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Toll Brothers, Inc. (TOL)

Q3 2025 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Toll Brothers Third Quarter Fiscal Year 2025 Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] 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 note this event is being recorded.

I would now like to turn the conference over to Douglas Yearley, CEO. Please go ahead.

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

Thank you, Drew. Good morning. Welcome and thank you all for joining us. With me today are Marty Connor, Chief Financial Officer; Rob Parahus, President and Chief Operating Officer; Wendy Marlett, Chief Marketing Officer; and Gregg Ziegler, Senior VP, Treasurer and Head of Investor Relations.

As usual, 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. Please read our statement on forward-looking information in our earnings release of last night, and on our website, to better understand the risks associated with our forward-looking statements.

Before we jump into our quarterly results and our outlook for the remainder of fiscal 2025, I'd like to take a moment to thank Marty for the enormous contributions he has made to our company since he joined us in 2008. As we announced in July, Marty plans to retire from the CFO role at the end of our fiscal year in October. During his 17 years with Toll Brothers, Marty has been an outstanding leader, business partner, financial steward and good friend. He has played a central role in enhancing value for our stakeholders, and helped shape the financial strategies that have been such a vital part of our success. Marty, your intelligence, wit, and the spirit of fun you bring to the office every day will be missed by all of us. On behalf of the entire Toll Brothers team, thank you.

Of course, one of our responsibilities we take very seriously here is developing talent. We have a very deep bench in our finance group, which includes Gregg Ziegler, a familiar name to many of you on this call. I am pleased that Gregg will be stepping up in November to become our next CFO. He has a wealth of experience, including 23 years at Toll Brothers and an unmatched understanding of our business. I look forward to working with him in his new role, and I am confident that he is the right leader to continue our track record of financial success.

With that, let's turn to our third quarter results. I'm very pleased with our performance in the quarter. In a difficult market, our balanced operating model, broadly diversified luxury business and strategy of prioritizing price and margin over pace continues to pay dividends. In the quarter, we delivered 2,959 homes at an average price of $974,000, generating record third quarter home sale revenues of $2.9 billion. Our adjusted gross margin of 27.5% exceeded guidance by 25 basis points, and our SG&A expense was 8.8% of home sales revenues, or 40 basis points better than guidance. The outperformance on both our top line and in our margins contributed to third quarter earnings of $370 million, or $3.73 per diluted share. We also returned approximately $226 million to stockholders through dividends and share repurchases in the quarter, positioning us to deliver another year of healthy profitability and solid returns in fiscal 2025.

In the quarter, we signed 2,388 net contracts for $2.4 billion. While units were down approximately 4% year-over-year, dollars were flat due to an increase in average sales price to just over $1 million. Our ASP was up 4.5% versus the third quarter of fiscal 2024, and up 3% versus last quarter. We are pleased with the resilience of our luxury business and more affluent customer base.

While our contract ASP was up and our margin outperformed, our sales volumes have been impacted by the softer market. As a result, and given our strategy of balancing price and pace, we now expect deliveries to be approximately 11,200 homes for the full year, at the lower end of our previous range. We are maintaining all other key guidance metrics, including a full year adjusted gross margin of 27.25%.

In this environment, we continue to actively manage our spec starts and inventory levels on a community-by-community basis to match local market conditions. In some markets, especially in the North region, where inventory remains low and demand is strongest, we have increased spec production. Overall, as local markets evolve in the coming months, we will be making decisions as to how many spec homes to start as we plan ahead for fiscal 2026.

In addition to the 3,200 specs that are in various stages of construction, we have another 1,800 building permits ready to go. As we see market improvement, we have the ability to quickly ramp up our spec production. Remember, our spec business model is differentiated. We sell our spec homes at various stages of construction, all the way from foundation poured to finished home. This offers some of our spec buyers the opportunity to personalize their homes with features and finishes that match their tastes, as choice remains a key pillar in the Toll Brothers buying experience, while also providing us a faster and more efficient construction schedule.

From a pricing perspective, we modestly increase incentives in the third quarter. The average incentive in new contracts was approximately 8%, up from approximately 7% in the second quarter. At third quarter-end, our backlog stood at 5,492 homes, valued at $6.376 billion, with an average sales price in that backlog of $1.16 million. We are pleased with both the average sales price and the gross margin embedded in our backlog. We also have 3,200 spec homes at various stages of completion.

Our cancellation rate was 3.2% of beginning backlog as compared to 2.4% in last year's third quarter and 2.8% in the second quarter. Our cancellation rate remains the lowest in the industry, continuing to reflect the financial strength of our buyers and demonstrating that they remain comfortable and confident in completing their home purchases.

About 26% of our buyers paid all cash in the third quarter, consistent with recent trends and well above our long-term average of 22%. The loan-to-value ratio for financed buyers was approximately 70%, highlighting the strong financial profiles of our customers.

We continue to make progress improving construction cycle time. Overall, we have not seen any significant impact on build costs from tariffs and we do not expect to see any this fiscal year. In fact, we are anticipating that build costs will come down modestly in the foreseeable future.

We ended the third quarter with 420 active selling communities. We remain on track to end the fiscal year with 440 to 450 communities, representing 8% to 10% year-over-year community count growth. Our land position remains strong and we continue to prioritize capital-efficient deal structures that support long-term growth.

In the quarter, we spent $433 million on new land. We remain disciplined in our underwriting and focused on securing high-quality land at attractive returns, with a continued emphasis on keeping land off balance sheet as long as practical to enhance capital efficiency.

At quarter-end, we owned or controlled 76,800 lots, 57% of which were controlled and 43% owned. This land position allows us to continue to be selective, disciplined and focused on efficiency when we assess new land opportunities.

With that, I'll turn it over to Marty.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

Thanks, Doug. I appreciate the kind remarks at the outset and want to express my sincere gratitude for the opportunity afforded to me to be Toll's CFO for the past 15 years. It has been a real honor and I'm proud of all that Toll Brothers has achieved over the past decade and a half. I would also like to express appreciation for the great teams I have here at Toll as well as at home.

I'm proud and pleased that Gregg will be picking up the reins when I step down. Gregg and I have worked closely since my first day and I have the utmost confidence that Gregg is the right person for the job.

Turning back to the numbers. It was a great third quarter. We significantly exceeded our guidance with earnings of $500 million before taxes and $370 million after, or $3.73 per diluted share. As Doug mentioned, we delivered 2,959 homes, generating record third quarter home sales revenues of $2.9 billion. This was a 5% increase in units and a 6% increase in dollars compared to last year's third quarter. The average delivered price of $974,000 was in line with the midpoint of our guidance of $975,000, and included approximately $207,000 spent on lot premiums, structural options and Design Studio upgrades, which are highly accretive to our margins.

We signed 2,388 net contracts for $2.4 billion in the quarter, a 4% decline in units, but flat in dollars compared to Q3 2024. The average price of contracts signed in the quarter was $1.010 million. The average price in our backlog is even higher at $1.16 million, which includes $234,000 of lot premiums, structural options and Design Studio upgrades. Our buyers continue to demonstrate their financial strength and the value they place on our homes with the significant investments they make.

Our third quarter adjusted gross margin was 27.5% or 25 basis points better than we had projected and guided. The outperformance was spread evenly across products and regions, and it was attributable to both greater efficiency in our homebuilding operations and favorable mix.

SG&A as a percentage of revenue was 8.8% in the third quarter compared to 9.0% in the third quarter of 2024, and compared to our guidance of 9.2%. SG&A came in better than expected, primarily due to increased leverage from higher-than-forecast revenues as well as cost controls. We remain very focused on efficiency, and we continue to see the benefits flow through our results.

Third quarter joint venture, land sales and other income was $15 million, ahead of our breakeven guidance, as we realized gains in income related to several joint ventures in the quarter and saw better-than-forecast earnings in our mortgage operations. Our tax rate in the quarter was 26%.

I'll turn it over to Gregg to review our balance sheet, financial position and liquidity.

Gregg L. Ziegler

Senior Vice President, Investor Relations & Treasurer, Toll Brothers, Inc.

Thanks, Marty. I'm honored to be the next CFO of Toll Brothers and appreciate the confidence you and Doug have shown to me.

As we announced earlier this month, in the third quarter, we issued $500 million of 10-year senior notes at a 5.6% coupon. At the same time, we called $350 million of senior notes that were scheduled to mature this November. With the issuance and redemption, we extended the weighted average years to maturity of our senior notes from 2.5 to 4.8 years. This comes on top of the refinancing of our credit facilities in our second quarter, which pushed out a revolver and term loan by five years and increased the size of the revolver by nearly $400 million.

We now have no significant bank or senior debt maturities until March of 2027. We finished the third quarter with a net debt-to-capital ratio of 19.3%, $852 million in cash and equivalents, and $2.2 billion available under our $2.35 billion revolving bank credit facility. This year, we expect to generate another $1 billion in cash flow from operations.

In the quarter, we spent $433 million to acquire 2,755 lots. We paid a dividend of $24.2 million and repurchased $201.4 million of common stock at an average price of $112.40. For the full year, we've repurchased approximately $402 million of common stock at an average price of $111.08. We continue to project $600 million of share repurchases for the full year.

To summarize, our balance sheet, financial position and liquidity are as strong as they've ever been. They provide us ample flexibility to both invest in the future growth of our business, while also returning capital to stockholders.

This has been a pillar of our overall financial strategy for at least the past decade, and will continue well into the future.

Marty, I'll turn it back to you to address guidance.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

Thanks, Gregg. As usual, our outlook is subject to all the caveats regarding forward-looking information and the assumptions, risks and uncertainties inherent to projections. Based on our backlog, recent sales activity and the number of spec homes completed or currently under construction, we expect to deliver approximately 3,350 homes in our fourth quarter, which comes to approximately 11,200 homes for the full year. The average price of deliveries in the fourth quarter is expected to be between $970,000 and $980,000.

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We continue to expect the full year average delivered price between $950,000 and $960,000. As Doug mentioned, we continue to balance price and margin with pace. This strategy, combined with the gross margin embedded in our backlog, gives us confidence in maintaining our full year projected adjusted gross margin of 27.25%. For the quarter, we expect adjusted gross margin to be 27%.

We expect interest and cost to sales to be approximately 1.1% of home sales revenues in the fourth quarter and for the full-year. Fourth quarter SG&A as a percentage of home sales revenues is expected to be approximately 8.3%. For the full-year, we continue to expect it to be between 9.4% and 9.5%. Other income, income from unconsolidated entities and land sales gross profit for the full year is projected to be $110 million. For the fourth quarter, we expect it to be approximately $65 million. We project the fourth quarter tax rate to be approximately 25.5%, and the full year rate to be approximately 25.1%.

Our community count at quarter-end was 420, compared to our guide of 430, as we move some openings into the fourth quarter. We continue to expect 440 to 450 communities opened by the end of the fiscal year. Our weighted average share count is expected to be approximately 98 million for the fourth quarter, and 100 million shares for the full year.

Putting this all together, we expect to earn approximately $13.75 per diluted share in fiscal 2025, achieve a full year return on beginning equity of approximately 18%, and bring our book value to approximately $88 per share at year-end, which would cap off another great year for Toll Brothers.

Now, let me turn it back to Doug.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Thank you, Marty. Our results in the third quarter and our projections for the full year reinforced the strength and resiliency of our business model. They prove out our ability to successfully navigate changing market conditions while still delivering attractive returns to stockholders. This is the result of the hard work of all of our Toll employees. It is their passion for our business, dedication to our luxury brand, and commitment to our customers that will ensure our continued success.

With that, let's open it up for questions. Drew?

QUESTION AND ANSWER SECTION

Operator: We will now 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, please limit yourself to one question and one follow-up. [Operator Instructions] The first question comes from Stephen Kim with Evercore ISI. Please go ahead.

Stephen Kim
Analyst, Evercore ISI

Q

Yes, thanks very much, guys. Appreciate all the color. Congrats to Gregg and Marty. I guess, let me just start off with a simple one. Your cash flow from operations, I think you got it to greater than $1 billion. What was it year-to-date? Because I didn't see that in the release. And then, if I could also ask you, you mentioned construction costs. You expect a decline in the near term. Was wondering if you could kind of give us a breakdown and what components you're expecting to get some betterment. Thanks.

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

A

Sure. Gregg?

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

A

Yeah, I was trying to find it.

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

A

Cash flow.

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

A

Our nine months to date – it's a little rough. It's probably somewhere in that 400-plus million dollars. So, we do expect to see a lot of that pickup happening in Q4 to get to that $1 billion for the year.

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

A

Which is typical. That's how it works.

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

A

Which is typical, because the Q1 is usually relatively negative; Q2 starts even out; Q3, positive.

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

A

Right. Building costs, flat to modestly down in the short term. Steve, we're just beginning to see trades negotiate a bit more than they were suppliers. We're out in the market for some major material, supply renewals, and we're making some progress there on good pricing. It's community and market specific but – and it's moderate, but building costs are beginning to come down across the board. I can't point to one or two things. It's a combination of both subcontractor, contracts for our major trades and materials.

Operator: The next question comes from John Lovallo and UBS. Please go ahead.

John Lovallo
Analyst, UBS Securities LLC

Q

Good morning, guys. Thanks for taking my question.

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

A

Hi, John.

John Lovallo
Analyst, UBS Securities LLC

Q

The first one is – hey. The only concern we're hearing out there really today is that the ability for you guys to grow next year. And maybe I'll frame the question this way, I mean, in the past, you've talked about achieving a sales pace of two communities – sorry, two homes per community per month on average through the year. I just want to confirm that there's no change in the thinking there. And do you think that this is something that can be achieved in fiscal year 2026, after what appears to be closer to maybe 1.8 in 2025?

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

A

Yeah. So, John, as you know, we're going to give all sorts of great details on 2026 in December. We are very focused on 2026. We are very excited by the community count growth we will see next year. In fact, we are expecting 20 to 30 openings in Q4 when you do the math off of the numbers we gave you of where community count stands at the end of Q3 and where we think it will be at the end of the year. We've had some terrific openings lately. We just opened a community this weekend in Philadelphia. That took 21 deposits. We actually shut down the action that got so hot at $2 million in Bucks County, Pennsylvania.

We have a community in Irvine Ranch, Southern Cal that has taken 24 contracts north of $6 million in the last month. We are positioning ourselves with the communities that are opening and with the business, we have to set up for next year. We have 3,200 spec homes in process. We have 1,800 spec permits that we are ready to start homes on as we see market improvement. And as I mentioned, we're already beginning to do that in the north. We have fewer shares right now, and we're going to have even fewer shares next year that helps drive some EPS. Average price is up, that $1.16 million average price in backlog, which right now is about 5,500 homes is significant.

But even on the homes we're selling today, the average price is up to $1 million. Build time, cycle time has come down. We now have about 35% of our communities that can build houses in eight months or less, that gives us more visibility, more ability to sell homes into the early part of the spring selling season and still have those homes delivered by the end of the fiscal year.

One of the things we look at all the time is what do we think a local market will look like next summer, when most people want to close on their home to get their kids into school and when do we have to start new specs to have those homes ready next summer. And those decisions are all dependent about how long it takes to build the specs in each given community and what the market demand looks like in that community. And we are evaluating those opportunities daily and making the appropriate decisions as we move through it.

On the macro level, rates have come down nicely. We're now at 6.375% here at Toll Brothers. It looks like short-term rates are going to be coming down for the balance of the year and hopefully into next year. While there's not a direct correlation between those short-term rates and the 30-year mortgage, it's certainly encouraging.

There's pent-up demand building out there every day. There's still such a imbalance between supply and demand, and every day, we have buyers who have been on the sidelines who are waiting to come back in. And of course, the demographics are terrific. Our traffic is up, both web traffic and foot traffic, in August. We're heading into the fall, which is a better time.

So I told you I wasn't going to give you any guide on 2026 into December, and I don't think I've given you any guide, except that we are positioned and very focused to have a good 2026. We understand that we do need to drive activity through the community openings and through the spec strategy that we have employed, and we're ready to go. It's a big focus of us and we're excited for the future year. We continue to have great leverage over SG&A. We're really proud of what we've done there. And as we continue to build spec, that leverage increases. And so there you have it.

Sorry for the long answer, but it gave me an opportunity to give you sort of my feeling about the market. I feel better today than I did a few months ago. I think the economy is starting to heal. I think the buyers are beginning to come back out. I think rates dropping a little bit is more psychological for our client than it is affordability wise, because we have more of a luxury client that can afford our homes. They just have to feel good about the economy. So we'll have to see what the fall brings. But we are positioned particularly with all these specs that permit to be nimble and react quickly. And I'm feeling – certainly feeling better than I was a few months ago.

John Lovallo
Analyst, UBS Securities LLC

Q

Yeah, that's really helpful, Doug. And that's really what I was trying to get at is, the backlog maybe being down a bit from where people would have thought it might be, perhaps. You guys still feel comfortable with the community count growth in 2026 and the ability to drive orders to drive growth as we move into the next couple of years.

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

A

We do, very much so. And we're really excited about our land positions, and we haven't guided yet, but on the last call, I gave a soft guide that we have similar community count growth projected for 2026. I could reaffirm that. We just have terrific land and terrific communities coming. So, it's all good.

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

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

A

Hi, Mike.

Michael Dahl
Analyst, RBC Capital Markets

Q

Yeah. Thanks for taking my question. Hi. Marty, heck of a run, congrats. And congrats, Gregg.

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

A

Thanks, Mike.

Michael Dahl
Analyst, RBC Capital Markets

Q

Doug just – and thanks for all that help. Just to follow up, can you help us walk through how sales pace trended through the quarter and maybe elaborate a little more on your August comments. And the follow-up question would be, similarly, if you think about the incentives ending up at 8% versus 7%, I think a lot of your peers talked about sequentially increasing incentives through each month of the summer period. So, if you could talk about how that shook out for you and whether we should be thinking the exit rate on incentives was higher than that 8%? Sorry, that's two questions in there, but those are my two.

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

A

We understand. So, May was the worst month. June and July were better. August has been similar to what we saw throughout the quarter. No, the incentives are not up at the end of July from where they were in May or they're not up today from where they were in July or June. The increase in incentive from that 7% to 8% is primarily driven by a little bit more discounting we had to do with some finished spec.

As we continue to explain, and I know you all understand, our spec strategy is a bit different, where we do sell a number of our specs earlier, where the client can hit the Design Studio, buy a bunch of upgrades, feel like it is a custom home even though we started it. And that process is very accretive to us, and the margin has been closer to build-to-order margin when we sell those specs earlier. But we do have a number of finished specs in some markets that are under a bit of pressure. And that explains the little bit of an increase you see on the average incentive.

I am a little bit encouraged. It's early, but over the last three weeks, we have seen the incentive in finished specs moderate a bit. So no, it's, in fact, not what you described, which is maybe going up a bit, but it's actually stabilized or come down a little bit. And again, it's only three weeks, so we'll have to see.

But we – as I mentioned earlier, our web traffic in August is up. That exact number is around 5% to 10%. And our foot traffic into our communities are up about 15%. It is taking people longer to deposit because they're more cautious, but our conversion ratio from deposit to agreement of sale is about the highest it's ever been, around 80%. So, four out of five people that go to deposit are several weeks later pressing firmly and moving forward with a binding agreement.

I mean, historically, that number when I was a kid in this business was running like 60%. So, it takes a bit longer to get them to the table to deposit. But then, they stick. And so, we haven't seen an immediate impact from the rates dropping from, call it, 6.75% or 6.625%, down to 6.375%. It's only been a couple of weeks. I wouldn't have expected it to be that immediate, particularly for our client, where it's not, oh my gosh, now I can afford that monthly payment. Let me jump in. Our clients don't think that way.

Plus, it's August. We're closing up some of our houses. We're getting kids back to school. I think people might be waiting to see if the rates come down a little bit more. We're going to know a lot more through the month of September. And I am anticipating, as these rates settle into the market, we're going to see more demand coming out from all this pent-up demand that's been waiting on the sidelines.

Michael Dahl
Analyst, RBC Capital Markets

Q

That's really helpful. Thanks, Doug.

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

A

You're welcome, Mike.

Operator: And we have a follow-up from Stephen Kim with Evercore ISI. Apologies. Please go ahead.

Stephen Kim
Analyst, Evercore ISI

Q

Oh, thanks very much.

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

A

Stephen, I'm sorry Drew cut you off. It was not us.

Stephen Kim
Analyst, Evercore ISI

Q

Great. I'll get even with Drew later. So, quick question, I guess, on the volumes that we saw, the orders. I think last year, Doug, you had referred to the order cadence. I think you had sort of talked about how typically 4Q orders are down about 10% from third quarter, and you had said last year that that was going to be different and all that. You kind of called that out, if I recall. Can you talk to us about what the order picture you think would look like this year as we move sequentially from 3Q to 4Q? Is there anything that would be helpful for us as we think about your near-term plans on absorptions?

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

A

So, I'll take a shot at this, Steve. I think, our community count growth in the fourth quarter is going to be outsized compared to other quarters this year and a year ago. So, that gives us encouragement. We see rates have dropped 50 basis points as we head to our fourth quarter. That's got to be a positive. We've had some of these new openings that Doug mentioned that have really jump-started right out of the gate for the fourth quarter. And as Doug mentions, he's feeling better than he did a couple of months ago. So, all that builds some optimism as we head to our fourth quarter period.

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

A

And, I mean, Steve, as you know, because you know the numbers so well, our fourth quarter is historically about 4% down from Q3. I have already mentioned that for three weeks of August, which is a very short glimpse into what's going to happen. We're about flat to Q3, but that's deposits. That's not even agreements. That's just a couple of weeks of taking the deposit checks. So, we'll have to see.

What Marty described is spot on. It gives us some optimism, but we'll just have to see how the balance of August and September and October play out. We are well positioned, with the community openings we have, with the interest we have, the interest list we have in some of those openings that are coming. But we'll just have to see how it plays out. But historically, it's down 4%, and first three weeks of August have been flat. So, it's trending about where history would suggest it should, but we do have some reason to be optimistic that we could do better.

Operator: The next question comes from Trevor Allinson and Wolfe Research. Please go ahead.

Trevor Allinson
Analyst, Wolfe Research LLC

Q

Hi. Good morning. Thank you for taking my questions. And I'll echo congratulations to both Marty and Gregg as well.

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

A

Thanks, Trevor.

Trevor Allinson
Analyst, Wolfe Research LLC

Q

First question, we've heard a few builders talk about seeing some relief on development costs. A couple of questions around that. Are you guys also seeing some softening on development? How widespread is that? And then if you are, what's the timeline for when that starts to flow through your P&L and how much benefit do you think you could receive from that from what you're seeing currently?

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

A

Trevor, we have not seen much relief on land development costs. There may very well be some downward pressure, if there is less activity for land developers and they become a bit more aggressive in their pricing. But I don't think we've experienced that yet.

Trevor Allinson
Analyst, Wolfe Research LLC

Q

Okay. Got you. Makes sense. And then the second question on the 4Q community account guide, looks like a really nice jump here sequentially going from 420 to 445. How should we think about the timing of those? Do they come on pretty ratably throughout the course – or the quarter, or is there a good portion that's scheduled to open up near the end of the quarter? And then any regional concentration that we should be considering. Thank you.

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

A

So, it's spread throughout. There's no real concentration in terms of timing. And remember, that's a net number at 445. So, there are some communities that are closing selling out in the next 2.5 months. So the gross number of openings will actually be modestly more than that 25. That gives you from 420 to 445 because of sellouts. Regionally, it's pretty well spread, right, guys, around the country. So, there's no – I wouldn't call any particular regional concentration. I'm sorry...

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

A

North, Mid-Atlantic, South seems to be a little bit of the concentration for Q4 openings.

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

A

I like that.

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

A

Yes.

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

A

Considering Boston to Washington, D.C., is our strongest corridor. Charlotte, Charlotte's been hot lately. So, there you go. A little bit more in the North, Mid-Atlantic and South.

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

Sam Reid
Analyst, Wells Fargo Securities LLC

Q

Awesome. Thanks, guys, and congrats to Marty and Gregg. Gregg, looking forward to keeping it going. Wanted to talk cycle times. 35% of your communities can build in eight months or less. It's a great, very helpful stat. Can you just talk to what cycle times look like across the remaining 65% of your communities? And then when we think about ways to improve that on the spec and build-to-order side, just talk through levers that you can pull to improve cycle times into next year.

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

A

So, the balance of 65% would be 8 months and a day to probably 11 months. And the 11 months, we'll take the extreme, is really big houses that have probably a lot of build-to-order, with a lot of money spent in the Design Studio and maybe a lot of structural options that are being offered, and the houses are more complicated. They may very well be in towns that have some difficult permitting and inspection processes that can slow you down a little bit. They could also be in locations where we have significant backlog because we've been hot and it just takes a little bit longer to build.

So, every community has its own story, but that is generally the reason why we have some that are still stuck at 11 months. And how do we get better? We just keep doing what we're doing, which is working really hard. We have teams out there that study every home we build every day, why we lost a day here or there, what we do – what we can do to improve it, how we make our floor plans and our architecture more efficient, more optimized, how we get people through the Design Studios faster. We track how many days it takes somebody to get through that Design Studio and sign off so we can get going. So, we are all over it. I am so proud of the progress we've made and there is more to come. The spec side of the business helps a lot, too

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

A

Exactly.

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

A

As a 50% spec builder now, those homes don't have a customer yet in the early stages, so we don't have – we're able to build them a lot faster because we pick the finishes, we pick the structural changes. We can go full speed without waiting for a Design Studio process, without reacting to a client's walk-through on Sunday afternoon as the house is under construction. And that's certainly helped bring the overall cycle time down.

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

A

And on the front end, we have that permit sitting on a shelf. We don't have to spend incremental time to go get that permit for those spec homes.

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

A

Right. Thanks, Marty.

Sam Reid
Analyst, Wells Fargo Securities LLC

Q

No, that helps, guys. Really appreciate it. Maybe switching to another line item on the P&L. In the prepared remarks, you alluded to better cost controls behind the SG&A beat versus guide. We just love a little bit of context in terms of what those cost controls were, how sustainable that is, perhaps, into 2026. And then thinking about Q4 specifically, you've got to step up in community count quarter-over-quarter. Would just love to know any grand opening expenses that might be embedded in that guidance for SG&A. Thanks.

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

A

Sure. So, our cost controls span the gamut of costs. We've done a great job of maintaining pretty stable head count, despite growth in community count. We've maintained inside and outside sales commissions at a reasonable level, despite the challenging market. And we continue to benefit from the technology investments we've made over the last six or seven years in terms of our systems from a CRM and an ERP perspective, and even in HR – sorry, there is pressure on some costs. Insurance costs are pressured. And there are incremental costs associated with community count openings, but they're all baked into our guidance.

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

A

And just to remind everyone, one of the – the primary reason why the Q4 guide on SG&A is modestly higher is because of all these communities we are opening that have front-end expenses without the revenue coming in yet.

Operator: The next question comes from Alan Ratner with Zelman & Associates. Please go ahead.

Alan Ratner
Analyst, Zelman & Associates

Q

Hey, guys. Good morning.

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

Hey, Alan.

Alan Ratner
Analyst, Zelman & Associates Q

I'll add my congrats to Marty and Gregg there. Looking forward to working with Gregg.

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

Thank you.

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

Thanks, Alan.

Alan Ratner
Analyst, Zelman & Associates Q

So, on the spec mix, Doug, I think you mentioned it's 50/50 today. Can you just refresh our memory what it was pre-COVID or kind of in more normal times, and what the margin differential currently is on your spec product, maybe across the three buckets in terms of completion status versus a built-to-order hump.

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

Sure. In the old days, 10% to 15% was our spec business. I remember when I was a kid and I was a project manager in the field, Bob Toll would give us one spec per community, and if we wanted to build a second spec, we had to go see him personally. So...

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

And what answer would he give you?

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

He would put you through the ringer is what he would do so that you wouldn't come back the next time. So yeah, it's, I'd say, 10% to 15% up to where we are today. The margin delta between spec and build-to-order is consistent with what we've been talking about for the last few quarters. It has widened a little bit. We're really pleased that the build-to-order side of the business has gone up to north of 30%.

And again, on the spec side, it depends a lot on when we sell the house in terms of the timing during the construction cycle. And of late, as I described, some of these finished specs we have, we've had to discount a bit more. But I – we love the business and the combined margin in that 27% range, as we've talked about, we think is the right way to run the business. There's tremendous capital efficiency that is brought to us by the spec business. There's obviously opportunities to pivot. As we've been talking about with all these spec permits we have, to move pretty quickly, if we want to, try to fill that hole in the future when the time comes for people who want to move in.

So, we have a 27% average. As we talked about last quarter, we were just north of 30%, around 30% or just north of 30% on build-to-order, call that 3 points, plus or minus, up. And so, obviously, if it's 50/50, the math would tell you we were about 3 points, plus or minus, down for the spec business.

Alan Ratner
Analyst, Zelman & Associates

Q

Got it. No, that's really helpful. And I guess my follow-up is a more difficult question. But presuming you don't maybe get back to 90% build-to-order, it sounds like, if you can get that share a little bit higher, that would certainly be a positive for your margin and certainly for the visibility in your business. How do you, the Toll, and the industry get back to a more normal build-to-order or spec mix?

I mean, it seems like everybody has kind of pivoted very hard towards spec. And during the early stages of the pandemic, when resale inventory was so tight, that made a lot of sense. But now it almost feels like builders are kind of forced to keep the spec machine running if they want to maintain growth and have the volume ready to go. So I'm just curious how you see this playing out and what can be done to get back to a more normal build-to-order mix.

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

A

Alan, it's a good question and I'm not sure what back to normal is going to mean in the future, because I think the industry for some time now has been pretty committed to some level of spec construction. We, as I described, had very few spec and we are very comfortable at 50/50, even in this somewhat softer environment. We're getting really good at it.

Our construction teams are not picking the structural changes that go into spec. They're certainly not picking the finished choices that go into spec. We have national designers that decorate our model homes that have come up with different packages, and we market those. These are curated packages that have been picked by the designer that you're walking through a model home and you fall in love with the decorating, and we tell you that our – the spec you're interested in was designed by that nationally acclaimed decorator who just decorated this model you love. And so, we're selling them at different stages.

I like the business. I mean, will it move from 40% to 50%, maybe to 60% back to 40%? Sure. And a lot of that is market-specific. But I don't think your thesis that when do we get back to the good old days of 90% build-to-order order, I don't see it. And you're hearing that from the one company that did the least spec out there.

So, it's fluid. You have to really manage it closely. But I – the buyers today also, particularly the millennials that are coming along that are more affluent and are not just buying more expensive first homes at 38 years old, but they're now in their 40s moving up, they're not all that interested in waiting a year and designing their custom house. And if we can give them a home that they can move into in 90 days, 5 months, 7 months, because it's under construction and still have the opportunity to pick finishes to make it feel like their own and live like their lifestyle and their decorating choices, it's a smart way to go. And we're going to keep at it within that range I talked about, I'd say, of, let's say, 40% to 60%.

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

A

We're generating great returns with this mix. We're maintaining high margins with this mix. I don't know why we would feel compelled at this moment to change this mix based on how we're doing. And I echo Doug's comments, I think there is a greater percentage of consumers that don't have the patience or the desire to wait and spend the time to design, particularly when they walk into some of our highly curated spec homes and say, wow, this is pretty good. Remember, we do this all day long. An individual does it one, two, three times in their lifetime. So we do it pretty well.

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

A

And the other thing, Alan, just to wrap it up, in many of our communities, we have some very special lots, home sites, that generate very high lot premiums. We save those for the build-to-order business. We're not going to spec on the $400,000 lot premium lot, because we know the buyer of that lot who's going to put a home on that lot, who's going to load it with structural changes and really load it with Design Studio changes, all of which are very accretive. And so part of our strategy is more of the vanilla generic lots, not all, but more of them get the spec outs and we drive the margin. One of the reasons that margin is north of 30% is because we are saving the better lots for the client who we know will spend more money with the upgrades.

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

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Great. Thanks. Thanks for taking my questions. And, Marty, it's been a pleasure. Best of luck in the future. Gregg, obviously, congrats, and looking forward working with you more.

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

A

Thanks, Mike.

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

A

Thank you, Mike.

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

A

I met Marty's grandbaby Saturday night, and now I fully understand why he's retiring.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

That's great. That's great. Yeah, a couple of questions. I guess, first, just on the incentives. It's very helpful, Doug, kind of giving the detail that a lot of that increase, 8% versus 7%, related to finished spec, and maybe that's come down slightly recently. But I think, if I'm right, looking back a couple of quarters, your incentives as a percent of sales have increased maybe closer to 200 basis points year-to-date. Obviously, you're expecting a little bit of relief on some build costs, perhaps lot cost inflation would be an ongoing issue on the other side. But it would seem like – again, without pinning it down to 2026 guidance, which I know you're not going to give, but is there any reason directionally why we shouldn't expect somewhat of a moderation in 2026 versus 2025 at this point?

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

A

Again, Mike, we're going to give all the details in December. You're right, it's in the numbers. Our incentive in the third quarter is higher than it was in the second quarter, and higher than it was in the first quarter. That 5,500 homes in backlog that has an average price of $1.16 million is high margined, and that is very comforting for us. But I'm not in a position to start giving you some guide on where the gross margin will be in 2026. We're going to – we'll address that in December. And frankly, there's a lot of time between now and December and there's a lot of market in front of us that is going to be evolving. And we've talked about our ability to start all these specs and be ready for next summer when people want to move in. We're just going to have to see where this market is through the course of September, October and November before that December call to have a much better idea for you on where things are. Because when you do sit on a lot of spec, current market conditions can really affect the amount of incentive on those specs.

As you recall, through the COVID years, Toll was penalized a bit because we didn't have the spec and home prices were going up so rapidly, we sold the house at agreement of sale, and the homebuyer got the benefit of home price appreciation during construction. And those builders that were spec builders got the benefit of the home price appreciation during construction because they didn't sell to the end. That was unusual, that doesn't usually happen. But we'll have to see what takes hold through the fall. And stay tuned for December.

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

Mike, I'd also point out that our gross margin a year ago, for the quarter ended a year ago, was adjusted gross margin 28.8%. And at the end of this year, our fourth quarter, it's projected at 27%. So, we've seen a lot of that margin unfortunate erosion already over the course of the past 12 months and the next 3 months in our projections.

Michael Rehaut
Analyst, JPMorgan Securities LLC
Q

Right. No, no, that's definitely fair. Thanks for that, Marty. And maybe just secondly, Doug, I think you alluded to earlier a little bit lower rates over the last maybe – by, I want to say, 20 bps, 30 bps, maybe on a broader market level. You talked about June and July being a little better from a sales pace perspective versus March, versus May, and obviously the last few weeks. I'm wondering if you're trying to maybe parse out the increase in incentives maybe throughout the quarter to – and maybe that was again to move the finished spec. And you also have, obviously, some seasonality. But I'm wondering between seasonality and maybe a little bit of a higher incentive, how do you think about that, let's say, 20-bp, 30-bp decline in rates impact on demand relative to some of the other factors that perhaps are driving sales pace currently and into the fall?

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

Mike, as I mentioned, we haven't yet seen an immediate impact in sales from the lower rate. It will be coming. With every tick-down in rate, you're going to have more buyers that step into the market. It's August, I think we just have to wait a little bit and see how it plays out. And we also have to see what the fed does, and we have to see what the macroeconomic world looks like. There's a lot of moving parts here, and I am encouraged by where it feels like things are headed, but I have no empirical data for you as to what's happened since rates came down. And I'm certainly not going to give you the crystal ball projection on where things go. We'll wait and see. We love our positioning and I'm feeling a bit better.

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

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

Drew, thank you very much. We appreciate it. Thanks, everyone, for all your great questions and all your interests. Have a wonderful end of the summer, and we'll see you all soon. Thanks. Take care.

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