Corrected Transcript

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Toll Brothers, Inc. (TOL)

Q1 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Toll Brothers First Quarter Conference Call. All participants will be in a 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 Douglas Yearley, Chairman and CEO. Please go ahead.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Thank you, Elisa. Welcome and thank you for joining us. With me today are Bob Toll, Chairman Emeritus; Marty Connor, Chief Financial Officer; Fred Cooper, Senior VP of Finance and Investor Relations; Wendy Marlett, Chief Marketing Officer; and Gregg Ziegler, Senior VP and Treasurer.

Before I begin, I ask you to read the statement on forward-looking information in our earnings 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.

Last night, we reported first quarter 2020 home sales revenue of $1.3 billion with a 20.9% adjusted gross margin and net income of $56.9 million or $0.41 per share diluted. Our first quarter backlog of 6,461 units and $5.45 billion was up 9% in units and 2% in dollars versus last year.

First quarter deliveries, revenue and earnings per share were lower than we had anticipated due to delayed closings in a few markets, principally in Northern California where we missed 60 closings valued at $67 million. Most of these homes should deliver in our second quarter.

With strong buyer demand, our first quarter contracts were up 31% in units and 28% in dollars and our contracts per community were up 28% compared to one year ago. California, which is now part of our Pacific region, was up 32% in contracts and 10% in dollars in the first quarter. This was the first quarterly year-over-year growth in contracts in California since fiscal 2018's second quarter almost two years ago.

Demand has remained strong through the start of our second quarter and we are experiencing pricing power in many of our markets. We continue to look for opportunities to expand our luxury brand to new product lines and price points. While we intend to maintain our leadership in the luxury segment, we are also strategically adding more affordable luxury communities to capitalize on demographic trends and to expand our footprint and customer base.

Nearly 40% of our current communities offer a home with a base price of $500,000 or less. These communities should turn inventory quicker and be more capital efficient. We continue to expand our presence in new markets. We have completed three acquisitions in the past nine months in the Southeastern United States. These acquisitions brought us into five dynamic new markets: Atlanta, Nashville, Charleston, Greensboro and Myrtle Beach. We've added three more markets with expansion into Portland, Oregon, Tampa and Salt Lake City within the past 18 months.

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Single-family permits rose in January to the highest seasonally adjusted annual pace since June 2007, even so housing supply remains tight. Interest rates remain historically low. Consumer confidence is healthy. Household formations are strong and unemployment is at or near record lows. According to the January existing home sales report from the National Association of REALTORS, the growth in existing home sales was strongest in the $500,000 to $750,000 price range.

According to the just released census report, new home sales were up 18.6% over last January, with sales of homes priced above $400,000 increasing more than 60% in the same period. With this positive macro backdrop, market fundamentals remain supportive as we continue to expand our luxury brand, the new price points, product lines, and geographies.

Now, let me turn it over to Marty.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

Thanks, Doug. Before I address the specifics of this quarter, I 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 our earnings release. I also want to note that our guidance is subject to our normal caveats on forward-looking statements. Additionally, in the coming days, we will file an 8-K detailing historical segment reporting for contracts, settlements and backlog based on our newly realigned reporting segments.

Our results for revenue and gross margin came in below expectations driven by a combination of delayed deliveries, unfavorable mix, and additional closeout costs related to certain older communities. These delayed deliveries, which Doug outlined and were concentrated in our higher-dollar Northern California communities, are expected to settle in our second quarter.

This lower delivery volume also impacted our SG&A leverage, but our SG&A, in absolute dollars, was generally in line with our expectations. As background for our margin guidance for the balance of the year, I want to remind you that orders declined for each quarter from October 31, 2018 to July 31, 2019. Due to the rapid rise in interest rates in the summer and fall of 2018, this timeframe became a buyer's market where we had negative pricing power.

While orders did increase in Q4 2019, pricing power was modest. In our newly formed Pacific region, which includes California, Portland and Seattle, contracts in dollars did not turn positive until this first quarter of 2020. Orders were up in the Pacific region 70% in units, and 30% in dollars in this quarter. This region driven by California and Seattle carries above company average margins. From a mix perspective, two-thirds of our projected margin change from fiscal 2019 to fiscal 2020 is driven by the combination of less volume and lower margins out of that Pacific region.

It takes us 9 months to 12 months to deliver our homes. So, we do expect sales from the improving market that began in late 2019 to benefit adjusted home sales gross margin in our second half by approximately 100 basis points compared to the first half of fiscal 2020. Most of this recent strong demand environment, evidenced by our growth in contracts and absorption pace and our increase in pricing power, coupled with our projected 10% community count expansion, should also contribute to margin and earnings improvement in fiscal 2021.

With our focus on capital efficiency, we are committed to improving our return on equity. In the first quarter of fiscal year 2020, we repurchased $476 million of stock at an average price of $40.73 per share. This reduced our

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share count by 11.7 million shares or 8%. We expect share repurchases to remain a significant component of our capital allocation strategy.

Our balance sheet remains strong. We ended the first quarter with $520 million in cash and equivalents and had $1.59 billion available under our bank revolving credit facility. We have no public or bank debt maturities in the next 24 months, and our weighted average debt maturity is 5.5 years.

Our strong balance sheet, extended maturities and available liquidity allows us to grow our business through land purchases and selective homebuilder acquisitions. We have increased our land owned and controlled by approximately 8,000 lots since a year ago. Our first quarter 2020 book value per share was $35.87 and our net debt to capital ratio was 42.3%.

Looking forward, we are projecting second quarter deliveries of between 1,850 and 2,050 units with an average price of between $800,000 and $820,000. We are projecting full fiscal year deliveries of between 8,600 and 9,100 units with an average price of between that same $800,000 and $820,000.

We expected adjusted home sales gross margin in our second quarter to be approximately 20.5% with full fiscal year adjusted home sales gross margin of approximately 21.25%. This implies a 100 basis point improvement in the second half of fiscal 2020 versus the first half. We project second quarter SG&A as a percentage of home sales revenues to be approximately 12.4% and full fiscal year SG&A as a percentage of home sales revenues to be approximately 11.4%.

As we discussed on our fourth quarter conference call, our projected 10% growth in community count by fiscal year-end 2020 involves investment in personnel and other costs in advance of revenue generation. In addition, we continue to implement our IT system upgrades. This is causing SG&A as a percentage of revenues to be higher this fiscal year.

Second quarter other income, income from unconsolidated entities and land sales gross profit is expected to be approximately $5 million. But we expect full fiscal year 2020 other income, income from unconsolidated entities and land sales gross profit to be approximately $115 million. We project the second quarter tax rate of approximately 26% and fiscal year tax rate of approximately 25%.

Our current Q1 fiscal year 2020 quarter tax rate was benefited by the reinstatement of the energy tax credit. Our second quarter weighted average share count is expected to be approximately 132 million with a weighted average diluted share count of 133 million for the year.

Now, let me turn it back to Doug.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Thank you, Marty. At this point, Elisa, let's open it up for questions.

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QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] The first question today comes from Ivy Zelman of Zelman & Associates. Please go ahead.

Ivy Lynne Zelman
Analyst, Zelman & Associates
Q

Good morning. I have several questions. Maybe Doug, if you can help us understand why, when you indicated that 1Q would be the low watermark, just several months ago, are we now seeing margins in 2Q that are going to be lower than 1Q? That's my first question.

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

Sure. Marty's got the list. So, he's going to take it Ivy.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

Well, I think the Northern California slippage that we saw is also coming with a bit lower margin than we had previously anticipated due to some production delays and production issues. That's the bulk of it. The rest of it is mix, including a little less Seattle than we had anticipated.

Ivy Lynne Zelman
Analyst, Zelman & Associates
Q

When you say production issues and close-out costs higher than expected, and just operational management challenges, maybe you can elaborate for us what's going on under the hood.

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

Sure. The issue in Northern Cal, which we have talked of before is a very large high-density condominium community called Metro Crossing in Fremont. It has about 600 units. We had terrific sales. It's a very, very complicated site with all condominium, which means it gets built at once and delivered basically at once. We ran into significant weather issues last winter, where San Francisco had the worst rains, I think, on record or at least for decades. And we had a lot of not only delays, but we had cost overruns. And we have been battling through that. We are beginning to – we started delivering in the end of 2019, and we continue to struggle. And we lost – most of those 60 units I referenced in Northern California as being pushed back came out of Metro Crossing. The margin, when we opened that community and sold early on, certainly looked better – looked better than the margin we have now that we are delivering. And so, the Northern California problem is pretty much isolated to one location that we have had major issues in.

Ivy Lynne Zelman
Analyst, Zelman & Associates
Q

Will that be a change in management, given the poor performance of ever who oversight of this community, because it sounds like it's execution problems and you're saying it's specifically related to one community. So, is this the division president who is not managing it properly?

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

No. it's not.

Ivy Lynne Zelman
Analyst, Zelman & Associates
Q

Okay. Let me ask one other question on SG&A, because SG&A was really surprising on your guidance. Just understanding the significance of your deleverage there, is there any non-recurring expectations included in that guidance, non-recurring items?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

So, we had previously mentioned about non-recurring items in our first quarter, they were compensation related. They are non-recurring in subsequent quarters, but there are components of that that would recur in every first quarter. In addition, we continue to spend on systems upgrades that have a life that should come to an end here in the next 18 to 24 months.

Ivy Lynne Zelman
Analyst, Zelman & Associates
Q

All right, real quick, Marty, can you quantify that in terms of the IT system upgrade impact on SG&A?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

It's in the neighborhood of $5 million to $8 million annually.

Ivy Lynne Zelman
Analyst, Zelman & Associates
Q

Okay. Thanks, guys.

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

You're welcome.

Operator: The next question today comes from John Lovallo of Bank of America. Please go ahead.

John Lovallo II
Analyst, Bank of America Merrill Lynch
Q

Hey, guys. Thank you for taking my questions. The first one, Marty, I think you mentioned that there were 60 closings that were delayed in the Northern California market. But closings were a little bit lighter than just that 60. Where else were you seeing delays?

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

John, I'll take that one. It's scattered. I mean, obviously, there are a number of locations that beat the projection, but those that missed by the most outside of Northern Cal, we missed 14 closings in Reno for $12 million of

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revenue. We missed 18 closings in Jacksonville for $11 million of revenue. We missed 13 closings in Northern Virginia for $10 million of revenue. And we missed 8 closings in Dallas for $10 million of revenue. That would be the top of the list.

John Lovallo II Q
Analyst, Bank of America Merrill Lynch

Okay. And then maybe just following up on that. When we think about the delay in the closings, was it related to labor, materials or just pure timing or age of the backlog, et cetera?

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

It's timing. Labor is not worse than it was the three, six, nine months ago. Materials are not worse. The Chinese tariffs or other international issues are not affecting the supply of our labor. In some cases, it's permitting. In some cases, it's obtaining that final certificate of occupancy from the municipality.

Subcontractors are stretched. They have been stretched. So, that's been an issue that we, as an industry and we at Toll, have been dealing with for some time. But every quarter there are divisions that beat their numbers and there are divisions that miss their numbers. And I think when you take the 60 units and $60 million-plus out of Northern Cal at Metro Crossing, the rest of what happened around the country is fairly typical.

Obviously, there were more misses than just Northern Cal. So, we had a little bit more on the downside than the upside. And I just described the biggest offenders. We're obviously examining everything that happened in those locations, but there's nothing in particular concerning labor or material that jumps out that is giving us more concern.

John Lovallo II Q
Analyst, Bank of America Merrill Lynch

Okay. Great. And then finally...

Martin P. Connor A
Chief Financial Officer, Toll Brothers, Inc.

There were also a few more cancellations this quarter than we had anticipated and that shows up as missed closings that aren't production related.

John Lovallo II Q
Analyst, Bank of America Merrill Lynch

Got it. And then lastly, how quickly can you guys get back in the market to start buying back stock?

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

Friday.

John Lovallo II Q
Analyst, Bank of America Merrill Lynch

Okay. Thank you, guys.

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Operator: The next question today comes from Jack Micenko of SIG. Please go ahead.

Jack Micenko
Analyst, Susquehanna International Group, LLP (SIG)

Q

Hi. Good morning. Marty, wanted to talk about the expenses. If I kind of back of the envelope the guide, it looks like G&A is probably up $100 million, give or take, year-to-year in 2020. You gave us the $5 million to $8 million on the systems conversion that's been ongoing. How much of the balance is sort of normal inflationary? I'm guessing probably, I don't know, 3%, 5%. And is the rest then all new communities? I'm trying to just think through what the G&A leverage then looks like in 2021 as we look at this, because it feels like you're sort of in the middle of a bit of a repositioning period here that should improve as time goes on.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

I think we definitely look for improvement as time goes on. The expansion in the number of communities is around two-thirds of the increase we look to see year-over-year. Most of the rest is kind of normal compensation increases. And the IT would probably be next. Additionally, we've added a few builders, including a builder down in Atlanta and Nashville, who expects to have deliveries very late this year, but nothing in the interim because of the attached nature of their product.

Jack Micenko
Analyst, Susquehanna International Group, LLP (SIG)

Q

Okay. And then, thinking through the ASP and some of the mix shifts both product and geography-wise, is the arrow flat, up or down, just big picture in 2021? Meaning, are we through a lot of the repositioning by the end of this year, or does that kind of continue into 2021?

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

A

It will continue. As we've said, we are committed to expand our price points, expand our buyer segments. As I mentioned, 46% of our contracts had a base price under $500,000. Now, remember, our buyers generally have a lot premium they pay and then they pick options and they go to the design center and they pick finishes. So, the delivered price of those houses, in some cases – in most cases, is probably over $500,000. But recently, I just got an update that 20% of the new land we bought is for homes that will be sold under $500,000. I don't think you'll see a dramatic shift in 2021, but it will be progressive. And we continue to see good deal flow at all price points. So, it's just going to be one more segment that we're going to focus on, but it will be gradual.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

And I think the diversity of our price points makes it tough to say directionally where the average price is going to come out, because it's so dependent on which regions are doing better than others from a market perspective. We're selling homes from low $300,000s to $3 million. And we've just seen the Pacific region, which is generally a higher price point, come back a little bit delayed compared to many of the other regions. So if that continues, it could have a meaningful impact on the average price.

Jack Micenko
Analyst, Susquehanna International Group, LLP (SIG)

Q

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Sure. And then presumably, you're going to get some of that back on pace, I would imagine, as well as the product mix continues to shift?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Yes. Thanks, Jack.

Jack Micenko
Analyst, Susquehanna International Group, LLP (SIG)

Q

All right. Thanks for taking my questions. Yeah.

Operator: The next question today comes from Truman Patterson of Wells Fargo. Please go ahead.

Truman Patterson
Analyst, Wells Fargo Securities

Q

Hi. Good morning, guys, and thanks for taking my question. I appreciate it. First, in the Northeast and Mid-Atlantic, orders declined a little bit. I'm just hoping you could discuss a demand in those regions and also your land positioning. I know historically in the Mid-Atlantic, you had some battleship and larger master plan positions there. And then, on the demand side, could you just discuss a little bit if SALT is really hitting those areas, that geography?

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

A

Sure, Truman. The flat orders in the Mid-Atlantic and the North is just a result of not having community growth. Our community counts are flat. As we've talked about it's our home. We do very well here. We have a dominant position. It is very difficult to find new land opportunities, because the entitlements are so hard, and there's not a lot of growth. We've recognized the growth in South and West, and we've positioned ourselves accordingly without giving up on the Mid-Atlantic and the North. Being flat with flat community count is I think what we anticipated, and we're comfortable with where we're positioned there.

Virginia is a top-five national market for us, performing very well. Philadelphia, Greater Philadelphia has seen strength over the last year to 1.5 years. And so, I think that's the story. It's just a lack of opportunities to grow community count and a lack of job growth and population growth.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

In terms of the larger kind of legacy communities that you asked about, Truman. I think there's a Active Adult job in Central Jersey that is coming to the end. And then, we have Loudoun Valley still chugging along in Virginia.

Truman Patterson
Analyst, Wells Fargo Securities

Q

Yeah. Okay. Thank you for that. And then, kind of the topic of the day is coronavirus concerns in California. Clearly, California orders rebounded in the first quarter. But given the heavily Asian buyer in that market, some investors are fearful that now both coastal and inland demand could at least be impacted near term. I guess what have you guys seen near term and how do you guys think of this kind of playing out going forward?

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

So, we believe 11 closings in California have been pushed out, we think and we hope, to the second quarter due to the virus. That's the intelligence we're receiving from our sales teams out in California. We are much smaller in Orange County right now than we were three years ago. And Orange County has been where most of the Chinese buyers have – at least for Toll Brothers, have purchased. We don't see nearly as many – we have foreign buyers throughout California. But the Chinese buyers, we're really concentrated in Orange County. We see very few in Northern Cal or in LA County or Northern San Diego County, where we also operate.

With respect to the supply side, the only interruption that we're feeling right now is lighting, which is coming directly out of California, and some of the small appliances where either components or the full appliance are being manufactured in China. Longer term, there's some chatter about whether steel will become an issue, but we're not feeling that yet.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

In the fourth quarter, our sales to foreign buyers was down to 7%, and it's approximately that percentage of our backlog right now.

Truman Patterson
Analyst, Wells Fargo Securities
Q

Okay. Just one follow-up on the lighting...

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

Sorry, first quarter, excuse me. In our first quarter, Truman, excuse me.

Truman Patterson
Analyst, Wells Fargo Securities
Q

Okay, okay. Thank you. Just a follow-up on the lighting supply being impacted by China and the coronavirus, do you have an alternate supply chain outside of China that you can source that from? It's my understanding that virtually all lighting in the US actually comes from China?

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

Yes, we do. And if there's any one product that was to be hit, lighting would probably be the least impactful because, worst case, you can always get a house lit up with temporary lights, and make it through a little while until the chandelier and the sconce arrives.

Truman Patterson
Analyst, Wells Fargo Securities
Q

Okay. Thank you.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

Thank you.

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Operator: The next question today comes from Matthew Bouley of Barclays. Please go ahead.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Hi. Thank you for taking my questions. So, I wanted to ask around kind of that margin delta in 2020 that you mentioned, specifically the lower mix of Pacific and the lower margins within Pacific. So, the second part of that, I guess. Do you expect that specific margins, as we move past kind of the operational challenges, the weather challenges that you've alluded to, is the underlying profitability there expected to actually turn higher sequentially in the second half? Or as you mentioned, those margins are above the fleet average, is there a risk that the Pacific margins kind of continue to move towards the rest of the business? Thank you.

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

A

Sure. It's a good question. So, the margin coming out of the Pacific is still higher than the company average. However, the California margin projected fiscal year 2020 versus actual in fiscal 2019 is 80 basis points lower. And in Seattle, 2020 to 2019 is 20 basis points lower. Is it going to creep down to the company average? No. Marty, would you...?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

I think, the other – I'd agree with that. But I think the other couple of points to make with respect to mix shift. In 2019, the Pacific was around 34% of our total volume. We expect it to be down around 5% in 2020.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Okay.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

And our single-family business, which generally has higher margins, is also going to decline approximately 5% of total from 74% to 69%.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Got it. Understood. Thank you for that color. And then, I guess, just a broader question about gross margins and visibility, because obviously you guys have the longer backlog and then there's always kind of a strong level – or generally has been a strong level of visibility as a result of that backlog margin. So as we move past, again, these unforeseen kind of issues at Metro Crossing, do you suspect just – as the business mix has changed, the product mix has changed, geographies, et cetera, is there any reason to suspect that kind of your level of margin visibility has also changed?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

No, I don't believe so, Matthew. I think we had some unique circumstances this quarter. Another matter that we didn't even mention is that our specs as a percentage of total sales for this quarter – for deliveries for this quarter

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was up to 4% or 5% – I'm sorry 17%, which is up 4% or 5% compared to our normal, of units delivered this quarter. And our specs generally have a little lower margin. So, a lot of moving pieces, but I don't think we're going to see long-term impact on our visibility as a result of this quarter.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Okay. Thank you for the details. Appreciate it.

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

A

You're welcome. Thank you.

Operator: The next question today comes from Susan Maklari of Goldman Sachs. Please go ahead.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Good morning.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Good morning.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

My first question is just around – you mentioned that you're not seeing any real change in the labor, the availability of it. But as we look out and think about yourselves having 31% order growth this quarter, a lot of your peers reporting similar kind of results, probably. Are you anticipating that the labor will be more constrained looking further out? Could your delivery times be further extended? What are you hearing from the trades and from your – kind of on the ground?

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

A

Susan, it's a great question. As we, as an industry, continue to post these robust order numbers, the trades will be stretched. And we would expect that in certain markets, there will be pressure in certain trades. And we need to manage that. Are we feeling it yet? No. The field is not talking about it. Costs are going up less than we have seen in some time. But if this spring season continues with the velocity we've seen in the beginning of it, then yes, I think, there's going to be cost pressure which also leads to construction cycle time pressure.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Okay. All right. Thank you for that. And then, can you just talk a little bit about how the integration is going with some of these more recent acquisitions that you've done? Anything there that has kind of maybe surprised you, or was unexpected. And anything we should be aware of?

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

A

It's all going well. They're all early. So, we're dealing with purchase accounting rules that have compressed margins below what they will really be once we put purchase accounting behind us and have normal operations. One of the acquisitions was two weeks ago. So, that obviously is very, very early. But so far so good with no surprises.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Okay. All right. Thank you.

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

A

You're welcome.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Thank you.

Operator: The next question today comes from Mike Dahl of RBC Capital Markets. Please go ahead.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Good morning. Thanks for taking my questions. First question just on gross margin going back to the comment you made in response to Matt's question. I think some people might be a little surprised that the California margins are only projected down 80 bps and Seattle only down 20 bps. So, I just wanted to – again, with respect to the first half versus second half dynamic, can you give us a little more color on what those margins are projected to be down in the first half of the year versus what's embedded in the second half?

And I guess, as part of that, maybe broaden out, talk a little bit more about your pricing power. Our own research suggests that you took pricing up in the vast majority of communities, including in California at the end of 1Q. Can you just give a sense of that and magnitude?

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

A

Hey, Mike, it's Gregg. I'll answer on the gross margin and I'll let Doug answer on price increases. When we answered about gross margin for fiscal 2020, we're talking about with – as it relates to California and Seattle, we were talking about where we would see an overall decline in company average gross margin for fiscal 2020 versus fiscal 2019. And so, California with its decline in overall mix has a negative 80 basis points impact on overall company gross margin. Same story for Seattle, only a 20 basis points.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Got it.

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

A

And then, on price increases I'll let Doug answer that.

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

A

So, yes, you're right, we had a company-wide price increase in mid-January. There's another company-wide price increase coming on Monday, allowing sales to sell through the weekend. And in between those, many communities on their own, because of good sales, are taking prices up. It is a community-by-community decision, except when we go national with what I just described as the January and, what is that, March 1 price increase.

We have also increased the prices in our design studios. We have also increased the prices of our structural options that are being purchased at the community before you move into the design studio. We are also looking, where possible, to increase lot premiums. So, there's a lot of different way – and by the way, we're also looking to decrease incentives. And so, all of those tools are being used. And right now, because of the strong demand, they have been effective and I am hopeful that they will continue to be effective through the spring.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

That's helpful, Doug. And just a quick follow-up on that one. Is it fair to say that some of these changes here, you may get some benefits in the second half, but a lot of them will be kind of carry over into fiscal 2021?

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

A

Yeah. From here forward, most of what I'm talking about is early 2021. There are still some communities that will deliver homes this fiscal year with sales into March or even April. And of course, we have spec home inventory that can be sold in August and September. But for the most part, what I just described is a benefit to early 2021.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Okay. Thanks. My last question is really on the share count. So, I guess, maybe a little confused by the share count guide given how much stock you purchased. And I think much of it was towards the end of the quarter, so wouldn't necessarily have been reflected in the first quarter. You say the buybacks are going to remain a big part of capital deployment going forward, yet I'm trying to reconcile why the second quarter share count is only 132 million, and then why the full year share count then is stepping up a little bit, if you're going to be progressively buying back more shares.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Mike, it's really just a function of the weighted average share count math in the first quarter, it's just the 90 days from November 1 to January 31 that the math implies. And then for the full year, it's the whole thing.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

What was your quarter end share count, Marty?

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Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Hold on a second. We're going to find that. We'll get that to you in a minute, Mike.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Okay. Thanks.

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

A

Elisa, while we look for that answer, let's move on to the next question.

Operator: Certainly. The next question comes from Stephen Kim of Evercore ISI. Please go ahead.

Stephen Kim
Analyst, Evercore ISI

Q

Thanks very much guys. Appreciate a lot of the color. Just to touch base one last time on this gross margin. You mentioned that the margin in the second half of 2020 was going to be up about 100 basis points versus, I think, the first half, Marty. I would just observe that you kind of did that in 2017 and 2018 as well. And this year seems to have more dramatic things to call out. And so, I was curious as to why we aren't going to see maybe more of a striking difference between the back half versus the front half. And I'm wondering, is that going to be because you still got this lingering effect of Metro Crossing deliveries coming at a really low margin, you want to account for that, or is it something else?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

I really think it's the cadence of the order growth in the prior year, right? Each quarter last year until our fourth quarter, we had a decline in orders. Generally, when you have a decline in orders, you get a little bit more aggressive in your discounting. We didn't have a positive in orders until the fourth quarter of 2019. There's a tendency, when you have a positive, to take it rather than price into it. And so, most of the increases are not happening until after we've first reported an increase in sales.

Stephen Kim
Analyst, Evercore ISI

Q

Okay. Got it. So, it's a little bit more of a lag. So, really what we're talking about here is kind of like what you were addressing, I think, with Mike about 2021 is really where we start to see a margin that is more reflective of the housing environment that we've been enjoying here more recently, really, that's – it's really 2021 for you guys.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Right. Great.

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

A

Yes, that's correct. [ph] Stephen (00:43:31).

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Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

That's right.

Stephen Kim
Analyst, Evercore ISI
Q

Okay. And then with respect to your pivot, you're moving to somewhat lower-priced homes. I was curious if you could talk about the likely impact of that on your backlog turnover ratios. I think that if we look at your closings guidance over the next several quarters or for the year, it doesn't seem to imply a significant improvement in backlog turnover ratios. And I was wondering whether or not that was conservatism on your part or if there's an opportunity to see that actually pick up, because typically, I think, smaller product, lower-priced homes typically have a faster backlog turn.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

I think I wouldn't consider it additional conservatism in the numbers. I think in periods where we have increasing orders, our backlog conversion tends to slow down. And I think that's what you're seeing in the guidance we've given.

Stephen Kim
Analyst, Evercore ISI
Q

Right. That's true. Okay. Okay. But again, 2021 would probably be set up to enjoy somewhat higher turnover ratios, I would guess.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

That's the plan with respect to the entire shift to some of the lower price points and quicker velocity homes.

Stephen Kim
Analyst, Evercore ISI
Q

Sure. And then related to this pivot or this transition, Bob, I'm going to harken way back to 1995 when you bought Geoff Edmonds. And I think I remember you first talking about this dumb tax concept that you acknowledged that, hey, we're going to absorb a bit of a dumb tax or pay a bit of a dumb tax as we move outside of the Northeast corridor, which we know so well. I'm wondering whether or not that kind of thinking should apply as you move into somewhat lower price points? And if not, why not?

Robert I. Toll
Special Advisor & Chairman Emeritus of the Board, Toll Brothers, Inc.
A

I think it's still appropriate to the dumb tax in your underwriting. Otherwise, you're going to be surprised and you'll end up the dummy. So, things are pretty much the same. We make these buys with significant underwriting that we don't have once you have the machine rolling for you.

Stephen Kim
Analyst, Evercore ISI
Q

Great. Got it.

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

I think when we enter a new market de novo, which is what I – I remember the conversation about dumb tax, which was if we can buy a builder to enter a new market that has an operation and a machine and a brand and architecture and contractors, you get a big head start over the organic entry into the market where you go through three or four division presidents, and you have the wrong architecture, and you buy the wrong land, and you have no contractors that want to work for you, and there's a huge dumb tax associated with the start-up.

When it comes to a new product line that is pretty similar to what we're doing, and it really kind of resembles, for example, Active Adult, which is at a lower price point, simpler houses, less upgrades and selections. Absolutely, we're learning from it and we can't buy trades yet at the pricing that some of the other low-priced builders can. I think we offset that through our brand, and some of what we offer is a little bit better and we have examples of that. So, we're still learning, but I think we're further along in having our arms around that and understanding it than what you kind of described as the old dumb tax definition when you enter the new market.

Stephen Kim
Analyst, Evercore ISI
Q

Yeah. Great, that's actually very helpful. Thanks for that, guys. Last question for me is a question about rentership. You've been very early and forward-thinking in terms of the relationship you made with BB Living for the single-family build-to-rent market. And I'm curious about the issue of whether rentership is losing its stigma. And given that you have such a strong presence, the Tony or price points of the market, and you're also seeing up close and personal the rentership side of the market and the receptivity in markets, when you're trying to get communities develop.

Do you believe that the stigma from rentership is declining? Can you give us a little bit of color, if you do believe that is so? And what implications you think that has for the industry going forward?

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

Yes. I think it's declining and I think it's a function of the quality of many of the new multi-family apartment communities that we and others are building that feel and live like condo living, with the lobby, the residents club, the gym, the golf simulation room, the pool on the roof, the 9-foot ceilings, the finishing of the unit, the location, the ability to lock it and leave it, and travel the world or head to Florida in the winter, or whatever you may want to do.

So when we look at the demographic and the wealth of our renters, we are amazed at how they would typically have been buyers who are now deciding, not for financial reasons, but for lifestyle reasons, that they want to rent. And so, yes, I think that stigma, while it is there a little bit, it is definitely declining. And I think we're positioning ourselves to take advantage of that, not only through BB Living, but through the 20,000-plus units we are developing through our Apartment Living group.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

And I think, our study of the single-family rental business implies that there are people in those products, because they have to be from a financial perspective, but there are many that choose to be in those products because they want to maybe from a frictional cost of ownership and disposition perspective, and having seen some challenges

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in the past in terms of liquidating their real estate. So, I would agree with Doug. And just to answer Mike Dahl's question from earlier, we have 129.8 million shares outstanding as of the last day of the quarter.

Stephen Kim
Analyst, Evercore ISI

Q

Thanks a lot, guys.

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

A

Thanks, Stephen.

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

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you very much. On the apartment rental business, I was wondering if you have an interest in creating a permanent capital vehicle in which to hold those REIT assets. In my experience in the REIT sector, valuations typically are maximized based on recurring earnings, rather than gain on sale type earnings which are more volatile and unpredictable to the market. Do you have any thoughts on whether that makes any sense? And also, if there could be any combination potential with others in the homebuilding space, like D.R. Horton and Lennar that are pursuing similar strategies?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Sure. So, I think we continue to study a long-term hold strategy for those assets – those multifamily assets that we may choose to hold. Whether that's on balance sheet or in joint venture form or via a separate REIT like or REIT entity remains to be seen. But certainly, the multiples of cash flow from operations, fund from operations that the REITs get valued at is very appealing to us as we grow that portfolio. In terms of combinations with the other builders, we are not having any discussions along those lines at the moment.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

And can you just remind us the amount of equity capital invested in each of the apartments business, the rental business as well as City Living?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

So, the rental apartment business right now has an investment of $680 million, although we expect to reduce that by around $300 million during the course of this year as we sell joint venture interests in future projects where we have already purchased the land and City Living is just under $0.5 billion.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you.

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Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Thank you.

Operator: The next question comes from Michael Rehaut of JPMorgan Securities. Please go ahead.

Elad Hillman
Analyst, JPMorgan Securities LLC

Q

Hi. This is Elad Hillman on for Mike. Just first, given the delays on the 1Q closings, could you expand on what gives you confidence that they won't be delayed further, and your level of confidence that you'll be able to deliver most or all of these missed closings in 2Q at both Metro Crossing and some of the other locations you mentioned?

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

A

Yeah, we've built in conservatism in our numbers. We are already seeing a month into the second quarter, some of those delayed deliveries now delivering. We are far enough along at Metro Crossing with units now delivering every day as opposed to two, three, four, six months ago when we were still waiting for inspections and certificates of occupancy to get started when things were more uncertain. So for those – those are the main reasons why we have more confidence that the missed closings will occur in Q2.

We are very focused, I assure you, on getting Metro Crossing right, and in those other markets I mentioned that have had misses, fixing the problems we have. I'm embarrassed by Metro Crossing. It is a huge lesson learned. It is one isolated, very large community in what otherwise has been a terrifically performing division. It should have been built more like a City Living project. While it's stick, it is more similar to a high-rise in that it is all condo. It is four or five stories on top of podium. It was incredibly complicated. We have learned lessons and we are fixing it. But it has been painful.

Elad Hillman
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you. And going back to margins and just looking a little bit longer term, what would be the right way to think about the new normal for adjusted gross margins and kind of margins in fiscal year 2021? Should we expect it to be back to maybe a 23%, 24% level or closer to 22% level, or even lower than that given the changing regional mix you mentioned, some of the better pricing trends, and also the mix to lower margin, but more affordable luxury?

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

A

We're not going to get that far out with the crystal ball. I think we'll leave it where we – our release was and what we said today, which is we're very encouraged by today's selling environment and the pricing power we are experiencing right now.

Elad Hillman
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you.

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Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

Thank you.

Operator: The next question comes from Jay McCanless of Wedbush Securities. Please go ahead.

Jay McCanless
Analyst, Wedbush Securities, Inc.
Q

Hey. Good morning. Thanks for taking my questions. The first one I had, this environment right now feels very similar to the beginnings of 2018 when builders were flexing prices higher, and I was encouraged to hear you guys are raising prices. But were there any lessons learned from two years ago that you're implementing now so that you don't push the affordability or push the pricing lever too hard?

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

Yeah. I think back then we don't feel like we pushed pricing too hard. We got blind-sided by a significant rise in interest rates in the summer and fall of 2018, it took the wind out of the sails of the industry. I don't think it was our pricing power – or our price increases, excuse me, that caused sticker shock. I think we were being fairly deliberate. I look back to that period of time, and with the exception of a few places, particularly out West, we did not hit price all that aggressively. Prices were going up, but it was measured. But I think what took it down then was the rates.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

Yeah, I think we underappreciated the consumer psyche impact from the relative move in interest rates, the 3.5% to 4.5%, mightn't have changed their affordability that much, but it changed their mentality [indiscernible] (00:57:47).

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

And remember, not only 3.5% to 4.5%, but the Fed messaging that over the next year we're going up to 5.5%, and because you can't lock your mortgage in until 60 days before your closing, when it takes 9 to 12 months to build the house, you're thinking forward to when I can lock, and that could then be into the low-5s. So, it had a bigger impact than just that 1 point move. It was the messaging around what more was coming.

Jay McCanless
Analyst, Wedbush Securities, Inc.
Q

Got it. Thank you for that. The other question I had, could you just talk a little bit more about the demand issues that you're seeing in the Northwest? What's behind that? And then also the closeouts that you all had this quarter. Is there the potential to maybe run the specs a little bit hotter and close out of some of this older land and get the gross margins up a little bit faster than what you've all anticipated?

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

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So for the Northwest, I'll focus on Seattle because Portland is a bit of a start-up and we're just very small there, just beginning to deliver. Seattle is up 265% in contracts in the first quarter. Seattle was our highest margin, best market, what Marty, 5, 6 years ago and then it was one of the first to slow down...

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

2 years ago.

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

2 to 3 years ago, I believe. And it baffled us, right, because the job growth was roaring, the economy was roaring, and I just think there was such sticker shock from all the pricing that we had and the increases we put in place that it was a bit of a bubble effect. That has now worked itself out in what has continued to be a very strong economic market. There has been – there's always limited supply in Seattle, because entitlements are so difficult. And we are just now seeing tremendous new demand coming back that resembles what we saw four or five years ago. And I just think it's the passage of time from when the market got some sticker shock, absorbed it, settled in, and now has come back. In terms of the margin, I'll give it to you, Marty.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

Sure. So, the closeout issues that we referenced early with respect to margin aren't necessarily associated with selling the last three or four homes in a community. These are costs that happened two, three, four years after we've left the community, either because the municipality says they don't like the way we paved the road or the community association wants some better trees, whatever it may take to finally get ourselves off the bonds there. We estimate what those costs are going to be as part of our gross margin as we deliver homes. And in this particular quarter, we had a few costs that were higher than those estimates. So, I don't think, Jay, to answer your question that, I'll say, pushing through the last few homes in a community to burn through margin is going to be something that we would look to do.

Jay McCanless
Analyst, Wedbush Securities, Inc.
Q

Okay. Well, thank you for closing the loop on that. I didn't know if those two were related. So, appreciate you all taking my questions. Thanks

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

Thank you.

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

Thank you.

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

Alex Barrón
Analyst, Housing Research Center LLC
Q

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Yeah. Hi, guys. Thanks. I wanted to understand the rationale for the switch in the regions. Is that reflecting some changes in the way you're operating the business, or what prompted that? And then the second question was what motivated you to do the most recent acquisitions? What is it that you liked about those particular builders or that region?

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

So, the new definition of regions is driven under SEC rules, by who in management has responsibility for certain territories. And we went through a bit of a reorganization here to better geographically align regions with our five regional presidents. For example, Seth Ring, who resides in Southern California, was promoted to Regional President, and now has responsibility for California, Oregon and Seattle. So, the Pacific region is tied to Seth. And those same examples apply to all five regionals. And because of SEC rules, that is the reason why the definition's changed.

With respect to the recent acquisitions, we are quite fond of the Southeast. We know there's terrific growth coming into the Southeast. And our presence has been too small down there. We had our eye on Atlanta. We found a great builder to acquire in Atlanta. We had our eye on Charleston, and Greensboro?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

Greenville.

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

I'm sorry, Greenville. Greensboro is in North Carolina. Greenville, sorry. And we found a builder that built in Greenville, Charleston and they threw in Myrtle Beach. We also had our eye on Nashville and we found an infill builder that builds more mid-rise town home higher-density in both Atlanta and Nashville, and that's our recent Thrive acquisition of a few weeks ago. So, they were all kind of strategic in terms of location and opportunistic in terms – we were able to put deals together that we think make sense for us. So, that was the rationale.

Alex Barrón
Analyst, Housing Research Center LLC
Q

All right. Appreciate it. Thank you.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

Thanks, Alex.

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

Carl Reichardt, Jr.
Analyst, BTIG, LLC
Q

Thanks. Hi, guys. Thanks for squeezing me in. Marty, on the can rate you mentioned it was higher than you thought and I realize we're talking about relatively small number of units. But can you talk just a little bit about what was surprising in the can rate or the rationale for the cans that surprised you?

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Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Well, I don't think there was necessarily anything in the rationale. I think many of those elevated cans were concentrated in the Metro Crossing job where the consumers have been patient, but maybe their patience has run out. Our can rate for years runs around 6%. It was elevated a little bit over the past few quarters. It remained elevated in this quarter despite a better selling environment. And I think that's what surprised us that when the market's tough, you might expect cancellations to go up. But when the market's good, we generally don't see that happen.

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

A

And Carl, as we expand our price points and even some of these builders we have acquired that build at lower price points, there are some markets where deposit requirements are lower. And it may be that in those markets there could be a little bit higher cancellation rate, because there's not as much pain when you do choose to cancel. On Metro Crossing, as Marty said, the cancellation rate has been elevated because we have been unable to deliver many of those units within the timeframe that was required under the agreements with our buyers. So, they had the right to get out, and some did. The only silver lining there is that most of those buyers who have canceled have either transferred within Metro Crossing to another unit or they bought so early in the process that we have had significant price increases, and the resale of those units has been higher than the underlying contract price.

Carl Reichardt, Jr.
Analyst, BTIG, LLC

Q

Okay. Thank you, Doug. I appreciate that. And then just a strategic question just back on the labor side. As you know, the narrative from a number of builders who have moved their mix to lower end and fast turns spec has been we – our subs love to do this, we don't offer as much in the way of options upgrades, so it's simpler to build, and we expect to capture more labor, keep them busy. Your product, even with the transition over time, is still going to be more complex typically offering more options and upgrades. So, I'm curious how in the markets, where you don't have a lot of share or scale, you feel that you can capture this labor pool that continues to be scarce. Is it different subs even in markets where you're in a master plan competing with other builders? Or what can you do? Or is it pricing? What can you do to retain those subs, given the complexity of your product relative to what some of the other guys are building on the low end?

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

A

Before we will venture into affordable luxury at a lower price point, we will make sure that we have access to the subs. We will get plans in their hands early and make sure we have our arms around the pricing. We have been successful in negotiating better prices because the houses are simpler. They will be built down the street. Every house will look more alike than a typical Toll community where there's a lot more customization. And so, in some cases, it's the same trade base that we have in a market that is willing to work for less because of the efficiencies, and in some cases, we go to new trades.

With the typical Toll homes at the higher price, I think the front-end trades are very similar to the other builders, because the excavator and the concrete company and the framer and the mechanical trades, they can handle a Toll house just like they can handle the others. But when you get into the finishes, the tile work, the trim work, which is much more complicated and we believe of a higher quality, we tend to have a different trade base that has been working with us for a long time, is loyal to us. And we're confident they'll be there. And so far, we haven't

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seen those labor problems. But that long answer is really that we will do our diligence on the opportunity to find trades at the right price before we will venture into a different market segment or price point in a market.

Carl Reichardt, Jr.
Analyst, BTIG, LLC

Q

Great. I appreciate, especially that front end versus the finished trade is a good point. I appreciate that. Thanks a lot, both.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Thanks, Carl.

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

A

Thanks.

Operator: And the last question today comes from Mark Weintraub of Seaport Global. Please go ahead.

Mark Weintraub
Analyst, Seaport Global Securities LLC

Q

Thank you. You obviously stepped up the share repurchase quite a bit in the fourth quarter. I apologize if you alluded to this, but what was the rationale for increasing it as much as you did. And were there any openings you had in January and did you buy back any stock in January yet?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

So, I think you mean February.

Mark Weintraub
Analyst, Seaport Global Securities LLC

Q

I'm sorry, February, yeah.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

We are blacked out from mid-January until Friday .As Doug mentioned, we are keen on Friday of this week, so we have not bought any stock since mid-January. We do put a 10b5-1 program in place during that period of time, but that's generally at much lower prices than we might choose to do in the open market since it kind of runs on its own. Our rationale for allocating capital to buybacks is with a focus on return on equity. It's just simple as that. Our stock, when we bought all those shares, was trading close to next year's beginning book value. We find ourselves in that same environment right now.

Mark Weintraub
Analyst, Seaport Global Securities LLC

Q

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Okay. You were buying it at levels not dissimilar, even somewhat higher than in the prior few quarters. So, I'm just trying to understand, was this reflective of increased confidence in the outlook, or was there anything else at play beyond what...?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

I think in stages of 2019, when we didn't know where demand was going to be, we were a little bit more conservative in holding on to our cash. Now, as we've seen demand turn in our favor, we've been a little bit more aggressive.

Mark Weintraub
Analyst, Seaport Global Securities LLC
Q

Okay. Thank you.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

Thank you.

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

Thank you.

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

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

Elisa, thank you very much. Thanks everybody for your questions today. I would like to conclude and wrap-up by acknowledging all of our Toll Brothers colleagues, who have worked tirelessly to build the great homes in the prestigious locations, and provide what we think is exceptional customer service. I'm very grateful for all of their passion and all of their dedication. We like our strategy.

We like the market we're in right now. We like how we are diversifying. We understand we've taken our lumps right now with some guidance and some recent performance. Thankfully, it has been a bit isolated to the areas we have talked about. We are very focused on those. And we will learn, and we will move forward, and we will continue to work hard to gain everybody's trust and support. And I thank you.

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

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