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Toll Brothers, Inc. (TOL)

Q1 2024 Earnings Call

CORPORATE PARTICIPANTS

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Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

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Sam Reid

Analyst, Wells Fargo Securities LLC

Stephen Kim

Analyst, Evercore ISI

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Analyst, Raymond James & Associates, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to the Toll Brothers First Quarter Fiscal Year 2024 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] The company is planning to end the call at 9.30 when the market opens. During the Q&A, please limit yourself to one question and one follow-up. Please also note, today's event is being recorded.

And at this time, I'd like to turn the floor over to Douglas Yearley, CEO. Please go ahead.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Thank you, Jamie. Good morning. Welcome and thank you all for joining us. Before I begin, I ask you to read our statement on forward-looking information in our earnings release of last night 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, interest rates, the availability of labor and materials, inflation and many other factors beyond our control that could significantly affect future results.

With me today are Marty Connor, Chief Financial Officer; Rob Parahus, President and Chief Operating Officer; Fred Cooper, Senior VP of Finance and Investor Relations; Wendy Marlett, Chief Marketing Officer; and Gregg Ziegler, Senior VP and Treasurer.

I'm very pleased with our strong first quarter results. We beat our guidance across the board and saw another quarter of solid sales with contracts up 40% in units and 42% in dollars compared to last year. In addition, since the start of the spring selling season in mid-January, we have seen a meaningful uptick in demand that has continued through this past weekend.

In our first quarter, we delivered 1,927 homes at an average price of approximately \$1 million, generating record first quarter home sales of \$1.93 billion, up 10.4% in dollars compared to the first quarter of fiscal 2023. Our adjusted gross margin was 28.9%, 90 basis points better than guidance and 140 basis points better than last year's first quarter. The outperformance versus our guidance was due to mix, driven by earlier than expected deliveries in certain of our higher-margin Pacific and Mid-Atlantic communities and fewer than expected deliveries in lower-margin Mountain communities.

SG&A expense at 11.9% of home sales revenues was 20 basis points better than last year's first quarter and 50 basis points better than guidance. In addition to greater fixed cost leverage from higher revenues, we continue to benefit from cost reduction initiatives we've taken over the past several years. We continue to look for ways to operate more efficiently.

Pre-tax income was \$311.2 million and earnings per share were \$2.25 diluted, up 23% and 32%, respectively, compared to last year's first quarter. With the outperformance in our first quarter and a strong start to the spring selling season, we are raising our full year guidance across all of our key homebuilding metrics. At the midpoint of our guidance, we now expect full year deliveries of 10,250 homes, an adjusted gross margin of 28% and an SG&A margin of 9.8%.

In addition, earlier this month, we sold a parcel of land to a commercial developer for net cash proceeds of \$180.7 million, which will result in a pre-tax land sale gain of approximately \$175 million in our second quarter.

We are raising our full year joint venture and other income guidance from \$125 million to \$260 million. Factoring in both the increase in our homebuilding guidance and the impact of this land sale, we now expect to earn between \$13.25 and \$13.75 per diluted share in fiscal 2024, up from the \$12 to \$12.50 we guided to last quarter. We now also expect our return on beginning equity to be approximately 21% in fiscal 2024, which would be our third year in a row above 20%.

Turning to market conditions. Demand in the first quarter was solid. We signed 2,042 net contracts at an average price of \$1.011 million, up 40% in units and 42% in total dollars compared to the first quarter of 2023.

Demand in our first quarter steadily improved as the quarter progressed, following the normal seasonal pattern. December was stronger than November and January was significantly stronger than December. Based on both deposit and agreement activity, our January was better than normal seasonality. The strong demand has continued through the first three weeks of February.

From a geographic standpoint, demand was broadly distributed across our footprint. We saw particular strength in our Pacific region, including all of California and Seattle, and also in Las Vegas, all of Texas, Denver and from Atlanta up through Boston.

Demand was solid across all product types as well with affordable luxury accounting for 45% of our units and 34% of dollars, luxury 36% and 49%, and active adult 19% and 17%. Another indicator of healthy demand was our deposit to agreement conversion ratio, which at 76% in the first quarter was significantly higher than our five-year average of 67%.

We are pleased that we have been able to continue taking advantage of healthy demand while managing our incentives. While mortgage rate buydowns are heavily marketed and offered nationwide, very few of our buyers use incentive dollars to buy down their rates. The vast majority of our customers can qualify for a market rate mortgage without a buydown and they prefer to use any incentive offered on design studio upgrades or to reduce their closing costs.

Additionally, consistent with the past several quarters, approximately 25% of our buyers paid all cash in the first quarter and the LTVs for buyers who took a mortgage dropped to approximately 67%, 200 basis points lower than our average over the prior four quarters. So for the 75% of our buyers who took a mortgage, on average, they put down 33%. All of these factors highlight the financial strength of our more affluent customers.

During the quarter, we once again benefited from our strategy of increasing our supply of spec homes, which represented approximately 50% of orders and 40% of deliveries in the first quarter. As we have discussed before, we sell our specs at various stages of construction, from foundation to finished home. This allows many of our spec buyers the opportunity to visit our design studios and personalize their homes with finishes that match their tastes. So choice, a pillar of Toll Brothers, is still part of our spec strategy. This benefits our margins as design studio upgrades tend to be highly accretive.

We are also pleased that our cancellation rate in the first quarter remained consistent with recent quarters at 2.9% of beginning backlog. Our low cancellation rate speaks to the financial strength of our buyers as well as the sizable deposits they make and how emotionally invested they become as they personalize their new Toll Brothers home.

We continue to expect community count growth to help drive results in fiscal 2024 and beyond. In the first quarter, we were operating from 377 communities, two more than we guided to last quarter. And we remain on target to reach our year-end guidance of approximately 410 communities, which would be an approximate 10% increase from fiscal year end 2023.

Importantly, we control sufficient land for community count growth beyond 2024. At first quarter end, we controlled approximately 70,400 lots, 49% of which were options. This land position allows us to be highly selective and disciplined as we assess new land opportunities.

We believe we have a competitive advantage acquiring land at the corner of Main and Main, where very few of the big well-capitalized publics and privates play. Our main competition for this land tends to be the smaller local and regional builders who are not as well capitalized.

Our balance sheet is very healthy with ample liquidity, low net debt and no significant near-term debt maturities. We also continue to expect strong cash flow generation from operations this year.

In addition, as I mentioned earlier, we received \$181 million in cash from a land sale at the start of our second quarter. As a result, we are increasing the amount we are budgeting for fiscal 2024 share repurchases from \$400 million to \$500 million. Longer term, we continue to expect buybacks and dividends to remain an important part of our capital allocation priorities.

With that, I will turn it over to Marty.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

Thanks, Doug. We are very pleased with our first quarter results. We grew both our top and bottom lines and operated more efficiently compared to last year. First quarter net income was \$239.6 million or \$2.25 per share diluted, up 25% and 32%, respectively, compared to \$191.5 million and \$1.70 per share diluted a year ago.

Our net income and earnings per share were both first quarter records. We delivered 1,927 homes and generated homebuilding revenues of \$1.93 billion. The average price of homes delivered in the quarter was \$1.003 million.

We signed 2,042 net agreements for \$2.06 billion in that first quarter, up 40% in units and 42% in dollars compared to the first quarter of fiscal year 2023. The average price of contracts signed in the quarter was approximately \$1.011 million. This was up 1.6% year-over-year and 2.3% on a sequential basis.

Our first quarter adjusted gross margin was 28.9%, up 140 basis points compared to 27.5% in the first quarter of 2023. As Doug mentioned, Q1 gross margin exceeded our guidance due primarily to more deliveries in our higher-margin Pacific and Mid-Atlantic regions and less than expected deliveries in our lower-margin Mountain region. We expect the inverse to be true in our second quarter, and this is reflected in our second quarter adjusted gross margin guidance of 27.6%. Overall, we have increased our full year adjusted gross margin of 10 basis points to 28.0%.

Write-offs in our home sales gross margin totaled \$1.5 million in the quarter and were all associated with predevelopment costs on deals we are no longer pursuing. SG&A as a percentage of homebuilding revenue was 11.9% in the first quarter compared to 12.1% in the same quarter one year ago.

Note that our SG&A expense in that first quarter includes \$14 million of accelerated employee stock-based comp expense that only hits in the first quarter. The year-over-year 20 basis point reduction in SG&A margin reflects leverage from increased revenues as well as benefits from tighter cost controls in the face of inflation.

Joint venture, land sales and other income was \$8.6 million during the first quarter compared to \$16.8 million in the first quarter of fiscal year 2023 and compared to our guidance of a \$10 million loss. We exceeded our guidance due primarily to better-than-expected results in our mortgage unit and higher than projected interest income.

Our tax rate in the first quarter was 23% or about 300 basis points lower than guidance due to the accounting benefit of stock compensation deductions, which we do not expect to repeat at the same level for the rest of the year.

We ended the first quarter with over \$2.5 billion of liquidity, including approximately \$755 million of cash and \$1.8 billion of availability under our revolving bank credit facility. Our facility has four years until maturity.

Our net debt-to-capital ratio was 21.4% at first quarter end, down from 27.5% one year ago. We have no significant maturities of our long-term debt until fiscal 2026 when \$350 million of notes come due in November of 2025. Our community count at quarter end was 377 compared to our guide of 375.

Looking forward, our guidance is subject to the usual caveats regarding such forward-looking information. We are projecting fiscal 2024 second quarter deliveries of approximately 2,400 to 2,500 homes with an average delivered price of between \$1 million and \$1.010 million. For fiscal year 2024, we are increasing our projected deliveries to be between 10,000 and 10,500 homes with an average price between \$940,000 and \$960,000.

As I noted earlier, we expect adjusted gross margin to be 27.6% in the second quarter and 28% for the full year, 10 basis points better than our previous full year guidance. We expect interest in cost of sales to be approximately 1.3% in the second quarter and for the full year. This is also a 10 basis point improvement from our earlier guide.

We project second quarter SG&A as a percentage of home sales revenues to be approximately 9.7%. For the full year, we expect it to be 9.8%, another improvement of 10 basis points compared to our previous guidance.

Other income, income from unconsolidated entities and land sales gross profit in the second quarter is expected to be approximately \$180 million, which reflects the impact of the commercial land sale Doug mentioned. We now expect it to be \$260 million for the full year, which is up significantly from our prior guide of \$125 million.

Aside from the land sale, much of this full year other income is projected from sales of our interests in certain stabilized apartment communities, developed by Toll Brothers Apartment Living in joint venture with various partners. We project the second quarter tax rate to be approximately 25.8% and the full year rate to be approximately 25.5%. That's 50 basis points of improvement compared to our prior full year guide.

Our weighted average share count is expected to be approximately 106 million for the second quarter and 105 million for the full year. This assumes we repurchase approximately \$166 million of common stock per quarter for the remainder of the year to reach the \$500 million guide Doug referred to earlier.

As Doug mentioned, with our updated guidance and the Q2 land sale gain, we now expect to earn between \$13.25 and \$13.75 per diluted share in fiscal 2024. This would result in a full year return on beginning equity of approximately 21% and would put our year-end book value per share at approximately \$77 per share.

Now, let me turn it back to Doug.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Thank you, Marty. Before I open it up for questions, I'd like to thank our Toll Brothers' employees for another great quarter. I'm so proud of their dedication, hard work and commitment to each other and our customers. Their talent and constant focus on our business is the driver of our long-term success.

Jamie, with that, let's open it up to questions.

QUESTION AND ANSWER SECTION

Operator: Ladies and gentlemen, at this time, we'll begin the question-and-answer session. As a reminder, the company is planning to end the call at 9:30 when the market opens. During the Q&A, we do please ask that you limit yourselves to one question and one follow-up. [Operator Instructions] Our first question today comes from Jesse Lederman from Zelman & Associates. Please go ahead with your question.

Ivy Lynne Zelman

Analyst, Zelman Partners LLC

Q

Hey, guys. It's actually Ivy, but thank you. First, I just want to say congratulations. This is a great quarter and really excited about your strategic initiatives of driving returns higher. With the land sale expected in 2024, just thinking about other opportunities to generate cash flow to maybe do some continued buybacks or other ways to drive returns higher. But it's really been quite a tremendous improvement in just overall management, working capital and returns, and love to see continued improvement, and wondering how strategically you can do so. Thanks for the opportunity.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Thank you, Ivy. Yeah, the land sale was – I shouldn't say never, but I think it was a one-off. We had a unique piece of property in Northern Virginia that we were processing for approvals to build homes on, and a data center operator came along and made us an offer that we couldn't refuse. There could be something like that out there, one never knows. But we will continue to always look for opportunities to be more capital efficient to drive gross margin, to grow this company. And that's beyond just core homebuilding where we get bigger in the markets we're in. And we have lots of opportunities to do that, because as everyone knows, at our price point, we tend to have a fairly small market share in many of our markets. And as we expand our price points, coming down in price, we have great opportunities in our 60 markets that we're in to get bigger. We have the widest variety of product and the widest range of price of any of the builders. And so we think that gives us the greatest opportunity for core growth within homebuilding.

Outside of that, we'll continue to focus on the apartment business. We'll continue to focus on other opportunities to generate positive cash flow. And as you can see, as you know, we're committed to return capital to shareholders. We're taking the vast majority of the proceeds from the data center sale to increase our buyback. We are committed long term to the dividend. We are committed to continue to grow that dividend.

And so I'm just really pleased with where we are. The initiatives to come down in affordable luxury price points is now well on its way, with 40% plus of our sales and our closings now in what we call the affordable luxury business model. We've also committed to a greater spec strategy and that is really working well. 50% of our sales in the first quarter were spec. 40% of our deliveries were spec. The market is very much in place with the tight resale market to gravitate towards Toll spec, particularly since, as I explained, much of that spec still allows us to offer choice where they can go to the design studio and pick finishes.

And spec is not just affordable luxury. It's not just the lower-priced, lower-margin communities. We are building spec across all of our price points, all of our product lines. And so you gave me a general question, I gave you a general answer.

Ivy Lynne Zelman

Analyst, Zelman Partners LLC

Q

No, no, no. It's really helpful. I think one thing that you've also done is a significant debt reduction, which the balance sheet is the best position it's ever been in. So I think that you're probably, my guess would be, at a debt-to-capital level that you're comfortable with. So are there opportunities for bolt-on acquisitions, given that privates are really disadvantaged for many reasons, not to mention cost of capital? Or is it more likely that you'll continue to grow organically and focus on share buyback to be capital efficient and generate higher returns? [ph] Thanks for the time (00:25:47).

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Thank you. We're always in the conversation on M&A. We've acquired 15 builders in 30 years. We're very selective. I'm very happy with our geographic footprint. So I can't tell you that there's 5 or 10 markets out there that we really want to get into where you use M&A most often to enter a new market, but there are a few markets we're looking at that are new. And there's many opportunities for bolt-on M&A to get bigger and diversify the offering in an existing market. About 5 of our 15 acquisitions were in existing markets. So those opportunities still exist. You're right, the M&A market has heated up a lot, and we are certainly studying opportunities. But I think you're going to see more with capital return to shareholders with Toll than you're going to see new M&A.

Ivy Lynne Zelman

Analyst, Zelman Partners LLC

Q

Great. Well, good luck, guys. Thank you.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Thanks, Ivy.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

Thanks, Ivy.

Operator: Our next question comes from Sam Reid from Wells Fargo. Please go ahead with your question.

Sam Reid

Analyst, Wells Fargo Securities LLC

Q

Awesome. Thanks so much, guys, and congrats on the quarter. I wanted to touch on the updated delivery guide for 2024. It clearly shows you're seeing some momentum in the spring, but my question is kind of help us gauge the level of conservatism that might be embedded in that outlook? And what would we need to see specifically in March and April for you to be comfortable to take that number up again?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Marty, do you want to go with that? Marty is looking at me. Marty wants to answer this.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

That's a tough question to answer the level of conservatism. I think, Sam, it's safe to say there's no difference in the construct of our guidance right now than there traditionally has been.

I think, obviously, if we see a really strong March and April, particularly with our spec strategy, that could result in additional deliveries beyond the guide that we've given. But we're very comfortable with the guidance we've given and we'll update it in three more months.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

And remember, on the build-to-order side of our business, which is 50% to 60% of our operation, these houses are big. These houses are complicated. They have upgrades because we send everybody through our design studio and let them design their house to their lifestyle. And so they take some time to build.

So we're now 3.5 months into fiscal 2024 and there aren't all that many communities remaining where the next sale of a build-to-order home can be delivered by the end of October. There are still some communities that can do that. But with every passing week, there are less and less.

We do have a lot of specs in process that are certainly going to be completed, sold and delivered by year-end, but I think as the year progresses, our guidance becomes even more definitive because of the build-to-order nature of our business.

Sam Reid

Analyst, Wells Fargo Securities LLC

Q

No, that's helpful. And maybe to drill down a little bit more on that kind of spec build-to-order dynamic here. So on your gross margin guide for second quarter, can you give us a sense as to what the spread between your spec deliveries and your build-to-order deliveries might be between those two buyer groups? And is there any inclination that that could potentially narrow going forward? Thanks.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Yeah, it's a great question. It has narrowed. Let me give a little historical for the last few quarters. In Q4 of 2023, our spec gross margin was 26.3%. In Q1 of 2024, this past quarter, that jumped to 27.9%. And as you know, the gross margin for the company for the first quarter was 28.9%. So in the first quarter, specs ran exactly 100 basis point below the full gross margin for the quarter.

Now, some of those specs came out of the West, out of the Pacific region, California, and were more expensive and had a higher embedded gross margin in them, but we are definitely encouraged by the increase in spec gross margin over time here, and we think that will continue. So in terms of the second quarter guide, guys, I think it's probably fair that that 100 basis point difference is about where we'll be?

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

[ph] Truly so (00:30:47). I think so.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Yeah.

A

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

It might be a little wider than that because...

[indiscernible] (00:30:51)

A

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

...less from the Pacific.

A

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Right.

A

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

But again, it depends to a certain extent on how strong the spring is...

A

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Right.

A

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

...and what we do with pricing as we progress.

A

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Right. And please understand, our business strategy and our business modeling is for the spec business to have a lower gross margin. We expect that. The houses tend to – the specs tend to be built on the more average lot that doesn't have the high lot premium. We save that very high lot premium for the build-to-order business where that client will spend a lot more money in the design studio.

A

We also – while we upgrade the spec homes, we don't take them, in some cases, to the level that the client will in a build-to-order purchase. So – and we also know that some of the spec inventory does make its way all the way to the end where it's a completed home that is unsold. And when that does happen, we know we may have to incentivize a bit more to move it because it's standing finished inventory that can deliver.

So our strategy has always been, as we got into the spec business, that there would be a lower gross margin, but we're very pleased with how close it has been to the overall company's margin.

Operator: Our next question comes from Stephen Kim from Evercore ISI. Please go ahead with your question.

Stephen Kim

Analyst, Evercore ISI

Q

Yeah. Thanks very much, guys. Appreciate all the color. And I just wanted to zoom the lens out a little bit and try to get a sense for maybe if 2024 is a year where we can see some of the dust settle on rates and some of the volatility subside. If we could focus a little bit more on what your longer-term targets are and how you seek to operate the business, let's start with the – with what you just were talking about with an increased spec mix. I would assume that that would allow you to run at a higher level of absorptions or sales per community. I think that you've talked in the past about something in the 24%, 25% per year range.

I was curious as to whether or not if this spec strategy is something that's going to be a going forward kind of a thing. We might see that more approach something like 30 a year. How you sort of feel about that? And also, whether we might see your backlog turnover ratio also sort of remain or move higher, let's say, into the 40s on backlog turns? I'm not talking about the next quarter. I'm not even talking this year. I'm just talking about in general going forward.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Great question, Stephen. You're spot on. We delivered 27 homes per community in 2023 and we expect to be at 27 to 28 homes per community in 2024.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

In 2023, we did 23 to 24, yes. In 2024, we're doing 27.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Did I not say that?

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

I think you said 23 twice – I'm sorry, you said 27 twice.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

My apologies. 24 per community in 2023 and 27 to 28 per community in 2024. And that is in part the spec strategy. It's in part cycle time coming down, but it's primarily the new strategy we have of building more and more spec. We think that can improve as we head into 2025 and beyond, and we are certainly planning for that.

You talk about 30 per year. Yes. That's out there. That's a goal that's achievable. With the spec strategy, we're nimble, we're flexible. We follow the market. And right now, there is a very, very strong market for our spec homes that can be delivered faster, particularly those homes that we may put on the market at frame that still allows the client the opportunity to get the design studio and fix the finishes to suit their lifestyle.

So it's been a big move for the company to go from less than 10% spec to now the 40% to 50% range. We are committed to it. And it's going to be another reason why we think we can increase community absorptions. And that's where we're certainly headed.

The existing homes, the resales on the market are still historically tight. Even with a modest drop in rates, that has not freed up the resale market. There is still a lock-in effect.

And let's not forget, even as rates do come down, which I think they will, and that market begins to modestly loosen up, the average resale home is now 45 years old. There is a flight to new that is not just because of unavailable inventory due to the lock-in effect, but because of the quality of that resale inventory, and that will continue even as rates come down and the resale market unlocks.

Stephen Kim

Analyst, Evercore ISI

Q

Great. Yeah. Appreciate that. I didn't hear the backlog turn comment, I don't think, in terms of where we could see that going. But – so I don't get cut off, I want to make sure I ask my second question, which is about gross margins and SG&A, and basically operating margin. You've given a rubric for this year or you've given guidance this year for effectively a 17% operating margin with an SG&A rate that's kind of in the high 9s.

So I wanted to sort of think about that in the same kind of context, like, kind of how you think about business longer term. When we look back at your margin history, we've had a lot of changes over the last couple of decades. And so, as we look ahead at how you seek to operate your business, should we be thinking that 17% is kind of like a normalized level for you, or do you think that the normalized level would be meaningfully different?

And if you could unpack sort of would that be the difference, would that be more on the SG&A side, maybe opportunities to get that lower or on the gross margin side relative to your guidance for the full year?

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

So, Stephen, I think operating margin is very important to us. Returns are very important to us. I think the numbers you are seeing are pretty close to where our long-term expectations might be. 17% that you mentioned is a really good number, maybe as high as 18%. We're looking for upper-teens to low-20s return on equity.

I want to throw in a shout out there for JV other and land sales as it relates to generating returns as well because it is something we have a history of doing. Gross margins feel very good right now at this level. They feel relatively sustainable at this level. And we'll continue to work on reducing our SG&A with our technology investments and efficiencies that we can try and generate.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Yeah. Stephen, I think we have a long-term strategy to continue to maintain a gross margin in the 27%, 28% range. We have an SG&A around 9%, which generates the operating margin at or above your 17% number.

Operator: Our next question comes from Mike Dahl from RBC Capital Markets. Please go ahead with your question.

Mike Dahl

Analyst, RBC Capital Markets LLC



Hi. Thanks for taking my questions. A lot of helpful color and context around how you're thinking about the business. Maybe just to draw back to kind of a little more near term. As you've seen the demand progress favorably through the last couple of months, can you talk more specifically about what you have seen and done on pricing? Our sense is you're still kind of [indiscernible] (00:39:52) pricing relatively flat. But can you talk about what you've done on kind of net pricing and how you're balancing [ph] pace/price (00:39:58) incentives, given the rebound in demand here?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.



Sure. So in the first quarter, we had price increases in about two-thirds of our communities. We also had a modest increase in incentives that was because the spec sales went up to 50%. And as I've already talked about on a prior question, we do – we have seen modestly higher incentives on the specs.

So, overall, I'd say the pricing has been flat. When you combine the modest price increases in two-thirds of communities with the modest increase in incentives on the spec sales, we have seen flat pricing.

As we entered the spring season a month ago, as we do in most spring seasons, we take the first month or so to monitor where the market is because the beginning of the spring season is very important for us to feel how much momentum and how much pricing power we may have through the spring. As we talked about, we've had a terrific four weeks. This is about the time, when we're in a good spring season that we begin to have price increases around the country.

They will be modest because we're being careful, rates while they came down, they ticked up a little bit. And so we are still being cautious. We want to continue to drive sales. We have the capacity, as we talked about, particularly with the spec program, to deliver these homes. And so there will be, starting right around now, modest price increases as we head further into the spring season.

Mike Dahl

Analyst, RBC Capital Markets LLC



Got it. Okay. Yeah, [ph] that's just on (00:41:49) a follow-up in terms of how you were thinking about that relative to the more recent uptick in rates again. So I appreciate that.

I guess, just secondly, on the updated other joint venture land sales, you outperformed in the quarter. You've got the new guide in there that's attributable to the one-off large parcel. It seems like ex that, that you didn't increase the guide by the full amount of this land sale. So maybe can you just talk through what some of the other moving pieces are in that line, whether it's kind of some of the delayed JV interest sales or anything that kind of got pushed out into fiscal 2025?

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.



Sure. At the beginning of the year, Mike, JV land sales and other included a placeholder of \$40 million to \$50 million for that land sale. We didn't want to count on all of it as there was very little deposit up and such deposit was not hard, but we also didn't want to fully discount it. So we had handicapped it at 25% to 35% likelihood of occurring. And so we included \$40 million to \$50 million from that in our JV and other.

So when we increased the guidance, it's not just being increased for the \$175 million. It's being increased a little less than that for the land sale, but some other things as well that are puts and takes. The important part is our guide was \$125 million and it's now \$260 million, and a lot of that \$260 million has occurred as we sit here today.

Mike Dahl

Analyst, RBC Capital Markets LLC

Q

Yeah. Got it. That's great. Thanks.

Operator: Our next question comes from Rafe Jadrosich from Bank of America. Please go ahead with your question.

Rafe Jadrosich

Analyst, BofA Securities, Inc.

Q

Hi. Good morning. Thanks for taking my question.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

Good morning, Rafe.

Rafe Jadrosich

Analyst, BofA Securities, Inc.

Q

Marty, I was wondering, can you just help bridge us between the first quarter gross margin of 28.9% and the second quarter guidance of 27.6%? I know there's a mix impact in there, but you are guiding to flattish delivery ASP. So I just wanted to understand, like, how much was the unexpected mix benefit to 1Q? Is that the full 90 basis points? And then, what is the sort of reversal of that or normalization in the second quarter?

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

Yeah. I think the majority of the 90 basis points was driven by the acceleration of high-margin mix. And so there'll be an inverse effect from that in the second quarter.

Another component of our outperformance in the first quarter, Doug touched on earlier, in that our QMI gross margin came in a little better than we expected.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Spec.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

I'm sorry, the spec. Excuse me, the spec, QMI is our internal term for quick move-in home. Spec is what you guys understand. In the first quarter, it came in a little better than we thought.

As we look at our second quarter, we expect less Pacific and high-margin Mid-Atlantic deliveries. We also expect more QMIs as a percentage of total – specs, excuse me, as a percentage of total than happened in the first quarter.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

But...

Rafe Jadrosich

Analyst, BofA Securities, Inc.

Q

Thank you. That's pretty helpful. And then...

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

...let's not get too hung up on quarter-to-quarter because the full year gross margin guide has been increased by 10 basis points.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

And another 10 basis points on interest in cost of sales.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Right.

Rafe Jadrosich

Analyst, BofA Securities, Inc.

Q

Got it. Okay. Yeah. That's helpful and that makes sense. And then just longer term on the increased mix of QMI or spec, there's been this strategy change. It's been successful. What has changed from the perspective of the market or from Toll's positioning where this makes more sense now than it has maybe like historically? Is this temporary because of resale? Is the resale markets really tight? What should we expect spec to go up or down over time depending on what's going on in the market? Or is this something where structurally so much changed at Toll where this makes sense that it hasn't historically to run spec at a higher percentage?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Yeah. What triggered it was the historically tight resale market, and we realized there was a void there that we could fill. But I do think this is long term, it's structural for a number of reasons. I mentioned the age of the resale home, the condition of that 45-year-old home. We have a number of people sitting around this table here that have taken themselves out of the market because they can't find a home of decent quality out there on the resale market.

We've also expanded our geographic footprint. We have come down in price. While we're building spec, as I mentioned, in all of our different price points, I think the confidence we got from having more affordable luxury communities that naturally would have more spec opportunities, also helped us move this strategy along. So I think it's here to stay. I can't tell you that it'll be 40% to 50% at all times, but it started because of the tight market, and now we're rolling. We're very confident in it.

And we define a spec as foundation forward and we have a strategy in place to put houses on the market at different stages of construction, allowing the client, in many cases, as we talked about, to still take advantage of

one of the real pillars of Toll, which is choice. We have 35 design studios around the country. The buyers go in there and they pick all their finishes. And for us to still offer that, but do so with a faster delivery because the house is partially built, when they buy it, I think it's here to stay.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

I think there's been some change in consumer preference. Our homes are really good and attractive and well decorated and well-appointed and well designed for today's lifestyles and interests. The resales that are out there, many of them need work. You have to get somebody to do that work. You have to have the money to pay for that work after buying the house. And so I think the consumer is gravitating to new, as Doug mentioned, and what we offer is pretty attractive.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

The cycle times are down a couple months. The spec business is driving higher IRR. When we open a community now, we may have 5 to 10 spec homes that have already been started. So when you come in to the sales center opening weekend, you don't just have to think a year out for a build-to-order home, but there's some inventory homes that are in various stages.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

We get the revenue quicker that way, too.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

So I think we are confident that this will continue to be a big part of our strategy as we continue to obsess with being America's luxury homebuilder and to focus on the brand. We will not let the spec strategy in any way bring down quality or take away choice were the special sauce of Toll Brothers.

Operator: Our next question comes from John Lovallo from UBS. Please go ahead with your question.

John Lovallo

Analyst, UBS Securities LLC

Q

Good morning, guys. Thanks for taking my questions. The first one is, if we look 2015 to 2019, so pre-COVID, absorptions increased, call it, 60% to 65% on average from the first quarter to the second quarter. You guys have talked about better than normal seasonality going on right now. So just curious how you're thinking about that potential step up this year.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

So I mentioned that January had outsized sales to December and November, looking at past trends, and February is following normal seasonality that we have seen looking back at historic trends. Our traffic in the last week was the highest week of foot traffic into our model homes since February of 2022. Our Web traffic is up dramatically. We have great optimism for what's coming this spring with a really good start in January and February. I think that's the best answer I can give.

John Lovallo

Analyst, UBS Securities LLC

Q

Okay. No, that's helpful and encouraging. And if we look at the first quarter – or actually, the first – I guess, the delivery ASP that you guys are talking about is slightly north of \$1 million here in the coming quarter. And if we think about sort of the full year guide of \$940 million to \$960 million, that would imply a pretty good step down. Curious – you guys did talk about mix. Is that the largest driver here or are we missing something?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

It's all, it's the entire driver. Our strategy from a few years back to come down in price to pick up bigger market share is now in place and is coming through in deliveries. So we are celebrating this drop in price because the strategy is working. And so that's it. It's 100% mix.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

And that mix shift is more South, more Mid-Atlantic, a little bit more affordable luxury and a little bit more age-targeted, age-restricted than the first half of the year.

John Lovallo

Analyst, UBS Securities LLC

Q

Helpful. Thank you, guys.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

You're welcome.

Operator: Our next question comes from Michael Rehaut from JPMorgan. Please go ahead with your question.

Michael Rehaut

Analyst, JPMorgan Securities LLC

Q

Thanks. Good afternoon, everyone. Thanks for squeezing me in before the end of the hour. First, I just wanted to circle back on the comments around gross margins where you said that you think gross margins can be sustainable going forward at 27%, 28%. Obviously, a lot of builders have kind of been working through, or in the process of working through, maybe a little bit of a reset from slightly higher priced land over – that was purchased, perhaps also some higher development costs over the last couple years and seeing a little bit of normalization.

Your comments would kind of suggest kind of staying at this higher level versus prior years, maybe a little bit of slippage, if you kind of say 27% to 28% and you're still at [ph] 28.4% (00:53:45) for fiscal 2024. I just want to make sure we're thinking about that right. And really, what's driving this higher level of gross margin, maybe a little bit of slippage in 2025 to the midpoint of the range, perhaps, but what's driving that higher level of gross margin today versus prior years? And could you have any risk of slippage similar – more similar to your peers?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Mike, I think we're in a unique position when it comes to land buying, and I know we're in a unique position when it comes to our underwriting thresholds. 50% of our own land was contracted for before December of 2020. And as we – our underwriting is fairly simple. And we do a combo score, we call it, between IRR and gross margin. That combo score, depending on the market and the performance of the team and whether the lots are improved and therefore, have less land development risk, and whether there's a long entitlement process and therefore, the deal may be a bit more speculative or expensive to get to the finish line, that ranges from the low to mid-50% combo to 60%-plus combo. And by that I mean, you're adding up IRR plus gross margin, and we see deals regularly. In fact, we require deals regularly to have gross margins north of 25% and IRRs north of 25%, and we're still seeing good deal flow. And we are conservative in our underwriting. We don't build home price appreciation into the model. We have big contingencies on land development costs because we know land development costs are still running away from the industry a bit.

And I think the main reason for it, not only do we have great land teams around the country who are incredibly hard working and diligent, but we generally at the corner of Main and Main where we build do not compete with the large publics and privates that are well capitalized and are accepting significantly lower returns to grow their companies. We compete at our price point in our locations with small local and regional builders who have lost their banking relationships with the regional banks, who are undercapitalized, who cannot write the big check and we have an easier time finding the land. And that's just proven out by the 20 to 25 land deals I get every Sunday night that I still review that have good, solid returns. That's what gives us the confidence.

Michael Rehaut

Analyst, JPMorgan Securities LLC

Right. Right.

Q

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

We have 70,000 lots. So maybe we don't have to be as aggressive in the next lot as some others might have to.

A

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

And remember, there's \$150,000 of upgrades being put in these houses by our client, and that – those upgrades are highly accretive to our company's gross margin. So we are driving – now that goes in the underwriting, of course. As we buy land, we know we're going to sell those upgrades. But that is driving an added margin because choice deserves an added margin. It's more difficult. It takes longer, more can go wrong. So we expect and we deserve that higher margin.

A

Michael Rehaut

Analyst, JPMorgan Securities LLC

Right. And I think you have said before that the combo IRR and gross margin that you're looking for has increased roughly 10 points over the last few years. Maybe, Marty, you can just touch on that as well.

Q

But I wanted to – the second question, just going back to the ASP question, you've kind of kept the \$940 million to \$960 million for the full year. You're doing \$1 million in the first half that would suggest something around low 9s in the back half. And I just want to kind of think – make sure we're thinking about it correctly without giving guidance for 2025. But that low 9s, call it, maybe \$920 million, maybe a little adjusted because of higher revenues, if that's the right kind of starting point that we should be thinking of for fiscal 2025?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Yeah. As I mentioned, I think our strategy to move into affordable luxury is now fully in place. So I think the drop you're seeing in the second half of 2024 to the low 9s is reflective of the future business at Toll.

Operator: And our final question is...

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Please go ahead

Operator: ...from Buck Horne from Raymond James. Please go ahead with your question.

Buck Horne

Analyst, Raymond James & Associates, Inc.

Q

Okay. I'll be brief. I appreciate the time. Just wondering, we have seen a little bit of a maybe unusual seasonal uptick in resale inventory in a couple of markets, particularly Southwest Florida and Texas. And just curious if you could speak to those regions, in particular, if you think some of the addition to resale inventory there is having any noticeable impact on the business through the early part of spring selling.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Texas has been terrific. We're in four markets in Texas. Austin, San Antonio, Dallas, Houston, just terrific. We've been thrilled with the business there. There's a lot of new homes in Texas. There's a lot of competition. We have a great brand there. We've been in the state a long time, and I'm very optimistic about our future there.

Land is relatively easy to find. The risk is less because there are land developers that feed us lots, which makes the business easier. We can have just-in-time lots provided to us, which, of course, can drive the IRR.

I wouldn't read too much into Southwest Florida. We're very small there. It's one of our smaller markets in the state. But Florida, we call Florida West, which is really Naples up through Fort Myers. And that is having a really good February. In fact, Florida East, which we call Fort Lauderdale up through Stuart is also having a really good February.

As the snowfalls in the North and the Midwest, the planes head south and we're taking advantage of that.

Buck Horne

Analyst, Raymond James & Associates, Inc.

Q

That's fantastic. Thanks for the color. All my other questions are answered. So congrats and great quarter, guys.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

Thanks, Buck.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Thanks very much. I think is that a wrap, Jamie? How are we doing?

Operator: Yes, sir. That'll conclude today's question-and-answer session. I'll turn the floor back over to you for any closing remarks.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Jamie, thanks. You've been great. Thanks, everyone, for your interest and support. As always, great questions. We're always here offline to answer any follow-ups you may have. And thanks again. Take care.

Operator: And with that, ladies and gentlemen, we'll conclude today's conference call and presentation. We thank you for joining. You may now disconnect your lines.

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