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Toll Brothers, Inc. (TOL)

Q3 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

At this time, I'd like to turn the conference call over to Douglas Yearley, Chairman and CEO. Sir, please go ahead.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Thank you, Jamie. Welcome and thank you for joining us. With me today are, Rick Hartman, President and COO; Marty Connor, Chief Financial Officer; Fred Cooper, Senior VP of Finance and Investor Relations; Kira Sterling, Chief Marketing Officer; and Gregg Ziegler, Senior VP and Treasurer.

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

We produced strong fiscal year 2019 third quarter results, including home sales revenue of $1.8 billion, a 23.1% adjusted gross margin, $146.3 million of net income, and earnings per share diluted of $1. Our third quarter contracts were down 8% in dollars and 3% in units.

In our third quarter, we were able to decrease incentives slightly on new contracts versus our second quarter. In addition, with demand off to a good start in our fourth quarter, we have increased prices modestly at over half of our communities. We will continue to strategically balance sales pace and price.

According to the NAHB, builder sentiment in August rebounded to the highest level of the year. The Census Bureau reported single-family housing starts in July were the highest level over the past six months, and single-family building permits rose for the third month in a row. And just one hour ago, July existing home sales numbers came out, and exceeded consensus expectations. We view these as positive signs of the overall health of the housing market.

We continue to broaden our product lines and price points beyond our traditional move-up and active-adult buyers. We serve the widest variety of home buyers in the industry with homes ranging from $275,000 to over $3 million. In fact, about one-third of our communities today offer homes with a base price under $500,000.

We have also expanded geographically. This year, we have entered the Atlanta, Salt Lake City and Portland, Oregon markets. We're also expanding northward on Florida's West Coast into Tampa. We have seen healthy demand across these new markets.

We're also serving urban and suburban renters. Through Toll Brothers Apartment Living, we currently have a pipeline of 19,000 units in various stages of approval and development across the country. In addition, our new single-family build-to-rent joint venture is growing, and we are excited to be a leader in this evolving market segment.

With demographics improving, low interest rates, record low unemployment, continued wage growth and limited new and resale inventory in many markets, we are optimistic about the opportunities ahead.

Now, let me turn it over to Marty.

Martin P. Connor

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

Thanks, Doug. Before I address the specifics of this quarter, I want to note that a reconciliation of the non-GAAP measures referenced during today's discussion to their comparable GAAP measures can be found in the back of our earnings release. I also want to note that our guidance is subject to our normal caveats on forward-looking statements.

This quarter, we have increased the midpoint of our guidance for fiscal 2019 full-year deliveries, average price and revenue. And we are reiterating our adjusted home sales gross margin guidance. With the longer construction timeline from our build-to-order model, particularly at our higher price points, the exact delivery date of homes in our backlog can shift between quarters.

During the third quarter, adjusted gross margin came in better than expected, driven primarily by favorable mix and timing of certain deliveries. Some of the timing benefits that we experienced in our third quarter, we expect to reverse in our fourth quarter. Irrespective of these timing differences, we are reiterating our fiscal 2019 full-year adjusted home sales gross margin guidance of 23% that we provided on our second quarter earnings call.

Turning to SG&A, our third quarter SG&A, as a percentage of home sale revenue, was 10.6%. This is better than expected due to home sales revenue coming in at the high end of our previous guidance. We continue to expect SG&A margin to be approximately 10.4% for the full year. Our SG&A margin is expected to be higher this year than in fiscal year 2018, due to lower revenue than last year, compensation increases, continued investment in our infrastructure and information systems, and an increase in the number of communities we are operating from.

We now expect fiscal year 2019 other income, income from unconsolidated entities and land sales gross profit to be $105 million, up $5 million from our previous guidance of $100 million. Our fiscal year 2019 tax rate is expected to be approximately 25.6%.

We remain focused on maintaining our conservative balance sheet with ample liquidity, low leverage and long-dated debt maturities. At the end of our third quarter, we had more than $1.9 billion of liquidity comprised of cash and available bank credit facilities. And we have only $250 million of debt maturing over the next 30 months. Our leverage and liquidity give us the flexibility to execute on our balanced capital allocation strategy. This strategy includes capital-efficient land acquisitions, returning capital to our shareholders through share repurchases and dividends, and maintaining conservative leverage.

During our third quarter, we repurchased $142 million of our stock. And since the beginning of our fourth quarter, we have repurchased an additional $8 million. This reduced our share count by 4.2 million shares or nearly 3% since the start of our third quarter.

Our book value per share at fiscal year 2019's third quarter end was $34.72, up 3% from $33.84 last quarter, and up 14% from $30.55 one year ago. Our backlog at the third quarter end was $5.84 billion.

We are pleased that our community count has grown from 301 a year ago to 322 at the third quarter end. We expect modest growth in community count in our fourth quarter as well.

Now, let me turn it back to Doug.

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

Thank you, Marty. Jamie, let's open it up for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And our first question today comes from Truman Patterson from Wells Fargo. Please go ahead with your question.

Truman Patterson
Analyst, Wells Fargo Securities

Q

Hi. Good morning, guys. Thanks for taking my question.

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

A

Good morning, Truman.

Truman Patterson
Analyst, Wells Fargo Securities

Q

Good morning. Just wanted to start off in California, the market slowdown, hoping we can dig a little bit further into it. Have you guys seen the international buyer return at all? Or even potentially retrace given the intensifying trade war? And I realized, it might be difficult to parse out but looking at kind of organic, domestic demand in California, are you seeing that buyer return at all?

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

A

Truman, we have not seen a change in the foreign buyer in California. For the entire company we have about 10%, foreign buyers. Obviously, that's concentrated primarily out West. And then in California, it's been trending pretty much the same over the last many quarters.

Truman Patterson
Analyst, Wells Fargo Securities

Q

Okay. Okay. Thank you. When I'm looking at your gross margin guidance for the full year, it implies that fourth quarter falls a bit sequentially. Could you just walk us through the drivers of that? And how we should think about this going forward some of the moving parts, thinking I should have a lower lumber costs flowing through? But I think you mentioned the – and cement levels have started to come in very modestly on the orders front, product mix shift, I was hoping if you can walk us through some moving parts there.

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

A

Sure. The timing difference as we mentioned, on our prepared remarks were concentrated in markets like New Jersey, Vegas, Colorado, Massachusetts, to certain extent Atlanta – our new acquisition there came in better than we had expected. And we expect those markets to not have quite as good a quarter just based on the timing of deliveries in the fourth quarter.

Truman Patterson
Analyst, Wells Fargo Securities

Q

Okay. Okay. Thanks, guys.

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 a lot, guys. Appreciate the info you gave thus far. I would – wanted to ask you a little bit about land spend and land development spend that we can anticipate going forward. First is kind of a general commentary. Is it your view that you will be skewing your land purchases more towards partials that would be appropriate at lower price points than what we have historically seen? If so, has that process begun already? How do you think that will play out in terms of your overall land spend in dollars and units over the next year or so?

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

A

Sure, Stephen. So, we spent $287 million on land in the third quarter. We expect to spend quite a bit more in the fourth quarter. That's just the timing of when deals are closing. We continue to be very opportunistic and look for land in all of our markets. Therefore, there will be a land purchase for higher priced communities and there will be land purchase for mid-priced, and then, yes, probably a bit more than historically for Toll at the lower price point.

The third quarter contracts – 40% of those contracts had a base price of the home under $500,000. So, we continue to be America's luxury builder, but we are committed to have a more diversity of product, more spread of price points. Right now, we're building more and more of our lower priced communities in places like Phoenix and Houston and Dallas and Philadelphia suburbs, all throughout Florida; Boise, Idaho, more coming soon in Denver and Northern Virginia, and with the acquisition of Sharp in Atlanta, some of that is at a lower price.

So, if you compare our land spend today to 5 or 10 years ago, yes, I would say, there is more of it on lower price communities, but we're still fully across the spectrum. We have great opportunities even at the higher price point, but on a percentage basis, if you look back that far in time, then the answer would be yes, there'll be more of at a lower price.

Stephen Kim
Analyst, Evercore ISI

Q

Thanks a lot for that, Doug. That's helpful. Just a couple of clarifying questions on that. The land spend, the $287 million, how much of that was purchase versus land development? And then when you talk about 40% of contracts having a base price under $500,000, can you give us a sense of what they have been, let's say, as recently as year ago?

And then, second, general question is about the – you talked about base prices. I was particularly curious as to whether or not your customer, with the falling rates, saw the opportunity to add more options and upgrades into their homes, particularly the stuff that really hadn't really begun getting outside of the framing stage, whether they could add and thus bolster your gross margin beyond what you may have thought when you were originally selling those home. So, just getting a sense of the ability to sort of up-sell as those rates have come down.

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

A

Sure. So, the $287 million – the first part of your question, that $287 million in Q3, that was all land. On top of that, of course, in some locations we must put roads in. However, 30% of the $287 million was for improved lots. And as we've talked about more and more, we're very focused on being capital efficient in our land acquisition, to move the ROE, and so when we can buy land over time or land values improved and ready to go, we will do that as much as we possibly can.

With respect to the numbers today versus one year ago, we will have to get back to you on that. We don't have that with us right now. That goes to the amount of communities that are selling under $500,000 versus one year ago.

And then, the final part of your question...

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

A

...was, can buyers add more, since rates went down?

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

A

Yes. Thank you. On incentives, our buyers, as you know, Stephen, don't generally max out their mortgage. So, it's not an affordability issue for them, where when rates go down, they have more capacity. When they maximize the mortgage, they put into the upgrades. So we really haven't seen much of an uptick in the options and design studio finishes. That are purchased in good market versus bad market, and low interest rate versus high interest rate market, because of sort of the financial health of our buyer, and the fact that they tend to put a lot more cash down and do not max out the mortgage.

Our design studios, I will say a little add here, are doing really well. The margins are improving. We're now over 30 design studios that have been all revamped or have been built fresh and new. We're thrilled with the new management team that runs all of that, and as many of you on the call, we hope have taken us up on visit to those design studios. They're really a differentiator and one of the major Toll advantages of being able to truly build your custom home by all the finishes and selections that we offer.

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

A

The only thing I would add, Stephen, because I know you modeled this way, is that the amount we spent on softs and improvements in the third quarter was approximately $215 million. So, we spent around $500 million combined with the acquisitions during the third quarter.

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

A

Of the land.

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

A

Yes.

Stephen Kim
Analyst, Evercore ISI

Q

Great. That's exactly what I needed. Thanks a lot, guys.

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

A

You're very welcome.

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

John Lovallo
Analyst, Bank of America Merrill Lynch

Q

Hey, guys. Thank you for taking my questions. The first one, Doug, last quarter, you'd mentioned that May traffic and deposits have been pretty encouraging. So, I'm just wondering how things kind of trended in May, June and July from an order standpoint. And then, if you could possibly quantify the solid start that you're speaking about for August?

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

A

Sure. So, May contracts were up 7%, June contracts were down 18% and July contracts were up 1%. [Technical Difficulty] (19:40) read too much into June. There were quite a few openings in June of 2018 than May, June of 2019, a difficult comp. And there were some sales events run around the country in May of 2019 that might have pulled a little bit of the June demand forward.

With respect to August, I think, we're going to stick with our comment that, demand is off to a good start. I did mention in my prepared comments that we have had some modest price increases in over 50% of our communities during the start of August. And so, we feel good about the beginning of the fourth quarter.

John Lovallo
Analyst, Bank of America Merrill Lynch

Q

Okay. That's helpful. And then, may be just dovetailing off of Truman's question on California. Clearly, it remains a challenging market. But I think what a lot of folks are trying to get a grip on is, are you seeing any signs of stabilization in that market, or potentially even early signs of inflection?

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

A

Yes. California is better. We fully recognize the comp gets easier from the fourth quarter forward, because of the slow fall and winter we had in California last year. Even in the third quarter where contracts in California were down 36%, actually in Southern Cal, contracts were only down modestly. They were down much more significantly in Northern Cal. And that was primarily due to a difficult comp back to third quarter of 2018, when we had either new openings or communities in early stages that were still working through significant pent-up demand.

John Lovallo
Analyst, Bank of America Merrill Lynch

Q

That's helpful. Thank you, guys.

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

A

You're welcome.

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

A

Thanks, John.

Operator: Next question comes from Michael Rehaut from JPMorgan Securities. Please go ahead with your question.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Thanks. Good morning, everyone.

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

A

Good morning, Michael.

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

A

Good morning.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

First question I had was just on community count and how to think about that? Obviously, appreciating the fact that you're not giving fiscal 2020 guidance yet, but just looking at your lot count over the last few quarters, it's been, I would say, somewhat flattish sequentially, going back to like the second half of 2018, maybe up a touch. Would that – I guess you said that, for the fourth quarter, you expect community count to be up a little bit sequentially, would that more flattish recent trajectory of your overall lot count result in more of a modest community count growth as we look into 2020? Or would you, in contrast, be looking to, potentially try and just increase the velocity of what you have? And we might still be able to expect a mid to high single digits type of year-over-year growth?

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

A

Michael, so, yes, we do expect modest community count growth in Q4. We will give guidance on the next call about the community count for 2020. All I'll tell you is we anticipate community count growth in 2020.

Michael Rehaut
Analyst, JPMorgan Securities LLC
Q

Okay. Appreciate that, Doug. I guess, secondly, you talked about incentives coming down slightly in the third quarter on orders. And fourth quarter increasing prices modestly in over half of your communities. Love to get a little bit more color around perhaps just geographically, which markets might have stood out, where those trends were a little more pronounced.

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

Sure. So, the strongest communities from a pricing perspective, which again would be I call that a combination of reducing incentives and increasing prices for Boise, Idaho; the State of New Jersey; the State of Florida; Seattle; Northern Virginia; Phoenix; Denver; Pennsylvania; and Orlando, Florida, those would be the top markets.

Michael Rehaut
Analyst, JPMorgan Securities LLC
Q

By contrast, what would be the softer markets?

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

We continue to struggle a bit in the Midwest with pricing power in Chicago and Detroit, and we continue to struggle a bit in Florida East, which for us is just north of Miami up to Jupiter.

Michael Rehaut
Analyst, JPMorgan Securities LLC
Q

Thanks so much.

Operator: Our next question comes from Ivy Zelman from Zelman & Associates. Please go ahead with your question.

Ivy Lynne Zelman
Analyst, Zelman & Associates
Q

Thanks. Good results, guys. You've done a great job at improving your ROE at now 14.6%. And one of the things that the market's laser-focused in on are those returns continuing to see an upward trajectory. But you guys have roughly six to seven years supply of land and continue to, as you pointed out, Doug, accelerate land spend and whether you're allocating land spend – or your capital to land spend. Do you think that you should be pulling back on the total land on the books both owned and optioned? Just more concerned that we are at a record level of growth for this recovery, economic recovery. So, just your thoughts there. And then, I have a second follow-up. Thank you.

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

Sure. So, Ivy, yes, we're very focused on being capital efficient in our land spend. I think as Marty mentioned in the prepared comments, we – our capital allocation strategy is now included a significant buyback program, regular dividend and keeping leverage low and conservative. We are opportunistic in land as we always talk about. We are being selective and we are much more focused on optioned land than owned land, because the optioned land is obviously the much more capital-efficient land to buy. So, we are focused on moving that ratio of owned to optioned more in favor of optioned. And you will see more and more of that. I think that's a full answer I can give right now.

We're certainly not reducing the land buy, but we are again much more focused on the capital efficient buys, which also includes, as I mentioned, buying finished lots that are ready to go. And that's why a third of what we spent this past quarter was on finished lots that are ready to be built on, because that does drive ROE, and it avoids, as you called it, that long six or seven-year land owned/controlled numbers. So, we're on it.

Ivy Lynne Zelman
Analyst, Zelman & Associates
Q

Got it. Thank you for that. You also have done a great job strategically positioning yourselves in the rental market, which every part of the housing equation, rental or for-sale, where we have shortages of shelter today. And going into BB Living, can you help us a little bit more about BB Living in terms of obviously strong pipeline? But talk to us a little bit about what the homes will look like in terms of comparing it to Toll product and the economics of that business and what should we expect in terms of returns on that business or any economics you're willing to share metrics, please?

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

Sure. So, BB Living is a joint venture between a Wall Street private equity, which has the largest part of the investment, Toll Brothers and BB Living, which is an existing company that is in the space. They started in Phoenix and they will now expand primarily into markets that we are in, because we have the land teams, the entitlement teams, the land development teams, the brand. We're not putting our name on it, but the brand brings contractors and brings attention. And so, we're really excited by the business.

It is primarily focused on taking sections of master planned communities or master developers now recognized that they're going to have houses at $1 million, houses at $600,000, houses at $400,000, maybe houses at $200,000, and then nice homes or town-homes that can be rented that look the same as the homes that are being built in the community by the for-sale builders. More and more renters are families that want to live and raise their families in a home with a swing set in the backyard and the bus picking their kids up at the corner, and being able to take advantage of the master planned amenities, the pool, the clubhouse, the tennis courts, et cetera. So we really like doing it this way, where we're part of master planned communities and we're getting great reception from the master planned developers. Some of those are in communities where Toll builds.

And as for the economics, Marty?

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

Sure. So, our planned investment in this venture is approximately $60 million. That investment will be deployed over roughly 36 months. It will be harvested back, hopefully, at a 3 times equity multiple over the subsequent 36 months, and all of our overhead associated with our role in this business will be absorbed by the joint venture.

Ivy Lynne Zelman
Analyst, Zelman & Associates
Q

Got it. Pushback that people have out there that I'd love your comments on, Doug, you just said, homeowners don't want renters in their community, and there is going to be a backlash, how do you rebut that?

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

A

You need to see it to understand it. It's professionally managed. The renters or families who are going to probably one day become homeowners, maybe even in the same community because they like it. And I think there is enough precedent and history out there to show that that's not happening. And based on the master developers, who are big and sophisticated and have certainly done their research, they are embracing the opportunity to sell sections of their community to BB Living. And I don't think they would be so shortsighted excited as to take a few bucks on one section to compromise of everything else they're developing.

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

A

These residents have a pride of ownership. They're putting pumpkins on front of their houses in the fall, putting Christmas lights up in December. They do take pride in where they are living.

Ivy Lynne Zelman
Analyst, Zelman & Associates

Q

Oh, good luck. It's exciting. Thank you.

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

A

Thank you, Ivy.

Operator: Our next question comes from Ken Zener from KeyBanc. Please go ahead with your question. Yeah. Mr. Zener has disconnected. Our next question comes from Mike Dahl from RBC Capital Markets. Please go ahead with your question.

Michael Dahl
Analyst, RBC Capital Markets LLC

Q

Good morning. Thanks for taking my questions.

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

A

Hi, Mike.

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

A

Hi, Mike.

Michael Dahl
Analyst, RBC Capital Markets LLC

Q

Hi. Doug, I wanted to follow up on some of the commentary you provided around some of the geographic dynamics on pricing, and ask it on contracts, but specifically the West was extremely strong off of what was still a difficult comp. And so, wanted to dig in a little bit, and get a sense for which specific markets we're really driving that strength? Or was it really broad-based across that segment?

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

A

Yeah, Mike, the two primary drivers of the 23% up in units in the West were Boise and Denver.

Michael Dahl
Analyst, RBC Capital Markets LLC

Q

Got it. Okay. Thanks. And the second question I had was just, could you give us an update on where you stand with Metro Crossing? What's in backlog? And I think last quarter you talked about some of the push-outs on some of those units, just an update on next couple of quarter deliveries, rom Metro Crossing? And how that may influence margins as well, if you could?

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

A

Metro Crossing is now moving forward according to plan, as we mentioned on the last call. With the historic rains in Northern California over the last six or eight months, there were some construction delays. We are now scheduled to begin closing units at Metro Crossing in the fourth quarter. And they will – because of the size of the backlog, that will continue into 2020.

Michael Dahl
Analyst, RBC Capital Markets LLC

Q

Okay. And do you – could you provide the updated backlog for that project?

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

A

We'll have to get back to you with that, Mike.

Michael Dahl
Analyst, RBC Capital Markets LLC

Q

Okay, got it. Thank you.

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

A

You're welcome.

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

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Hi. Thank you for taking my questions. Just back on California, I think, just year-to-date gross margins, I think, it's still been running kind of several hundred basis points ahead of rest of the traditional home building. How does that differential look in your backlog today, just given the demand trends we've seen there in these past few months? And kind of any sense you can provide beyond the fourth quarter on that margin differential would be helpful as well. Thank you.

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

Sure. So, the California margins continue to be in excess of company averages, and not dissimilar from what we reported in the past.

Matthew Bouley
Analyst, Barclays Capital, Inc.
Q

Okay. Perfect. And then, Doug, when you said that you've increased prices modestly in light of the strong start to the fourth quarter, just wanted to understand the timing there. Is that a comment specifically around the first three weeks of August? Or have we – can we see any of those price increases already in the order ASPs from Q3? And really just on a net basis, would you say that you have increased your prices, net of some of what you talked about with some of the softer markets? Thank you.

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

It is the three weeks of August. So no, you would not see it in the Q3 orders and it is pretty much nationwide.

Matthew Bouley
Analyst, Barclays Capital, Inc.
Q

Okay. Perfect. Thank you.

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

You're welcome.

Operator: Our next question comes from Jack Micenko with SIG. Please go ahead with your question.

Jack Micenko
Analyst, Susquehanna International Group, LLP
Q

Hi. Good morning. Circling up on the incentive and pricing power question a little more, is there any product type or price point range – you talked about regions, but what about product segmentation? Any – may be performing better or worse around the incentive and pricing discussion?

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

No. It's pretty much across the board.

Jack Micenko
Analyst, Susquehanna International Group, LLP
Q

Okay. And then, sales paces come in two quarters in a row double-digits. And I know, I think, for you guys, it's more of an output than an input, but just thinking big picture wise, as you mix two lower price points, does that change your thinking? Or does that change the way we should think about the sales pace and thinking about modeling the company going forward?

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

I apologize. I do not understand the question.

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

I think the question is – go ahead.

Jack Micenko
Analyst, Susquehanna International Group, LLP
Q

Generally speaking, you're going to sell more $500,000 homes and $3 million homes. And does that – is that mix that you're sort of transitioning towards changes the sales pace outlook from where you said?

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

No. I think it is fair to say that in the mid-$4 millions, we're generally going to sell more homes than we're going to sell in the mid-$2 millions. We have the one example we given a very successful community in Phoenix that is now up to 71 is it, Gregg?

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

It is.

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

70 – hey, there you go. 71 sales, since we opened about 10 months ago with the average price in the high $300,000s. So I think it's – as I say, it's fair to say as you go down in price, the buyer pool is bigger. There is more people that can afford a $400,000 house than can afford a $2.5 million house. So the more traffic means, the more deposits, which means the more agreements, then we of course underwrite those communities to have a higher pace as they should. So I think as price does come down a bit, the sales per community should naturally go up a bit.

Jack Micenko
Analyst, Susquehanna International Group, LLP
Q

All right. Perfect. Thanks.

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

You're welcome.

Operator: Our next question comes from Jade Rahmani from KBW. Please go ahead with your question.

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

Q

Thanks very much. Can you tell us what percentage of deliveries this quarter were from spec sales or quick delivery homes? And how that compared with last quarter and perhaps a year ago?

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

A

One moment please as Mr. Ziegler gives us that answer.

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

A

Go ahead and answer, Gregg.

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

A

Yeah. Gregg, please answer.

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

A

Sure. So, this quarter, our spec settlements as a percent of total was on high-teens, call it, around 18%. And I think you asked a year ago, a year ago it was mid-teens, call it, 13%, 14%.

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

Q

Okay. Thanks very much. I was also wondering if you could provide any color on the New York City condo market, just an overall update? And also, if you could inclusive of that touch on Toll's recent acquisition of the Marrakech Hotel site, looked like maybe an off market or stressed acquisition. Wondering if you're seeing any interesting opportunities there.

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

A

Sure. So, we can't comment on the specific land deal you mentioned, I'm sorry. I'd love to talk about deals, but that one I cannot. New York has felt better this summer. We don't have as much open, of course, as we talked about, we haven't been buying ground in New York for the last four or five years. It's only 3% of our business at the moment, but it feels better this summer.

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

Q

Okay. Thanks very much.

Operator: Our next question comes from Megan McGrath from Buckingham Research. Please go ahead with your question.

Megan McGrath
Analyst, The Buckingham Research Group, Inc.

Q

Hi. Good morning. Just a couple of quick follow-ups. Sorry, if I missed this. But could you give the actual incentives per home this quarter? I think it was $34,000 last quarter.

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

A

Megan, I think our preference because of all the moving parts associated with that kind of dollar figure is to give you a percentage. It was 4% a quarter ago. It's down to 3.8% now.

Megan McGrath
Analyst, The Buckingham Research Group, Inc.

Q

Okay. Great. And to follow up on that in terms of the gross margin, thinking about both next quarter – and I know you're not giving guidance for next year, but how much of next quarter's implied sequential decline? You talked about the mix issue, but how much of that is the higher incentives starting to roll through 4Q compared to 3Q? And should we think about the build cycle? I think these numbers were on orders. So, like a nine-month build cycle, as we think about how these headwinds might roll through on their own over the next couple of quarters?

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

A

I think we've talked about some of the timing differences involved in the gross margin guidance as set today versus set 90 days prior. We're very comfortable with the margin guidance we've given. Certainly, the incentive growth that has happened during the challenged sales period is starting to see its way into the margin. And we're going to leave it at that.

Megan McGrath
Analyst, The Buckingham Research Group, Inc.

Q

Okay. And then, quickly, there was an article this morning in the Journal on [indiscernible] (42:35) I think they were calling it unconventional loans non-QM. Maybe you could take this opportunity to comment on any financial statistics or the health of your particular buyers?

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

A

We really haven't seen much change in the buyer profile, still around 20% to 21% cash, still around 67% LTV, and not much change between the conventional and jumbo mix. Our FICO scores are right on where they were three months ago at 762.

Megan McGrath
Analyst, The Buckingham Research Group, Inc.

Q

Okay. Great. Thanks very much.

Operator: Our next question comes from Jay McCanless from Wedbush Securities. Please go ahead with your question.

Jay McCanless
Analyst, Wedbush Securities, Inc.

Q

Hey. Good morning. Marty, could you give us what the incentive percentage was in 3Q 2018?

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

A

It was approximately 3%.

Jay McCanless
Analyst, Wedbush Securities, Inc.

Q

And then, wanted to ask Jack's question may be a different way. If you guys are talking about going to a lower price point, trying to buy more land under or lots under $500,000, and then, also talking about a third of your lots being finished lots which theoretically should generate higher sales pace, why wouldn't your monthly orders per community or your monthly sales absorption, why wouldn't that move up over time? Or did I misunderstand your answer, Doug?

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

A

Oh, no. I think, it will.

Jay McCanless
Analyst, Wedbush Securities, Inc.

Q

I mean over...

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

A

Yeah. I think as I said, we underwrite and expect and have seen higher sales paces at lower price points. We got more buyers. And as we continue to diversify and expand our offerings across multiple buyer segments and price points and demographics, you should see a higher velocity, because of that.

Jay McCanless
Analyst, Wedbush Securities, Inc.

Q

Do you think Toll does that – are you guys are at the point now where you can start to inflect over the next year? Or is it still shifting the mix, going to take a couple of more years before we see that type of inflection in the sales pace?

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

A

I think it will take not sure a couple of years, but it will take time. We are carefully and slowly expanding the price point. So, we've been talking about what you call, T Select or Toll Lite, or the 3 Series BMW, as these millennials hit their mid-30s and become homebuyers, because they're 10 years older than their parents who bought in their mid-20s, many of them are wealthier and be able to afford a little bit more expensive starter home, that's the group we're focused on. We're not focused on going down and grabbing the $180,000 home buyer. We're focused on going after the modestly more affluent, first-time homebuyer. That's a little bit older, which is what these demographics are supporting. It's still luxury. It's still different. We're committed to our brand and focused on it.

And we are carefully going down in price, making sure it all fits within the way we operate with our brand, the homes we deliver, the service we provide. And so, the answer to that long story is it will take a little bit more than a couple of months or even a couple of quarters for you to see that difference.

Jay McCanless
Analyst, Wedbush Securities, Inc.

Q

Okay. Thank you very much.

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

A

You're welcome.

Operator: Our next question comes from Alex Barrón from Housing Research Center. Please go ahead with your question.

Alex Barrón
Analyst, Housing Research Center LLC

Q

Yeah. Thanks, guys. I wanted to see if you could expand a little bit more on BB Living? In terms of what are some of the – I mean have you guys put on a few more deals since you launched this? Have you expanded to other states beyond Arizona at this point? And is this $60 million just an initial commitment? Or is this pretty much the extent of the commitment that you see? Or is that going to depend on how this opportunity evolves?

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

A

I think any subsequent commitment will certainly depend on how this opportunity evolves. The venture at this point has acquired a parcel. It has a pipeline that I would consider encouraging. The markets that we are evaluating are Arizona, Boise, Denver and some Texas markets as well as Florida. And we're encouraged by the opportunities we're seeing, the way the venture is working together and the receptivity from the master planned community developers to including the rental product.

Alex Barrón
Analyst, Housing Research Center LLC

Q

Okay. Great. And then in terms of the numbers you'll be reporting and the way this deal is working out, is that all going to be like off-balance sheet like in the joint venture? Are you guys owning this land on your balance sheet? Are you reporting any – are you going to be reporting any like units? Can you just give us a sense of how we can track the progress of BB Living?

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

A

This will be in our investment in unconsolidated ventures line items. We will not include any deliveries or lots in our Toll Brothers' deliveries or lots data. This is roughly a $400 million piece of equity that the three parties have agreed to contribute. We're $60 million of that. It will have some element of leverage that is still being developed, but you will only see this as an off balance sheet joint venture as currently structured.

Alex Barrón
Analyst, Housing Research Center LLC

Q

Okay. Got it. Thanks a lot.

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

A

Thank you.

Operator: And our next question comes from Ken Zener from KeyBanc. Please go ahead with your question.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

Hello, gentlemen.

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

A

Hi, Ken.

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

A

Hello, again.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

Doug, obviously, there's a lot of talk around price points. Let me ask you this, just to make it a bit more quantifiable. The backlog price, which is down about 6% – average sales price is down about 6% year-over-year. Obviously, backlog price [ph] versus closed exits (50:15) tends to be higher because of the higher price units stuck there. But isn't – what's wrong with the logic to assume that is the forward price trend you will see as we move into FY 2020 somewhere in that magnitude?

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

A

Ken, that is mix primarily driven by less California.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

But wouldn't that still apply to what your ASPs will be trending towards?

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

A

Yes.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

And then – thank you. Now, by the way, Doug, the BMW 3 Series peaked in that 2015 in the U.S., but the California stuff, meaning the...

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

A

I never liked that one.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

Oh, sorry, I just wanted to give you that update. The order rates that we've seen, I mean, clearly California – the CAAR has given data today. Orange County, where you guys drive a lot of profits, I mean the existing sale side is kind of flattening out. The declines are over, the inventory increases are over, places like River Side are doing better and the Bay Area is okay. But what you're seeing in terms of the lower orders, how can – is there a way that you could express to investors that that's not going to result in margin compression next year as today's orders flow through? I mean what would be the logic that would keep one from coming to that conclusion? Thank you.

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

A

We will discuss 2020 in three months. As I mentioned earlier, very little of the California order decline in Q3 came out of SoCal. It was much more out of Northern Cal, where we had a very tough comp.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

Right.

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

A

We're doing well in our locations, in Orange County. We're doing well in LA County. We have a very large new community that will be coming online next year in LA County. So, no, I would not jump to the conclusion you are jumping to about next year. And the Western region, of course, we break out California because of its size, but the West is seeing significant growth and very strong gross margins.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

Thank you very much.

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

A

Thank you. You're welcome.

Operator: And ladies and gentlemen, with that, we'll conclude today's question-and-answer session. I'd like to turn the conference call back over to management for any closing remarks.

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

Jamie, thank you very much. Thanks, everyone, for your interest and support, and enjoy what little bit we have of the summer. Thank you.

Operator: Ladies and gentlemen, the conference has now concluded. We do thank you for attending today's presentation. You may now disconnect your lines.