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Toll Brothers, Inc. (TOL)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Toll Brothers Fourth Quarter and Fiscal Year-End Conference Call. All participants will be in listen-only mode. [Operator Instructions] Please note today's event is being recorded. I would now like to turn the conference over to Doug Yearley, Chairman and CEO. Please go ahead sir.

Douglas C. Yearley

Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

Thank you, Rocco. Welcome, and thank you for joining us. With me today are Bob Toll, Chairman Emeritus; Marty Connor, Chief Financial Officer; Rob Parahus and Jim Boyd, our new Co-Chief Operating officers, overseeing Toll East and Toll West, respectively; Fred Cooper, Senior VP of Finance and Investor Relations; Wendy Marlett, Chief Marketing Officer; and Gregg Ziegler, Senior VP and Treasurer.

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

Fiscal 2019 ended on a strong note building on a steady improvement in buyer demand throughout the year. Our fourth quarter contracts were up 18% in units and 12% in dollars and our contracts per community were up 10% compared to one year ago. Through the first six weeks of fiscal year 2020's first quarter, we have seen even stronger demand than the order growth in fiscal year 2019's fourth quarter. This improving demand should positively impact gross margins over the course of fiscal 2020.

We reported fourth quarter home sales revenues of $2.3 billion with a 21.9% adjusted gross margin and net income of $202.3 million or $1.41 per share diluted. Our fiscal year-end backlog was $5.26 billion and 6,266 units which was down 5% in dollars but up 3% in units from last year. We are positioning ourselves for growth as we expand our luxury brand to new price points, product lines and geographies. Our land position supports this strategy and, we believe, provides the platform for continued growth in coming years.

We now operate in 23 states and the District of Columbia. This year we expanded our footprint into 4 new states and 7 new markets. We acquired Sharp Residential in our Metro Atlanta and Sabal Homes in our Charleston, Greenville and Myrtle Beach, South Carolina. Both companies offer a wide range of price points to their customers. We also opened our first communities in Salt Lake City, Utah, and Portland, Oregon and we have land under contract in Tampa Florida.

We remain committed to our luxury niche. We will always be America's luxury homebuilder. We will continue to buy land and build communities at the corner of Main Street and Main Street and allow our customers to and our buyers to customize their homes through our unique design studio experience. This market is strong and demographics suggest it will grow over the next decade as millennials mature.

We're also strategically focusing on more affordable luxury communities. One-third of our current communities offer a home with a base price of $500,000 or less. We believe we receive a premium for these homes because of our brand. This will position us for faster growth as we expand our product lines, price points and geographies.

While affordable luxury crosses all buyer segments including move-up and active-adult, this initiative is driven in large part by a growing number of millennials who are older, more affluent and more discerning when they buy their first home. Think of it as a BMW 3 Series, a great example of affordable luxury. In fact in fiscal year 2019 over 20% of our closings had one purchaser 35 years old or under. This strategy builds on our strong brand reputation and complements our focus on capital efficiency as lower-priced, faster-paced communities tend to turn capital quicker.

Our multifamily group which develops upscale rental apartments and student housing in both suburban and urban locations across the country continues to show impressive growth. Toll Brothers Apartment Living was named number 14 largest and number one fastest growing apartment developer in the country in 2019 by the National Multifamily Housing Council. We have a nationwide pipeline of over 20,000 units in various stages of development or operation nearly all of which we undertake in joint ventures. Some of these projects will be held long term and others will be sold upon completion.

Most recently, we entered the purpose-built single-family rental market in partnership with an experienced operator and a major financial institution which we believe has great potential. As we enter our fiscal year 2020, the economy remains very supportive of housing. October housing starts were at their highest levels since July of 2007 while the month's supply of homes in the market remains constrained. Consumer confidence is healthy, household formations are strong and interest rates and unemployment remain low.

With this positive environment as a backdrop, we're encouraged by the start of fiscal 2020. We're projecting 10% community count growth over the course of year. With this growth, our well established brand, our great land positions, our broadening geographic footprint and our increasingly diverse product lines and price points, we believe we are well positioned as we enter this new decade.

Now let me turn it over to Marty.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

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

Q4 home sales gross margin was 18.8% of home sales revenue. Adjusted home sales gross margin which excludes interest and inventory write-downs was 21.9% of home sales revenue. These numbers are consistent with our guidance at third quarter end and are reflective of the challenged sales environment a year or so ago when we sold most of these just-delivered homes. SG&A as a percentage of home sales revenues was 9%. Income from operations was 9.5% of total revenues. Other income, income from unconsolidated entities and land sales gross profit was $48.4 million.

Our balance sheet remains strong. We ended fiscal year 2019 with $1.3 billion in cash and cash equivalents and had $1.7 billion available under our bank revolving credit facility. Benefiting from our strong reputation in the capital markets and favorable market conditions in fiscal year 2019's fourth quarter, we increased our bank revolving credit facility from $1.3 billion to $1.9 billion and extended the facilities maturity to five years, along with that of our $800 million bank term loan facility.

During our fourth quarter, we also raised $400 million of 10-year 3.8% debt in the public capital markets, a portion of which we later used to retire $250 million of more expensive maturing public debt. As we begin fiscal 2020, we have over $3 billion of liquidity through cash and undrawn bank credit facilities with no public or bank debt maturities in the next 24 months. Our weighted average debt maturity is 5.8 years. We have increased our focus on capital efficiency in our land acquisition process. By broadening our geographic footprint, price points and product types, we intend to also improve efficiency through quicker inventory turns and lower upfront land cost.

We continue to execute on other capital efficiency initiatives as well. In fiscal year 2019, we repurchased approximately 6.6 million shares of common stock at an average price of $35.28 for a total purchase price of approximately $233.5 million. In our fourth quarter, we purchased 1.85 million shares at $35.66 per share for approximately $66 million total. Fiscal year-end 2019 stockholder equity was $5.07 billion compared to $4.76 billion at fiscal year-end 2018. And our fiscal year 2019 book value per share was $35.99 compared to $32.57 at fiscal year-end 2018. We ended fiscal year 2019 with a net debt-to-capital ratio of 32.9%.

Looking forward, we are projecting first quarter deliveries of between 1,650 and 1,850 units, with an average price of between $800,000, and $820,000. The drop in average price from $863,000 a year ago is strategic and reflects changes in mix as we execute on our geographic and product diversification strategy. It also reflects our increased focus on the affordable luxury segment and a reduction in the number and mix of homes being delivered in California to more lower priced and attached homes.

We project first quarter adjusted home sales gross margin of approximately 21.25% of home sales revenues. This first quarter gross margin should be the lowest of the fiscal year as most Q1 2020 deliveries were from contracts signed in the first half of fiscal 2019, which was our slowest period. Sales were down 21% in the first half of 2019 compared to 2018 and that challenged selling environment impacts gross margins in Q4 of 2019 and Q1 of 2020.

As the latter half of 2019 and the beginning of this year have seen a progressive improvement in market conditions, we have been able to increase sales pace and, in many cases, increase price. And over the same period, building cost increases have slowed. For these reasons, we anticipate that our gross margin will increase modestly quarter by quarter as fiscal 2020 progresses. With the stronger demand, particularly over the last quarter and a half, we want to carefully evaluate and understand how it impacts full fiscal 2020 results before providing full-year unit deliveries, revenue and adjusted gross margin guidance.

We project first quarter SG&A as a percentage of home sales revenues of approximately 13.5%. This includes approximately $10 million of G&A expense related to stock compensation that is not expected to occur in the subsequent quarters in fiscal 2020. With our projected 10% growth in community count, which involves investment in personnel and in other cost in advance of revenue generation, we would expect SG&A as a percentage of revenues to be modestly higher this fiscal year. Essentially, as we open new communities, we will incur some costs in advance of the revenue, but we believe this investment is appropriate and the resulting home sales revenue will provide SG&A leverage in future years.

First quarter other income, income from unconsolidated entities and land sales gross profit is expected to be approximately $15 million. We reiterate our expectation that we will generate $100 million to $150 million of such income annually and expect the same in fiscal 2020. We expect that the majority of this income will be realized in the last two quarters of the year. We project the first quarter and full-year tax rate of approximately 26.5% and Q1 fiscal year 2020 weighted average shares outstanding of 142.5 million shares.

Now, let me turn it back to Doug.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

Thank you, Marty. For the fifth consecutive year we were named World's Most Admired homebuilder by Fortune Magazine. This honor is a tribute to all of our Toll Brothers colleagues. We thank them for their tremendous hard work.

Now let's open it up for questions. Rocco, we're ready.

QUESTION AND ANSWER SECTION

Operator: Yes, sir. We'll now begin the question-and-answer session. [Operator Instructions] And today's first question comes from Ivy Zelman of Zelman & Associates. Please go ahead.

Ivy Lynne Zelman
Analyst, Zelman & Associates

Q

Thank you, Rocco. Good morning and congrats on a solid quarter, guys, in an environment that's definitely looking a lot more positive than where we were a year ago. So, it's nice to hear good news. Maybe we could just dig in a little bit on where we've seen weakness and have started to see the reacceleration of demand, a little bit more color around California, your orders were still down double digits and is that community count or absorption? A lot of concern, Doug, around SALT. And obviously you commented that you do have pricing power in community. So, just maybe first question just drilling in on California for us please.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Sure. So, just to give a bit of an update, Southern Cal was pretty flat to last year, Ivy, and it's running at about the company average for sales. And for the first six weeks, so call it half of this quarter, the quarter that we're now sitting in, we're encouraged that deposits [ph] are up (00:17:02), call it, low-double digits in SoCal.

Northern Cal was down year-over-year and that was primarily driven by a number of cancellations that we had that came through in Q4 from a large community outside of San Francisco called Metro Crossing and those cancellations occurred because of weather that led to construction delays. This is a significant multi-condo town home community that had construction cycle time of 14 to 20 months that then with weather extended even as long as two years and we had about 250 or more homes in backlog.

And because of the weather delays we lost some of those contracts. Thankfully, many of those were lost earlier and the prices are actually up, but that issue was what led to a bit of a distorted drop in the California numbers because those cans came through pretty much in one quarter as the buildings are now delivering and they threw the numbers off a bit.

Overall, we're encouraged by what we see in California. It feels a lot better. Our mix is a bit different as we mentioned where the price is down a bit. But I think, for sure, California feels better than a year ago, even six months ago, so I hope that helps with a bit of an understanding of where we are in California.

Other top markets [indiscernible] (00:19:09)

Ivy Lynne Zelman
Analyst, Zelman & Associates

Q

Okay, go ahead, sir.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

More recently, I'd say Boise is doing really well, Northern Virginia, Denver, Orlando, New Jersey, Massachusetts, New York City living feels better, Las Vegas, Reno, those sort of round out, I'm not sure I gave you 10 but I gave you about 10, so they would be on top of the list.

Ivy Lynne Zelman
Analyst, Zelman & Associates

Q

Well, thank you for the detail and just to have my follow-up and let others drill in on California if they'd like in more detail, but that was really helpful, I got what I needed. You guided for 10% community count growth over the next year which is stronger than even we were anticipating and it's just great to see the growth coming. Can you talk about the mix of how that business evolves in terms these communities opening in terms of like smaller square footage? I think you guys have done an excellent job of keeping luxury but providing a smaller square footage. So, just trying to understand like what should we be thinking about absorption versus actual community count and how that breaks down by price point a little bit.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Sure. So, we expect to open 156, that's a very specific number, new communities this year. That obviously moves up and down with approvals and with new land we acquire, but obviously that's a huge number. There is many that are selling out, so obviously that's not the net number but that's a lot of activity and that also helps explain Marty's commentary on SG&A and how that can get out ahead of revenue coming in.

In terms of locations, the top locations for those 156 new openings are Arizona, which for us is Phoenix, Philadelphia, Denver, Jacksonville, Seattle. Now there's many others that could hit the list but I'm just giving you the top five.

Price point, it will continue to get wider and wider. We are fully committed to Main Street and Main Street selling luxury first, second move-up with the opportunity to truly customize your home and that is a major part of the Toll Brothers' business. However, there is more and more 3 Series BMW affordable luxury focused on the little bit older, more affluent millennial plus some move-ups and frankly some move-downs that aren't going to reach quite as high as the typical Toll house but is still chasing affordable luxury.

So, I think what you'll see is a modestly higher percentage of lower-priced communities that will have higher sales velocity because of their lower price and faster turns with less customization and smaller homes we can build them more efficiently and faster. And so, that will get mixed in, but it is incremental. We've been at this now for a couple of years. It is accelerating but it is really just supplementing the core business of the traditional luxury move up.

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

A

Another point to make on our...

Ivy Lynne Zelman
Analyst, Zelman & Associates

Q

Sounds great, Doug.

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

A

Another point, Ivy...

Ivy Lynne Zelman
Analyst, Zelman & Associates

Q

I was just going to say, Marty...

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

A

...community count is – that is going to happen over the course of the year. I think in other of these calls we've stated it as back-ended. This is a bit steadier over the course of the year.

Ivy Lynne Zelman
Analyst, Zelman & Associates

Q

Great. And just making sure I understand that sounds awesome just with respect to absorption growth, when you're looking at existing business, are you comfortable saying that you can grow same-store on top of the community count at this time based on what you guys see today?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Based on what we see today with our commentary on how the first six weeks of Q1 are even better than the sales growth we saw in Q4, yes, but we don't have that crystal ball as to how the balance of the year plays out. But right now the macroeconomic environment is encouraging, our land positioning is very encouraging, our geographic growth is exciting, our price points and product line diversity is strategic and exciting. So, right now we feel very good about the business.

Ivy Lynne Zelman
Analyst, Zelman & Associates

Q

Awesome. And a special shout to my buddy, Bob. Happy Holidays. Great to have you on the call.

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

A

Thank you, Ivy. Happy Holidays to everybody.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Thanks, Ivy.

Operator: And our next question today comes from John Lovallo of Bank of America Merrill Lynch. Please go ahead.

John Lovallo
Analyst, Bank of America Merrill Lynch

Q

Hey, guys. Thank you for taking my questions. The first one is on gross margin, understanding that you did say that it's going to improve throughout the year and you don't want to give a full year look, but is it unreasonable to assume that as we trend through the year that we could exit the fourth quarter at somewhere closer to that 23.5% or 24%?

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

A

John, I don't think we're going to get into any particular numbers but that one feels a bit aggressive.

John Lovallo
Analyst, Bank of America Merrill Lynch

Q

Okay, understood. And then just looking at the West and the South which we know obviously performances were very good from an order standpoint. Can you just help us understand some of the drivers there, maybe some of the key markets that help support that growth?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Sure. So, on the South where sales were up 49% that was primarily driven by Orlando, Jacksonville, Raleigh, and of course the acquisitions of Sharp in Atlanta and Sabal in three markets in South Carolina. And in the West which was up 46% in units that was driven by Boise and Denver and then number 3 would be Phoenix, and remember we entered Salt Lake City and Portland which also contributed.

John Lovallo
Analyst, Bank of America Merrill Lynch

Q

Okay. That's helpful. If I could squeeze one quick one in here, on the land sales, the $87 million. It seems like you came at a fairly low margin, can you just give any color on that?

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

A

Yeah. I think you'll see that in our income statement in the future. It really relates to finding joint venture partners for our apartment. So, we will often buy the apartment land a few months before we find a partner and the accounting rules are that we reflect that as land sales revenue and land sales cost when we sell it. Sometimes we sell it for a gain but oftentimes we'll sell it at our cost into the joint venture and that's what happened in that quarter.

John Lovallo
Analyst, Bank of America Merrill Lynch

Q

Got it. Thank you, guys.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

You're welcome.

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

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Hi. Thanks for taking my questions and for the helpful information so far. Marty, just a quick clarification on the community count growth comment, you said it'll be a bit steadier. Is that in terms of the year-on-year growth rate steady each quarter around the 10% or a steady sequential build in the number of communities throughout the course of the year?

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

A

The 10% will happen evenly over the course of the year.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Okay, thanks for that. And second question just on Metro Crossing, I guess now that the project is starting to deliver on some of these buildings, guess a little surprised to see cancellations come through, understanding that there has been significant delays but it is still a supply constrained market and that's a pretty prime location.

So, pricings I would imagine up over the course of the life of the community so far as you've been selling. What have you heard as far as the rationale for the cancellations at this stage in the game, and then are you finding success maybe in these first six weeks of the first quarter at reselling some of the canceled units, any additional color you could provide there would be great.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Sure. So, Metro Crossing is in Fremont. It's right next to the Tesla plant. It's at a new BART Station. It is a spectacular location and we're building 800 plus or minus condos and town homes in what feels like a village with multiple product lines within that high density community. And when we open for sale we're incredibly hot and we quoted 18 months delivery and because of significant weather delays that occurred in Northern Cal, that I think we're all familiar with from last year, those buildings took 24 months to deliver, we lost six months.

There were a number of buyers where their lifestyle changed, where they needed to move, where they wanted to move within the timeframe that we quoted and they ask to get out. It is a small percentage of the 250-plus in backlog that we had right around 10%. And we have backfilled many of those with new sales, in some cases at higher prices because the community has seen significant price increases over those 24 months, so that's the extent of it. And thankfully that market is still very strong, we are now delivering and prices are up.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Okay, that's helpful. And yeah, just seems like then the distortion is really just because it's low volume selling period and 25 or so cancellations actually makes a difference. Thanks.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

You're welcome.

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

Christina Chiu
Analyst, Barclays Capital, Inc.
Q

Hi. This is actually Christina Chiu on for Matt today. My first question is regarding the first quarter gross margin guidance and commentary that 1Q margins would be the bottom for the year. Is this just attributed to a timing of deliveries from the first half or what's giving you confidence in margin improvement?

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

Chiu, it generally takes us 9 to 12 months to build a home, so the deliveries in the quarter we just had and the quarter that we're in are associated with sales that happened approximately a year ago and that was the most challenged sales environment that we have seen in quite a while and that results in a little lower price, maybe a little bit more incentive and thus lower margins.

Christina Chiu
Analyst, Barclays Capital, Inc.
Q

Got it. And then...

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

As the world has gotten better over the balance of 2019 and here into the first six weeks of 2020, we don't face those same market challenges and it gives us optimism on gross margin.

Christina Chiu
Analyst, Barclays Capital, Inc.
Q

Got it. And then on the California margin differential versus the remainder of your homebuilding business, how does the differential this quarter given the mix down in California that you mentioned earlier compared to what you've previously seen?

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

I think the California marketplace a year ago was hit a bit harder than many of the others and so the margin there is down a couple hundred points compared to where it has been in the past, but it is still higher than company average and as we outlined on the first question, we're encouraged by California.

Christina Chiu
Analyst, Barclays Capital, Inc.
Q

Got it. Thank you.

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

Susan Maklari
Analyst, Goldman Sachs

Q

Thank you. Good morning, everyone.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Good morning.

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

A

Good morning, Susan.

Susan Maklari
Analyst, Goldman Sachs

Q

My first question is just around the land strategy, can you talk to any changes that we should expect in there, especially as you do pursue this kind of shift to a wider ASP and a wider product range. Is there anything in terms of maybe optioning more lots or pursuing other means of kind of land acquisition that we should be aware of?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Sure, Susan. So, as we talked about in our opening comments, we're very focused on capital efficiency and with that comes how you structure a land buy trying to get optioned land over owned land with a land seller where you can have a purchase money mortgage and pay for land over time. On occasion, we've gone to third-parties to land bank land to increase the capital efficiency and you will continue to see more and more of that from us.

When we buy the expensive land at the corner of Main and Main, it is more difficult at times to do that. When we buy land for lower-priced luxury communities, affordable luxury that may be in master planned communities, for example, where there are developers that will feed you finished lots on an as needed basis, there is more opportunity to do that. Those lower-priced affordable luxury homes will also turn faster, we should have more sales because of the price point and of course that returns capital quicker and that also leads to more capital efficiency.

So, over time, you will see us with more diversity of land at more different price points which generally means more lower price points and those deal structured with more options and less owned. In the fourth quarter, 32% of the lots that we put under option had a proposed base price of homes under $500,000. So, I think that is fairly consistent with our strategy. That number has been like that for several quarters now and I just think it shows, as a supplement to our traditional Main and Main strategy, more and more affordable luxury that will be more capital efficient.

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

A

And that's a base price...

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Yeah.

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

...of $500,000. It doesn't include options or lot premiums et cetera.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

Correct, correct.

Susan Maklari
Analyst, Goldman Sachs
Q

Okay, great, that's very helpful. And then just as a follow-up, can you talk a little bit to what you've seen on the cost side of things in terms of labor and materials? It seems like lumber prices have come up a bit lately. How were you thinking about that heading into next year?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

We're encouraged in that cost in the fourth quarter for both labor and materials were flat and tariffs have not had an adverse impact.

Susan Maklari
Analyst, Goldman Sachs
Q

Okay, thank you.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

You're welcome.

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

Paul Przybylski
Analyst, Wells Fargo Securities LLC
Q

Yeah, actually, it's Paul Przybylski. First, I was wondering if you could give us any color on the active-adult demand in the quarter and if the impeachment proceedings were weighing on that buyer's sentiment?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

Active-adult in Q4 was steady. It's a very important part of our business and it's doing very well and it's expanding as we talked about. We're moving it into many new markets. We have a number of very exciting active-adult communities coming, one of which is in LA County; another very large one is in Phoenix. And no, I have not heard that the impeachment proceedings are weighing on that buyer. That's nothing that has gotten to me from anyone in the field and the sales results would not reflect any added concern...

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

For any buyer...

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

...from that demographic.

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

A

For any buyer segment.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Correct.

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

A

We haven't heard the impeachment proceedings till Paul just raised it.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

And if you look at the results we've been talking about for the last 4.5 months, those proceedings have been ongoing. They don't appear to have any adverse impact whatsoever.

Paul Przybylski
Analyst, Wells Fargo Securities LLC

Q

Okay. As you look to improving your inventory turns to improve your returns, is there anything you could do on the vertical capital side and increase the efficiency there to also aid that effort?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Paul, we're looking at that all the time. As you know, we have five panel and truss plants that very efficiently help us build houses in the Northeast, Mid-Atlantic and Midwest. There is no new technology or extraordinary innovation that we have yet found in the industry. We're very involved in tracking all of that and even investing in some of that innovation that's coming to homebuilding. But for us, it's to continue to refine our architecture and make it as efficient as possible to have a very robust purchasing group that works very hard at driving prices down, by having organized job sites where when contractors show up, the house is ready, they can get in and get out and make their money. And of course taking advantage of the balance sheet to make sure we pay religiously every other Friday, and we'll continue to build on those disciplines and hopefully drive cost down.

Paul Przybylski
Analyst, Wells Fargo Securities LLC

Q

Thank you. And one final real quick one, is there any purchase accounting in the 1Q gross margin guide?

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

A

Very modest, Paul.

Paul Przybylski
Analyst, Wells Fargo Securities LLC

Q

Okay thank you.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

You're welcome. Thank you.

Operator: And our next question today comes from Jade Rahmani of KBW. Please go ahead.

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

Q

Thanks very much. I think in your opening remarks you commented that City Living or perhaps that was in response to a question that City Living was seeing an uptick. I was wondering if you could comment on how you see things in the New York City condo market, some of the brokers have indicated sales seem to have picked up in November?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Yeah. So, we're active in Hoboken, Jersey City and Manhattan. We're under – beginning construction in Philadelphia for an exciting high-rise. We have a small mid-rise building in LA and we're about to begin a new high-rise in Downtown Seattle. So, right now, the revenue is coming out of New York and the Gold Coast of New Jersey. And as I remind you, we're not in the super luxury towers. We're focusing on plus or minus $2,000 per square foot in Manhattan and $1,000 per square foot on the Jersey side. That is relatively affordable in the New York City market and we like that niche and we have done pretty well.

As an example, we've a building at 77 Charlton, which is in, we call it, West Soho and that building at about $2,000 a foot, took 20 sales in the fourth quarter. And in the Hoboken, Jersey City side, we continue to sell well at $1,000 a foot. We had 14 sales in a building in Jersey City. We had 10 sales in a building in Hoboken during that fourth quarter. So, New York is not back to where it was four or five years ago, but it's better. And I very much like where we positioned ourselves at these price points and locations I've described.

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

Q

Thanks very much. Secondly, can you give the percentage of deliveries that came from quick delivery homes and how that may be compared with the year-ago period?

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

A

Sure can.

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

A

Gregg is looking that up for us.

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

A

Let's see, QDs in Q4 of 2019 it was approximately 15% and you asked about a year ago. Let's see, so Q4 of 2018, it was about 13.5%, so not much of a difference. That's pretty much in line with our long-term average as we look at this over time.

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

A

[indiscernible] (00:41:43)

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

Q

Thanks very much.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Thank you.

Operator: And our next question today comes from Stephen Kim of Evercore ISI. Please go ahead.

Trey Morrish
Analyst, Evercore ISI

Q

Hey guys, it's actually Trey Morrish on for Steve.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Hi, Trey.

Trey Morrish
Analyst, Evercore ISI

Q

So, the talk about the affordable luxury clearly is something that we greatly appreciate, moving down the price point, being more open and appealing to the more millennial buyer. But how big do you ultimately think this accented part of your business can get and how do you view the general margin profile on these types of homes relative to the traditional Toll homes?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

So, affordable luxury absolutely focuses primarily on the millennial and, of course, we've talked about there's 75 million millennials, which is the same size as the boomers. But we've also recognized now that we have a bunch of it out there, that we have move-up buyers, that are just looking for a bit more affordable luxury home and we have active-adults and empty-nesters that want to move down to a bit more affordable home.

So, when you put that all together, again driven primarily by the millennial, as I've mentioned, 37% I think I said a third in my prepared comments, but 37% of our communities have an opening price that's base price that's under $500,000. That's not all starter home and some of that again is affordable move-up and affordable move-down.

But I think that gives you some indication where we're approaching 40% of our communities have at least an opening price under $500,000.

Now, you add a lot premium and you add some finishes and some structural changes to the home and certainly that house could get to $600,000. But we have other communities that are opening at $375,000 as an opening price or $399,000 in places like Phoenix and Houston and Las Vegas and Jacksonville and Boise. So, I think it's probably fair to consider that number, 35%, 40% as accurate.

But understand we're not defining affordable luxury as a segment. Our segments are move-up, move-down, first time, in our case, it will be more luxury first time. So, we're not going to be delivering sort of an affordable luxury segment to you, but it's important that you all and I can tell you all get it that we're more and more focused on having a greater diversity of locations, price points and product lines.

Trey Morrish
Analyst, Evercore ISI

Q

Okay, and...

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

A

This comes...

Trey Morrish
Analyst, Evercore ISI

Q

Go ahead.

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

A

This comes to us from – dependent upon what vantage point to look at the result, the price. Three, four, five years ago, we did a lot of luxury stuff that took our average price way up.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

California.

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

A

Yeah, yeah [indiscernible] (00:45:38).

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Average price in Southern Cal [indiscernible] (00:45:42) $2 million, right. Average price in Northern Cal $1.6 million.

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

A

We have one job where the average price was $2.4 million.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

Right.

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

[indiscernible] (00:45:51) about the same as the $800,000 to $900,000 house...

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

In Philly.

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

[indiscernible] (00:46:01) so, you have to step back and look at this from a vantage point. One man's ceiling is another man's floor, you've got here just a difference in mix that's occurred. We're rediscovering what made Toll Brothers. This is the Toll Brothers market [indiscernible] (00:46:27) then we got the $2 million and $3 million in the average [indiscernible] (00:46:29)

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

Right. Correct.

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

Now, we're just finding more Toll Brothers product.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

And we have this demographic coming that is very large and are settling down later buying their first home later and therefore are more affluent and discerning and just as their first car, I'll give Audi a plug, can be the A4 their first home can be Toll.

Trey Morrish
Analyst, Evercore ISI
Q

Got it. But the margin on these homes, I would imagine they're probably a little bit lower given that they're smaller, a little bit smaller footprint but the turns will be faster, so the return focus that you guys have been talking about for a few quarters is probably in line to a little bit better than the traditional products, is that a fair way to think about it?

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

I think it's...

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

I think that's very fair. We think the gross margin will be a little bit less and the ROE will be higher.

Trey Morrish
Analyst, Evercore ISI
Q

Okay. And then lastly, you talked about how you expect JV and other income this year to be in that $100 million to $150 million range, what are the things happening in any given year that can end you up in the low-end versus the high-end of that?

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

Well, as you know, in that line item is $50 million to $60 million of kind of routine other income from our security business, from our title business, from our mortgage business, from our interest income, on our cash balance and various other components. The balance is apartment sales, some commercial pieces of ground sales, the retail sales under some of our buildings in Manhattan, the golf business we sold, the sale of accumulated pile of customers in the security business, various pockets that we can pull some income from.

I think as we move forward, part of the strategy in our apartment business is to generate more and more of that JV income from disposition of apartment buildings and we're enthusiastically looking at 2020 as a sizable year for our apartment starts and JV formations. And then you also have gains on land sales that can occur either through those JV formations or through some of our master planned communities where we sell lots to other builders.

Trey Morrish
Analyst, Evercore ISI
Q

Okay, thank you very much guys. I appreciate it.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

Thank you. You're very welcome.

Operator: And our next question comes from Jack Micenko of SIG. Please go ahead.

Jack Micenko
Analyst, Susquehanna Financial Group LLLP
Q

Hi, good morning. Marty, I wanted to touch on the 2020. You guys have the cycle time 9 to 12 months. You talked about it in the opening comments which you sold last year you delivered this fourth quarter. So, it seemed like you've got a lot of 2020 visibility. The reticence around lack of a full year I guess would be I mean are we thinking more quick delivery homes as you shift the product set? Is cycle time at Toll going to compress as a product changes? Is there more maybe attached product? Help us sort of understand the gap between your visibility historically and why 2020 is a little different from – as we think about deliveries and margin and mixing the business.

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

I think you touched on a couple of the points there, how much quick delivery, how compressed might cycle times get as we move to some of these affordable luxury price points. It also factors in the pretty wide range we have in our pricing. We're selling homes between $300,000 and $3 million and a few less at the $3 million range can really impact not only margin, but expected revenue.

So, we're going to carefully study this particularly in light of the pretty rapid expansion in sales we saw in the fourth quarter and we handed that six weeks into the first quarter and how that increase in business is going to be able to be delivered and whether that's going to happen in the traditional 9- to 12-month period or in a 6- to 9-month period instead or even if this rapid growth comes up – continues, what it might do to the labor availability.

Jack Micenko
Analyst, Susquehanna Financial Group LLLP

Q

All right, that's helpful.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

There are still a number of communities that can deliver homes that sell in the traditional spring selling season, right, late January to mid-April is when this industry sells most homes and we have communities that can sell at least in the early part of that spring selling season and still deliver by October. So with, as Marty said, the pretty significant improvement in orders over the last 4.5 months and as we're about to approach that spring season, I think it's prudent for us just to take a little more time to understand the full year.

Jack Micenko
Analyst, Susquehanna Financial Group LLLP

Q

All right. Thanks for that. Yeah.

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

A

And Jack, in the second quarter for example of 2019, our average delivered price was $895,000. Nine months later here, we're projecting it at $810,000. That gives you some view on how rapidly things can change for us.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

But that's mixed.

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

A

Yes.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

That is not...

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

A

That's all mix.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

That's not the price of a same-store. That's just mix.

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

A

Right.

Jack Micenko
Analyst, Susquehanna Financial Group LLLP

Q

Sure, okay. And then you had an active quarter on the debt side. I think on the reported margin I think you were at, what, 2.6% of interest. Some of the things you've done this quarter on the debt side, is that a tailwind to reported gross margin in 2020 versus 2019?

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

A

I don't think it happens as rapidly as a year. We capitalize interest into our inventory and it could take 18 to 36 months before the benefit flows through the income statement.

Jack Micenko
Analyst, Susquehanna Financial Group LLLP

Q

But net benefit not punitive?

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

A

Not punitive, correct.

Jack Micenko
Analyst, Susquehanna Financial Group LLLP

Q

All right, great. Thanks, guys.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

You're welcome, thank you.

Operator: And our next question today comes from Michael Rehaut of JPMorgan Securities. Please go ahead.

Elad Hillman
Analyst, JPMorgan Securities LLC

Q

Hi. This is Elad on for Mike. First, I just was wondering if you could share your order contracts growth by month for 4Q and any more color on what you've seen so far in the first six weeks of 1Q in particular any regions where you're seeing particular strength or weakness so far in 1Q or any changes in 4Q besides just overall being stronger, anything more in particular? Thanks.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

So, every month of the fourth quarter was better than the prior year's month and that trend continued even more so in November and the first half of December. And then in terms of the first quarter, the areas where we've been hottest, without getting into specifics since we haven't given you specifics on these six weeks except the general commentary, would be Austin, Jacksonville, Northern Virginia, Southwestern Florida, Phoenix, Orlando, Salt Lake City, Denver, Boise.

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

A

Very consistent with the fourth quarter.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Those are on my list and they're fairly – that's right, I think New Jersey was on the fourth quarter and maybe something else we have, Massachusetts maybe, but yes it's fairly consistent.

Elad Hillman
Analyst, JPMorgan Securities LLC

Q

Great. Thank you. My second question just on incentive levels, so, overall they have been improving throughout the year and I was wondering where incentive levels are in the market now and in particular if you could share the incentive percentage this quarter compared to last year in 4Q 2018 and also anything to call out in incentive trends in the market or anything special by region? Thanks.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Incentives are flat. They have been flat for some time. There is no specific market trend worth noting. We are encouraged with recent sales activity that is giving us some pricing power.

Elad Hillman
Analyst, JPMorgan Securities LLC

Q

And just to clarify, you mean flat sequentially, correct?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Flat. That's correct.

Elad Hillman
Analyst, JPMorgan Securities LLC

Q

Thank you.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

You're welcome.

Operator: And our next question today comes from Ken Zener of KeyBanc. Please go ahead.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

Good morning, everybody.

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

A

Good morning, Ken.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Hi, Ken.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

So, I hear you about the asset turns and stuff, I just want to start with California where Doug seemed to be saying 25 units came out of the Metro Crossing and that would put California down about 7% year-over-year adjusted for that, is that correct? I assume Southern California flat, Northern California was still weaker?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

The improvement maybe is not as dramatic but, yes, somewhere in that ballpark, yes.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. So – and the reason I ask is the margin and I don't have the fourth quarter by EBIT, but Northern California still represents just on – California, not Northern, about just under half of your guys' segment EBIT. If you guys are moving down in price points broadly, but also in California, I assume, how should we think about FY – while the first quarter's price as the benchmark for all of next year, I mean FY 2020, and then does the mix of California's EBIT for the year, so just under 50%. I mean is that something that we should think about next year? Is that going to really kind of change? Because [ph] canned units (00:57:21) at Metro Crossing, obviously you guys have built that place so you are still going to close them, which it seems like that will be margin accretive. There's a couple of different questions here but I'm going to as California is concentrated in FY 2020 in your opinion as was in 2019% of EBIT. And your ASP, I mean first quarter's ASP really what it's going to be for FY 2020.

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

A

So, Ken, I think when we look at EBIT from California in 2019, we think it's in the upper-30s and for 2020 I think we would expect it to come down to the lower-30s as a percentage of total. We expect margin around the company including in California to improve through the course of the year compared to the first quarter.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. And then the SG&A you said for FY 2020 it's going to be modestly above FY 2019, was that correct, Marty?

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

Yes, it is.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.
Q

Is that excluding the $10 million you called out in the first quarter?

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

It includes the $10 million I called out.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.
Q

And then what percent I guess on an annual basis have your SG&A do you describe as fixed versus variable? Thank you.

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

So, I think the asset is mostly variable and we would expect that to be around 40% of the total SG&A.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.
Q

Thank you very much, gentlemen.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

Thank you.

Operator: And our next question today comes from Jay McCanless of Wedbush Securities. Please go ahead.

Jay McCanless
Analyst, Wedbush Securities, Inc.
Q

Hey. Good morning. Thanks for taking my questions. The first one I had, could you all break out the order growth in 4Q that came from the acquisitions versus your organic growth?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

Greg?

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

Yes, yes. All right.

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

A

He's paging through...

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

A

Got a lot of pages, okay, so we have.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Pretty small.

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

A

That's right. Looks like...

[indiscernible] (00:59:46)

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

One second, Jay, we're...

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

A

Sharp was 44 contracts in the quarter and Sabal was 35 contracts in the quarter. Sabal was about half a quarter owned by Toll.

Jay McCanless
Analyst, Wedbush Securities, Inc.

Q

Thank you for that. And I'm sorry I know you all discussed it before but I didn't hear the answer, in terms of incentives how did those compare year-over-year for the fourth quarter and then maybe 4Q versus 3Q 2019?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Incentives were flat 4Q...

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

A

Versus 3Q.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

... to 3Q and year-over-year, let's see, hold on. Gregg is going to pull that up. It looks like incentives peaked in the second quarter just by a little. They just ticked up ever so little and then they were flat in the third and fourth quarter of 2019.

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

File is loading. Maybe we should get back to [indiscernible] (01:00:48)

Jay McCanless
Analyst, Wedbush Securities, Inc.
Q

Yeah. I'll follow-up offline.

[indiscernible] (01:00:50)

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

Do you have another question while our file loads?

Jay McCanless
Analyst, Wedbush Securities, Inc.
Q

Yeah, absolutely. So, maybe just asking Jack's question a different way, if you guys are moving to a smaller price [ph] or on a (01:01:02) smaller square footage, at what point does that start to impact the cycle time and when should we should expect that to contract a little bit or is that not going to happen, it's just a product that's going to be a 9- to 12-month cycle time?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

No. The smaller more affordable luxury homes will be – they should cycle faster for the reasons we gave which is they're smaller and they have less options. It will be incremental over time.

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

They don't happen over time, Jay. It's real tough to tell you that six months from now we'll have a better...

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

Right.

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

...and a final mix of product type. It's going to vary. It should just go down.

Jay McCanless
Analyst, Wedbush Securities, Inc.
Q

[indiscernible] (01:01:54)

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

And the incentives compared to a year ago were basically flat.

Jay McCanless
Analyst, Wedbush Securities, Inc.

Q

Yeah, great. Appreciate all...

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

The same answer, Q4 to Q3 and Q4 to prior Q4 it's...

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

A

They're like $1000.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

Plus or minus $1000 right within the same range.

Jay McCanless
Analyst, Wedbush Securities, Inc.

Q

Great. Thanks again.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

A

You're welcome.

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

A

Thank you.

Operator: And ladies and gentlemen, today's final question comes from Mark Weintraub of Seaport Global. Please go ahead.

Mark Weintraub
Analyst, Seaport Global Securities LLC

Q

Thank you. I was hoping if you could just give us your feel for recognizing how complex this question is. If we look at the adjusted gross margin guidance for the coming first quarter and we think of three variables at play, one, timing related to the health of the market which sounds like that was the biggest factor as you pointed out health of the market is getting better; but two, you also would have geographical mix shift; and three, we have the shift to the more affordable product and again recognizing this is complex. But if you were to guesstimate the impact of those three variables on the delta and expected margins for this year versus last year's first quarter, what percentage might fall in those buckets?

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

A

I don't think I can give you percentages, but I think the geographic mix is going to skew with less California and then the marketplace is obviously a positive to margins, and then the mix will have the least – I'm sorry the price point mix will have the least impact on things.

Mark Weintraub
Analyst, Seaport Global Securities LLC
Q

Right. And markets are negative for the first quarter but then will become a positive going forward just to clarify.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

Correct.

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

Yes, correct. Right.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

That's correct.

Mark Weintraub
Analyst, Seaport Global Securities LLC
Q

Right and then one other quick follow-on if I could. You also referenced labor availability one of the variables that makes it trickier to forecast 2020 and I guess there are two different ways that that could play out, wanted to understand which one you were focusing on. One, is it the ability to get all the homes you would want to get built versus the cost of building those homes?

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

We have the labor to build the homes and we are encouraged that labor and material costs in the fourth quarter were flat to the third quarter, and we have not been able to say that in some time.

Mark Weintraub
Analyst, Seaport Global Securities LLC
Q

Okay, I'll leave it there. Thank you.

Douglas C. Yearley
Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.
A

Thank you.

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

Thanks, Mark.

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

Douglas C. Yearley

Chief Executive Officer & Chairman of the Board, Toll Brothers, Inc.

Rocco, thank you very much, you did a great job. Thank you everybody for your interest and support and have a wonderful holiday season.

Operator: Thank you, sir. Today's conference has now concluded. We thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.