acquisition. And then, we expect a moderate growth from there through the balance of the year.

Michael Rehaut

*Analyst, JPMorgan Securities LLC*

Q

Great. Thanks so much.

Douglas C. Yearley, Jr.  
*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

You're welcome.

**Operator:** Our next question comes from John Lovallo with Bank of America Merrill Lynch. Please go ahead.

John Lovallo  
*Analyst, Bank of America Merrill Lynch*

Q

Hey, guys. Thank you for taking my questions. The first one, Marty, you noted the roughly 100 fewer 3Q closings due to the weather in Northern California, which would explain a lot of the delta versus our forecast. But I'm just curious if your 3Q delivery outlook takes into consideration the 125 homes in backlog from Sharp.

Martin P. Connor  
*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Yes. We expect 25 to 50 homes from Sharp to close in both the third and the fourth quarter.

John Lovallo  
*Analyst, Bank of America Merrill Lynch*

Q

Okay. That's helpful. And then, the 3Q SG&A as a percentage of sales is forecasted to rise, I think it was, 160 basis points year-over-year. The lower deliveries are probably a big driver there, but is there anything else that we should be considering in that increase year-over-year?

Martin P. Connor  
*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Yeah. I think certainly a little less revenue compared to 2018 impacts that math. We have the normal compensation increases for our teams. We have some Sharp transaction costs in the third quarter that are \$500,000 to \$1 million. And we have period costs associated with the rollout and training of our new CRM and ERP systems that we've talked about for the past couple of years. We're finally getting those implemented and the teams are pretty excited about it.

John Lovallo  
*Analyst, Bank of America Merrill Lynch*

Q

Okay. That's helpful. Then finally, will you keep the Sharp brand in Atlanta? And is the Sharp management team going to stay in place?

Douglas C. Yearley, Jr.  
*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Yes and yes.

John Lovallo  
*Analyst, Bank of America Merrill Lynch*

Q

Great. Thanks, guys.

Douglas C. Yearley, Jr.  
*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

You're welcome.

**Operator:** Next question comes from Alan Ratner with Zelman & Associates. Please go ahead.

Alan S. Ratner

*Analyst, Zelman & Associates*

Q

Hey, guys. Good morning.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Hey, Alan.

Alan S. Ratner

*Analyst, Zelman & Associates*

Q

So, good to hear about the April-May trends. I was curious if you could talk a little bit about what was going on with incentives and pricing over that time period. And just bigger picture, do you think we're kind of past the worst of the incentive pain?

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

So, our incentives at the end of this quarter stood at an average of approximately \$34,000 per home. That's up from around \$22,000 per home a year ago, which is impacting a lot of our margin guidance. And so, in the quarter, incentives grew very modestly around \$3,000 to \$4,000 per home.

Alan S. Ratner

*Analyst, Zelman & Associates*

Q

And, Marty, is that on closings or orders, just to clarify?

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Those are in contracts, orders.

Alan S. Ratner

*Analyst, Zelman & Associates*

Q

In contracts, okay. Got it. And then, I guess, just if I look at kind of the guidance, if we kind of strip out some of the moving pieces, you mentioned the purchase accounting, the delays in California, it kind of feels like all else equal, the back half would have been closer to that 23% range that you guided to for this quarter originally. So, just as we think about all the moving pieces in your portfolio, the mix shift towards some lower price product, the entry into markets like Atlanta and Salt Lake and Portland, which is also going to below company average, are there any differences in kind of margin profiles longer term, or is this kind of fairly representative of where you see the business longer term?

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A



I think it's fairly representative, Alan. We're delivering now what we sold 6 to 12 months ago. So back then, our sales were a bit slower, as we all know, and there were obviously some incentives in certain locations. There is a mix change, but we're still a margin-driven company. We're very, very focused on that.

I'm very hopeful that if April and May trends continue, the incentive will come down to more of our historical norm, which call it the mid- to high-\$20,000 per house. And so, I think that would be encouraging for us, as California does deliver, particularly Northern Cal. If it's been pushed a little from Q3 to Q4 and then naturally into Q1 and Q2 of next year, those are high-margined markets. Even New York City, we mentioned two units that we believe will close in Q3 and Q4 at a lower margin. That was not indicative of the City Living business. Those were two legacy very large, very expensive units in one of our older buildings that we're happy to be selling, because the newer City Living buildings that we'll be delivering, they're not at that 50% margin that we used to brag about four and five years ago, but they're still high margins. They are higher than the company average. So, even with the shift to some different markets and some lower price point, I don't see a significant change in the margin profile of the company.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Right. And positively, we've seen cost stabilize for contracts signed this quarter. The labor and material costs of home construction, on average, only increased around \$250.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

And California was down \$5,000.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Right. And that \$250 compares to kind of a marching army over the past few years of \$3,000 to \$4,000 a quarter, so that's a positive.

Alan S. Ratner

*Analyst, Zelman & Associates*

Q

That's great, Marty. And then just to squeak one last one in on that cost front. Just any quick thoughts on tariffs and impact that that might have going forward?

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

They have had no impact on us to-date and we do not anticipate an impact in the future.

Alan S. Ratner

*Analyst, Zelman & Associates*

Q

Thank you very much. Good luck.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Thank you.

**Operator:** Our next question comes from Matthew Bouley with Barclays. Please go ahead.

Matthew Bouley

*Analyst, Barclays Capital, Inc.*

Q

Hi. Thank you for taking my questions. I wanted to ask back on California, just kind of reflecting on, I guess, the order patterns from the past few months and where the backlog is, and kind of outside of the noise around weather. I mean, how should we think about revenue growth in California at this point? We kind of can understand what things might look like in the next quarter or two, but is the implication from where the backlog is that perhaps revenues can, I guess, remain somewhat under pressure at the beginning of fiscal 2020? I know you're not going to give guidance, but we've talked about this in prior quarters. But what's the implication from that to gross margins perhaps recovering in early 2020? Or what else can you say there? Thank you.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

So I think as we've said at the beginning of 2019, California will be bigger in our income statement in 2019 than it was in 2018 and it will be smaller towards the back end of 2020 than it was in 2019, unless we see a significant change in the marketplace. And so we feel good about California. It's still a top 10 market. But as we've said a few times here, it is not quite as strong or as significant as it was a year ago. A lot of the strategy we've tried to deploy to get a bit more diversified as an organization.

Matthew Bouley

*Analyst, Barclays Capital, Inc.*

Q

All right. I appreciate that. Thank you. And then I wanted to follow-up on the SG&A side. I think, Marty, you mentioned that there's a lot of spending in the books already for 3Q. Is that just a function perhaps near-term there's some less flexibility around that? But as we look into 2020, do you suspect that you might be able to kind of right-size some of the SG&A spend at all based on where the topline is? Thank you.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

So, the spend for our CRM and our ERP system should continue a bit into the beginning of 2020 and then trail off, and hopefully, we begin to see some efficiencies from those new pieces of technology from that point forward.

So the G&A is generally fixed and the sales is much more variable, and so we're actively managing the G&A, as we always do, and we feel very optimistic about the successful implementation of these couple pieces of software and their ability to drive some efficiencies longer term.

Matthew Bouley

*Analyst, Barclays Capital, Inc.*

Q

All right. I appreciate it. Thank you very much.

**Operator:** The next question comes from Mike Dahl with RBC Capital Markets.

Michael Eisen

*Analyst, RBC Capital Markets LLC*

Q

Good morning. Actually, Mike Eisen on for RBC. Following up on some of the commentaries you guys had both regionally and the sequential cadence of improvements in April. Just wanted to follow-up. You mentioned a

number of markets that showed great improvement. Are there any markets or areas of weakness that are still down year-over-year in April?

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Yeah. Our bottom three are Seattle, which is still struggling. I think there's still some sticker shock in Seattle. I think the economy is strong. Obviously, the job market and diversity of that job market is pretty incredible. But we had such huge price increases over the last three or four years that, I think, the market is digesting a bit. Dallas has been slow, but we are encouraged of late, and then the third one that has shown some softness would be Michigan.

Michael Eisen

*Analyst, RBC Capital Markets LLC*

Q

Got it, very helpful.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

That's for the quarter. That's not for the – I know you asked about the month of April. I'm not going to get that specific, but that's – what I just gave is commentary on the quarter.

Michael Eisen

*Analyst, RBC Capital Markets LLC*

Q

Sure. Helpful. Thank you. And then around the incentives commentary, similar vein. Can you help us think about where that step-up in incentives per home if there's different pockets where you've been able to pull back on incentives as affordabilities become somewhat better with the moving rates or any areas where seeing more rational pricing actions?

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Yeah. The one thing I do want to point out, the incentives are up \$4,000 from \$30,000 to \$34,000, and our average house is in the 8s. So, it's a 50 basis point move in incentive. I still find an incentive that's 3.5%, 4% range to be healthy. Even in very good markets, we always have some modest incentive. Because when you buy a house at that price point, you want to feel like you won. You want get a little something, a little credit at the design studio when you pick out your finishes.

Where it's spread out? It's really – its community-by-community, its market-by-market. There are not a handful of isolated markets where that move in incentive – I can attribute that move in incentive to just a few markets. I mentioned Dallas has been slower. Well, naturally, Dallas has had some higher incentives. I mentioned Seattle has been slower. We've raised some incentives in Seattle. So it really moves by the demand. And it – I can't point to just a handful. I think it – sort of each community has its own story.

Michael Eisen

*Analyst, RBC Capital Markets LLC*

Q

Got it and very helpful. And then one more, if I can sneak it in. Now, that tax season has passed, can you help us think about – you guys have some more exposure to SALT-impacted states, what are you hearing from your salespeople and is there any expected impact from the changes in the tax code? Thanks and good luck.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Thank you. Just to finish up on the incentive conversation, Gregg just showed me a few markets that are big markets for us where the incentive had come down. And they are East Coast markets of Greater Philadelphia, we call Pennsylvania, and Northern Virginia.

SALT, we're not hearing about it at the sales centers of California and New Jersey, New York, Connecticut. We do hear a bit about it in the sales centers of Boise, Reno, Las Vegas, Phoenix and Dallas, where there are some people that are leaving the State of California to take advantage of non-SALT or lower SALT.

So there're still a lot of people that buy in California. California has always been a very, very expensive state to live in pre-SALT, but I think we are well positioned for those that are a bit fed up and they want to go to the other locations where we have great offerings.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Chad, we had a question come in via e-mail, and that concerns what is Toll's view on investment grade ratings, specifically with respect to the recent outlook change from S&P, and how might that impact our capital allocation plans, specifically share repurchases and debt reduction.

So we were very pleased with the upgrade from S&P. Often, that sort of move telegraphs a subsequent upgrade to investment grade in a 12- to 24-month cycle. We're investment grade with Fitch, a notch below with both Moody's and S&P.

And so achieving investment grade is something we would love to have, would be very respectful of. And I think based on where we currently stand and the flexibility we have on our capital structure, it shouldn't impact too much how much stock we choose to buy back or debt we choose to retire.

**Operator:** Thank you, sir. The next question is from Scott Schrier with Citi. Please go ahead.

Scott Schrier

*Analyst, Citigroup Global Markets, Inc.*

Q

Hi. Good morning. I wanted to ask a little bit about your average contract price, in many of your markets had increased. And I'm curious if you could parse some of that out what was between -- whether it was product mix, base price, design studio options, lot premiums. And then also, what are your assumptions going forward from margins in terms of those lot and option premiums?

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Scott, there has not been a change between the base price of the home and the lot premium and the options. Our buyers still spend about 20% of the delivered price of the home on the options, which is a combination of the structural changes to the home that add rooms, move walls. And the finish options that are purchased at our regional design studios. And that number really has not moved. Lot premiums are based on the local community. If you have a view of the Pacific Ocean, we may actually get \$1 million lot premium. If you're on the 18th Green, we may get a couple of hundred thousand. And if it's more vanilla community, \$10,000, \$20,000, \$30,000 tends to be the range and our strategy and the buyer's willingness or appetite for premiums really has not changed at all.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

I'd encourage you to take a look at the contract data on page 10 of our release, shows all of six of our regions. Our average price of units in contracts for the third quarter went down roughly \$70,000 – second quarter, excuse me. But we were up in five of the six quarters. And so that average contract is really impacted by the California situation being not as strong as last year.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Five of six regions.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Five of the six regions, excuse me.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

But that's just math, because in California, the price held up, there's just less of them.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Correct.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Right.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

We've seen price increases in five of six of our regions on an average basis. But on a company-wide basis, the average price has gone down because of the impact of California.

Scott Schrier

*Analyst, Citigroup Global Markets, Inc.*

Q

Great. Thanks for that. And then for my follow-up, and I know it's early. I just wanted to ask a little bit about your investment in the build to rent model. Are you seeing a preference or competition from build to rent homes in your market even at your price point? I'm curious, if the investment is indicative of losing share in your view, meaning this might be a way to recapture some of that, or is this just viewed as an ancillary income stream?

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

It's viewed as an ancillary income stream. We are not losing share. We see this as more and more renters may prefer to raise a family or live in a single-family home versus a apartment complex or community or building. And so it is a part of our Apartment Living group. It is not at the price point or the monthly payment of our for-sale business; strictly ancillary.

Scott Schrier

*Analyst, Citigroup Global Markets, Inc.*

Great. Thanks a lot for that. I appreciate it. Good luck.

Q

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

Thank you.

A

**Operator:** The next question comes from Jade Rahmani with KBW. Please go ahead.

Ryan Tomasello

*Analyst, Keefe, Bruyette & Woods, Inc.*

Hi, everyone. This is Ryan Tomasello on for Jade. In terms of M&A, I was hoping to get your view on large-scale transactions like merging with a similar size peer. Would the strategic rationale make sense in terms of improving scale, construction efficiency, offsite capabilities and product diversity? And also, as you know, some of the other builders have apartment businesses and are adopting their land strategies so it seems like there could be overlap there as well.

Q

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

All of what you say makes sense. We have no deal cooking. As you know, there's always conversations between big to big, mid to mid, big to mid, big to small, public to private. Integration and synergies is difficult. It's proven to be difficult over the years with many of these larger deals, but you gave a lot of good reasons why it does make sense. Everyone has our phone number. We have all their phone number, so there's nothing cooking at the moment.

A

Ryan Tomasello

*Analyst, Keefe, Bruyette & Woods, Inc.*

And as a follow-up, I'm sure if I missed it, but can you give a color on the 2Q impairments which seems a bit outsized relative to recent quarters?

Q

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

So we had roughly two communities that made up about three quarters of those impairments, one in Illinois and one in suburban Philadelphia.

A

Ryan Tomasello

*Analyst, Keefe, Bruyette & Woods, Inc.*

And was it specifically related to changes in underwriting or current demand levels in those communities? Any color you can provide?

Q

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

I think the one in suburban Philadelphia was reflective of current demand levels and the need to adjust price. And I think the one in Illinois was reflective of a return the capital to the company and put it to work elsewhere

A

mentality and build through the situation we have. We've been struggling at that community for quite a while and it's time to get our money back and move on.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

I think the one in Illinois is a little more reflective of the market and the one in Philadelphia is not as Pennsylvania has done very well for us. It's a unique property that had a unique land plan, unique architecture, and in retrospect, was a bad land buy.

Ryan Tomasello

*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

Got it. Thanks for taking the questions.

**Operator:** The next question will be from Jack Micenko with SIG. Please go ahead.

Jack Micenko

*Analyst, Susquehanna International Group, LLP (SIG)*

Q

Hi. Good morning. I wanted to just ask, first, about the other income line. The full year guide's down from, I guess, 2018, and I know you've got a big pipeline of apartments in the hopper. But is that just a function of a flat spot and timing of monetizing, or is there some strategic shift here where maybe you're holding on to more of these for operating income versus some of the merchant-build gains? Curious what your outlook is there.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Jack, that's a flat spot, as you referred to it. We are working on three separate deals that will each generate \$10 million to \$20 million in gains in the future and that will be reflected in that line item. Two of these are not reflected in our guidance. Our best estimate has them closing early in 2020. There's potential for them to move up, but we just didn't feel comfortable moving them up.

Jack Micenko

*Analyst, Susquehanna International Group, LLP (SIG)*

Q

Okay. And then, you're clearly more bullish on the M&A commentary on the call today. I guess, the question is, is it the bid side or the ask side? You talked a lot about diversifying your business, both geography- and product-wise. I'm guessing the back half of 2018 was a reality check for some smaller builders. But curious how much of it's bid, how much of it's ask? How much of it that you, as a company, saying, well, we got to accelerate the diversification of our business versus sellers becoming more rational?

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

I think it's a combination of all of that. I think, bid-ask could come in a bit. I think you are right that some smaller builders got a little spooked by the market nine months ago. They got through 2007 to 2011. They're now a decade older. And they saw what happened last fall, and they're thinking maybe this would be a nice time to move to Florida. So, I think it's a combination of our appetite for sure, the bid-ask coming in, and a few more sellers out there that are motivated.



Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

I think we have to find something that matches up well with us as well.

A

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

Always.

A

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

We looked pretty hard in the Salt Lake market and the Portland, Oregon market. We had a builder under contract in Portland, and it didn't work out. But in Salt Lake, we didn't find anybody we felt like dancing with.

A

Jack Micenko

*Analyst, Susquehanna International Group, LLP (SIG)*

All right. Thanks, guys.

Q

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

Welcome.

A

**Operator:** The next question comes from Megan McGrath with Buckingham Research. Please go ahead.

Megan McGrath

*Analyst, The Buckingham Research Group, Inc.*

Good afternoon now. Thanks for taking the question. Just wanted quickly to ask about, you mentioned going into getting some property on the West Coast in City Living. You've been talking about that for quite some time, so just curious what changed. Was it just timing of these properties coming on to markets that you've been watching or has anything changed in that area that allowed you to make these purchases?

Q

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

We've been studying West Coast opportunities for quite a while now and have one, we think, great one in L.A. It's a mid-rise infill property in a great location, and then we have a second high-rise right next to the new Amazon campus in the heart of downtown Seattle that we're excited about. The market comps there are doing extraordinarily well. And I hope that's the first two of many on the West Coast.

A

Megan McGrath

*Analyst, The Buckingham Research Group, Inc.*

Great. Thanks. And then, I apologize if I missed this. I don't think we've talked about the source of the beat – the top line this quarter versus your guidance. So, just curious if that coming in above the high end of your range, was it any specific geography or area, or was it pretty broad-based that you were able to close more than you had anticipated?

Q



Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

I think it was closing more than we had anticipated on a broad level. Our delivery guidance for Q2 included in expectations for continued elevated cancellations that we saw in Q1 and that didn't happen. So, that was a positive development for us and the ops teams did a great job, getting things over the finish line and close.

Megan McGrath

*Analyst, The Buckingham Research Group, Inc.*

Q

Great. Thanks very much.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

You're welcome.

**Operator:** The next question comes from Carl Reichardt of BTIG. Please go ahead.

Carl E. Reichardt

*Analyst, BTIG LLC*

Q

Thanks. Hi, gang. Wanted to ask about the National Sales Event, Doug, that you guys ran in April, and trying to parse it, it looked like it was kind of a store-by-store basis. But could you give me some details about kinds of the incentives or what you were offering to consumers? Given the pickup in orders in April relative to March, I have to believe it had a pretty positive impact beyond just the organic improvement in demand.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

We always run the event in April. It's been the same, was the same in 2018 as it was in 2019. The incentives are very similar. It is a combination of vendor participation where some of our larger partners will offer upgraded flooring, upgraded kitchen cabinets, upgraded plumbing fixtures at either a reduced price or no additional price. And then we, in selected locations, will add our own little something just to increase the overall impact.

But it hasn't changed, and it certainly had some impact on April. But that's not what I attribute to my optimism, because we had the same program in 2018, and as I said, our sales were up 11%, which was not the case in March-over-March and February-over-February.

The other little encouraging piece is Easter fell in April this year, which is a pretty quiet week for sales. And last year, Easter fell in March. So, that makes me even feel a little bit better about the April numbers.

Carl E. Reichardt

*Analyst, BTIG LLC*

Q

All right. Fair enough. Thanks. And then, just on the next quarter's orders and the comp, if I recall right, you had a fair amount of Metro Crossing orders in Q3. I might be wrong about that. Is that going to create a tougher comp for you in Q3 on orders just because of that community, especially in California? Or it might – I'm not sure. I might be wrong about that, but I'm just looking at the numbers and that's what it appears to me will be the case.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

California last year was down year-over-year 4% in orders in the third quarter. So, that comps much easier than the first two quarter comps of this year. There is a little less inventory available to sell for Metro Crossing. And California isn't quite as strong this year as it was a year ago. Overall, I think our orders grew in the third quarter last year about 6%. So as I mentioned earlier, the comps for the third and fourth quarter get quite a bit easier for us as a company on the whole.

Carl E. Reichardt

*Analyst, BTIG LLC*

Q

Okay. Thanks, Marty.

**Operator:** The next question comes from Alex Barrón of Housing Research Center. Please go ahead.

Alex Barrón

*Analyst, Housing Research Center LLC*

Q

Yeah. Thanks a lot. Yeah. I wanted to ask about the single-family rental business. If you could discuss a little bit more, I guess what is going to be your role in the partnership, are you going to be the builder or just the financial investor? And what are the type of homes that you guys are targeting to build and what's the buyer demographic? If you can – are they going to have the Toll brand? I know there's number of questions there, but if you can just address some of those.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Sure. The venture will be marketed as BB Living. It will not be branded Toll Brothers. Our role is, yes, financial partner, but also parental supervision of operations. We will be looking at land opportunities because it's in markets that we were in. We will be helping with architecture. We will be helping with construction. BB will play the lead role when it comes to management and lease up.

The locations are primarily in master-planned communities, large master-planned communities that have a wide variety of price points and products now and the master-planned developers are excited to bring in a single-family or townhome product that looks the same as many of the other builders, the for-sale builder's product. It'll just happen to be a rental.

The buyer demographic is primarily younger families, and as I said, want a rent or they want to raise a family, want to rent a home. And BB Living has had great success before us in Phoenix. We will now be joining them for future opportunities in Phoenix and expanding their operation into the market I mentioned earlier.

Alex Barrón

*Analyst, Housing Research Center LLC*

Q

Similar size of I guess the general builder communities like let's call it roughly 100 units, that type of size?

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

So, I think these are going to be 1,500 to 2,000 square-foot homes in the \$240,000 to \$300,000 price point, if you were to sell them. That's not our intention. And these are in master-planned communities in pods of 100 to 200

generally. And as Doug mentioned, BB is in its first in the Phoenix market and they're looking for us to help them expand their business to other markets where we have a significant presence.

Alex Barrón

*Analyst, Housing Research Center LLC*

Q

Got it. Okay, that's helpful. And then if I could ask one on the M&A side. I think today, if I recall, the only M&A you guys have done is mainly private builders mainly to enter market. So, what would it take for you guys to consider something different like going down acquiring a public builder? What characteristics would be – I guess would you be looking for there to switch in the direction?

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

Alex, it would be similar to the analysis we've done on the 10 other builders we've acquired. So, I wouldn't get hung up on whether it's private or public. It would be based upon the quality of the opportunity and our feeling of good fit and the ability to grow the company and make more money.

Alex Barrón

*Analyst, Housing Research Center LLC*

Q

Okay. Great. Thanks a lot.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

You're welcome.

**Operator:** The next question comes from [ph] Justin Winn (01:08:52) with Citi. Please go ahead. Please proceed Mr. [ph] Winn (01:09:04), your line is open.

A

Chad, I think we should move on.

**Operator:** All right. We'll move on to our last question of the day, which is a follow-up from Michael Rehaut with JPMorgan Securities. Please go ahead.

Michael Rehaut

*Analyst, JPMorgan Securities LLC*

Q

Thanks very much. Appreciate it. Just wanted to ask about incentives, and I know you kind of addressed this in a couple of different ways during the call and I might have missed exactly the full answer. But just wanted to try and get a sense when you looked at incentives on your orders during the quarter, if you can give us a sense of what it was on a year-over-year basis for the quarter overall on the orders and how that year-over-year dynamic might have changed as you progressed from February to April.

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

So, Michael, our incentives currently are \$34,000 on average. They were approximately \$30,000 a quarter ago, and they were \$22,000 a year ago.

Michael Rehaut

*Analyst, JPMorgan Securities LLC*

Q

And that's on orders, not closings?

Martin P. Connor

*Chief Financial Officer & Senior Vice President, Toll Brothers, Inc.*

A

Correct.

Michael Rehaut

*Analyst, JPMorgan Securities LLC*

Q

Great. Thanks so much.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

A

You're welcome.

**Operator:** This concludes our question-and-answer session. I would like to on the conference back over to Doug Yearley for any closing remarks.

Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

Thank you, Chad. Thanks everyone. Have a fantastic holiday weekend.

**Operator:** Thank you, sir. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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