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Toll Brothers, Inc. (TOL)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

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

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Hi Nick, this is Doug, are we ready to go?

Operator: Yes, go ahead, sir.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Thank you very much. Welcome and thank you for joining us today. I hope you, your families and colleagues are staying safe and happy. With me today are Marty Connor, Chief Financial Officer; Fred Cooper, Senior VP of Finance and Investor Relations; Wendy Marlett, Chief Marketing Officer; and Gregg Ziegler, Senior VP and Treasurer.

Before I begin, I ask you to read the statement on forward-looking information in our earnings release and on our website. I caution you that many statements on this call are forward-looking based on assumptions about the economy, world events, housing and financial markets, the current and long-term impact of the COVID-19 pandemic and many other factors beyond our control that could significantly affect future results. As noted in our May 6 press release, due to the uncertainty surrounding COVID-19 and its impact, we have withdrawn our second quarter and fiscal year 2020 guidance.

Now let's begin. We're pleased with our performance in the second quarter. Under complex and challenging circumstances, our teams delivered 1,923 homes and produced revenues of \$1.52 billion, our second quarter adjusted gross margin of 21% and our net income of \$75.7 million or \$0.59 per share diluted. Our second quarter end backlog of 6,428 units and \$5.49 billion was down just 1% in units and 3% in dollars and our net signed contracts of \$1.55 billion and 1,886 units were down 22% each from one year ago.

Our second quarter was essentially bifurcated by the impact of COVID-19. Fueled by strong demand, a healthy economy, low mortgage rate and a limited supply of new and existing homes nationwide, our net signed contracts were up 43% through the six weeks ended March 15 compared to the prior-year same period.

With approximately 40% of our selling communities and 50% of the dollar value of our backlog concentrated in highly impacted markets including Pennsylvania, New Jersey, New York City and its suburbs, Connecticut, Massachusetts, Michigan, Metro Seattle and California, government stay-at-home and business closure orders made it especially challenging to sell, construct and deliver homes.

In these markets during this restricted period, most of our sales centers were required to be physically closed and operating virtually or open by appointment only. As a result, from March 16 through April 30, our net signed

contracts declined 64% year-over-year. Net signed contracts declined 79% in these highly impacted markets over the same period versus 52% in our other markets. Fortunately, government restrictions have eased and the sales and construction operations have resumed in almost all of our markets. While net signed contracts in the first four weeks of May were down 37% year over year, we are very encouraged by recent deposit activity. Our deposits, which represent a leading indicator of current market demand, were up 13% over the past three weeks versus the same three-week period last year.

Year-over-year deposits from last week were the highest since 2005 on both a same-store and gross basis. As a reminder, our customers first post a refundable deposit that reserves a home site and affords them time to make final decisions on architectural design and structural options to personalize their home before signing a binding contract. This process from deposit to contract typically takes about three weeks.

Importantly, our recent deposit to contact conversion ratio has remained consistent with pre-COVID-19 levels. Web traffic has also steadily improved from the lows we experienced in mid-March and has returned to the same strong level of activity we enjoyed pre-COVID-19, with web traffic in this most recent week actually exceeding pre-COVID levels for each week of February and March. Foot traffic through our sales centers has also increased significantly. These early trends suggest the housing market may be more resilient than anticipated just two months ago.

During the lockdown, our teams quickly adapted to new operating environment and transitioned to a combination of remote ways of working, virtual communications with our customers and safe construction practices. Our focus was on keeping our employees, trade partners and customers safe and our business running. The online and community sales teams engaged home shoppers in person, by phone and online.

Design studio appointments moved forward in person and virtually. Closings continued to occur, often by remote and paperless practices for customers eager to move into their new Toll Brothers homes. Through creativity and virtual tools, we were able to continue to provide the high-quality home buying experience that defines our trusted brand.

As we prepare for a further reopening of the economy, we continue to develop new ways of running your business to meet the many challenges presented by the pandemic and its impact on the economy. We have learned to operate more efficiently, which will make us better now and in the future. We also intend to continue pursuing our strategy of diversifying our product mix and geographic presence with a focus on more affordable luxury home communities and expansion into higher-growth Southern and Western markets.

We believe this strategy will enable us to reach a larger segment of the affluent home buying market.

Now, let me turn it over to Marty.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

Thanks Doug. Our adjusted gross margin of 21% was better than we expected this quarter. We attribute this to a combination of pre-COVID-19 pricing power, stronger cost controls and a favorable mix of deliveries. The average delivered price of our homes in the second quarter was \$789,000 compared to the midpoint of our expectations of \$810,000, due primarily to more deliveries of affordable luxury homes in Idaho and delays in deliveries in higher priced markets such as California that were heavily impacted by shutdowns.

Our balance sheet remains strong. We ended our second quarter with \$2 billion of liquidity, including \$741 million of cash and \$1.3 billion available under our \$1.9 billion revolving bank credit facility which does not mature until November of 2024. The weighted average maturity of our debt is more than five years and we have no significant debt maturities until 2022.

During the quarter, we paid \$0.11 in dividends and repurchased 4.3 million shares of our common stock for \$157.5 million. These repurchases all occurred prior to the onset of the pandemic in mid-March. At the end of our first – excuse me – at the end of our fiscal second quarter, book value per share was \$36.34. During the second quarter, we took a number of actions to reduce spending, maximize liquidity and maintain financial flexibility in order to deal with current challenges and be prepared for potential opportunities that may arise during the recovery.

One of our initial steps in mid-March was a sizable draw on our bank revolving credit facility due to initial concerns regarding potential bank liquidity and capital market accessibility. All of this draw has been repaid as those concerns have abated and the capital markets have been opened for homebuilders and many other sectors. We are very focused on converting our backlog, which should generate significant cash. Our backlog at the end of April stood at 6,428 homes and \$5.5 billion, providing us with good visibility on cash inflows for the next few quarters as cancellations have remained low.

Another major step that we took to preserve liquidity was to significantly reduce spending on new land acquisitions and land development. We evaluated all pending land deals in our pipeline and requested additional time on deals with near-term cash outlays. Most of our sellers were receptive, although we did have one sizable deal in Virginia, where we could not come to terms with the seller. We therefore wrote off \$10.7 million in some costs, which constituted most of our second quarter impairment charge. Land acquisition spend dropped from February to March and was essentially zero in April. Land development spend was also significantly curtailed.

With 37,100 owned lots, of which 17,200 are already improved, we can and will choose to selectively invest in new land acquisitions based on local market conditions. We believe that our attractively located land pipeline in the most desirable markets will position us for growth as the economy recovers. With our strong balance sheet, we will continue to be opportunistic as land and other growth opportunities become available.

In light of the uncertainties presented by the pandemic, we also acted quickly to accelerate our efforts to improve efficiencies and rationalize overhead expenses by reducing G&A spend. These actions included, among other things, a hiring freeze and reductions to payroll through a combination of job eliminations and employee furloughs. While these decisions were difficult to make, we believe they will help our business in the near term and make us more efficient over the long term. We anticipate that these actions will decrease overhead expenses by approximately \$50 million on an annualized basis going forward and we expect to realize approximately \$25 million of savings over the remainder of fiscal 2020.

Included in our second quarter SG&A is approximately \$8 million in severance cost, offset by the reversal of an \$8 million accrual for discretionary benefit plan contributions that will not be made. We will continue to review our cost structure as we further refine operating efficiencies and as market conditions evolve.

As we look to the third quarter, we expect some delivery times to remain challenged due to the several weeks of lost or limited construction activity in certain shut-down markets in our second quarter as well as evolving construction practices. We also expect our JV, land sales and other income in the next few quarters to be lower due to market conditions. We will delay selling several of our completed apartment communities and other assets

until the market for those sales improve. Nonetheless, during the second quarter, we did complete the previously contracted sale of our golf course operations, which generated approximately \$13 million in gains in other income.

Now, let me turn it over to Gregg Ziegler.

Gregg L. Ziegler

Treasurer & Senior Vice President, Toll Brothers, Inc.

Thank you, Marty. We have continued to see ample mortgage availability for our customers, approximately 20% are all cash buyers and take no mortgage and only 25% take a jumbo mortgage. Our customers who take a mortgage borrow on average 70% of the home price and contribute the rest in equity. With average FICO credit scores above 760, our buyers have had little trouble getting mortgages. Also, we do not retain servicing rights to these loans. Marty mentioned the size of our backlog and the cash flow it is expected to generate. Our contracts are backed on average by a nonrefundable down payment of \$70,000.

Obviously, this represents a significant financial commitment. Our customers also become emotionally committed to their new home as they personalize it with structural options and interior design selections through our design studio process. Our buyers also tend to be more financially secure with better long-term job prospects and accumulated wealth. We believe that these factors have contributed to our relatively low cancellation rates. As a percentage of backlog, our cancellation rate was 3.1% in our fiscal second quarter compared to 3.0% in the first quarter and as a percentage of gross contracts signed was 9.7% in our second quarter versus 9.4% in the first quarter.

Our Apartment Living business has been healthy. Across our stabilized properties, we are 96% leased. Rent collections have remained stable, with April delinquencies only down 1%, above the average for January through March and May up approximately 3% compared to the first few months of this calendar year. We continue to have access to the capital markets for new apartment project construction debt and equity financing.

In mid-April, we closed on a new Toll Brothers Apartment Living joint venture to develop a 289-unit rental community in Boston's Woburn suburb. We have received various debt and equity term sheets since mid-March for other projects and expect to close several additional joint ventures for Apartment Living projects in the second half of fiscal 2020.

Now, let me turn the call back over to Doug.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Thank you, Gregg, thank you, Marty. We are encouraged by the pickup in deposits in May, but remain cautious as to the long-term impact of the pandemic on the economy and the housing market. We expect to have a clearer view of the long-term implications of this later this summer and fall as the economy reopens and people return to the workforce.

We believe Americans now more than ever appreciate the comforts of home. Our marketing efforts are focused on: your home is your sanctuary and your home is the most important place in the world. With our trusted brand, experienced management team, diversified product offerings, strong liquidity and high-quality landholdings, we believe we are well prepared for the immediate challenges ahead. We also believe we are well-positioned to take advantage of the favorable long-term demographic and supply-demand trends that underlie the housing industry and which we expect to continue as the economy recovers.

Before opening it up to questions, I would like to thank all of our Toll Brothers team members, whether it's our operation teams who were able to deliver over 1,900 homes this quarter in extremely difficult conditions or our sales teams who guide our customers through the home buying process or the rest of the Toll Brothers family. I am so proud of how they have responded to the challenges we have faced during this time.

We have seen firsthand their creative thinking, how hard they are working and their incredibly positive spirit. They are completely dedicated to moving our great company forward, while taking care of our customers every step of the way.

Nick, let's open it up to questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin with the question-and-answer session. [Operator Instructions] First question is from John Lovallo, Bank of America Merrill Lynch. Please go ahead.

John Lovallo II

Analyst, Bank of America Merrill Lynch

Q

Thank you for taking my questions and I hope everybody is well on the team. First question is I think it was in the third quarter of 2017, maybe in the fourth quarter, you guys got out of the business of providing kind of that nonbinding deposit results because they just weren't indicative of full quarter signed contracts. So just curious why you think that this might be a more reliable indicator now?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Thanks, John. We – several years ago, before that, we used to give fairly detailed information about the three or four weeks between the end of a quarter and the earnings call and we recognized that it was better to just give a general commentary such as the prior three or four weeks have been similar to the prior quarter; we feel good about market conditions in the last few weeks. But we believe on this call, for this time, the market, the investors, the analysts are looking for as much detail as we can possibly give and that's exactly what we've done; I think that's exactly what the other builders have done.

We have tried to be fully transparent in giving you agreement information, not only pre and post COVID by giving you agreement information for the month of May, but also giving you what we believe is the best indication of today's market. That is not in any way trying to suggest that that will continue through the quarter. I cannot comment on that, but today's market over the last three weeks, our best indicator is our deposits because of the process we have described as to how we take a deposit and then it converts to an agreement in about three weeks. And by the way, I know I mentioned and it's important, that our conversion ratio from deposit to agreement has stayed the same since March 15 as it was pre-March, February, January, last fall. And just I know the question will come up, that ratio runs about 65% for us.

John Lovallo II

Analyst, Bank of America Merrill Lynch

Q

Got it, that's really helpful. And then maybe just taking a step back, there's clearly uncertainty in the market and the direction of things, but in your gut Doug, I mean how confident are you in sort of the sustainability of the

current activity and what would you need to see to begin kind of buying land more consistently across your markets?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

I can't comment on what's coming over the next few months. I am very encouraged by the last three weeks. We had a really tough geographic footprint in terms of the markets that we are active in and how shut down they were and it wasn't just that the government closed construction, that the government closed sales, that the government had shelter-in-place; it was that these markets were also hotspots so that we had a clientele that was more vigilant in staying home and being more careful.

And so, as that has lifted and the last lifting was around the 9th of May, the only market we have left that has not opened up constructions or sales is New York and at least suburban New York is coming shortly. I think the city will be a little bit longer, but as that has lifted since early May, I feel a lot better than I felt in mid-April, than I felt in mid-March because we are now seeing significant increases in traffic. Obviously, the deposits are up significantly. I mentioned that this past week was the highest deposit number, both gross and on a same-store basis since 2005. But that's the extent to which I'm commenting; I'm not going to project forward because of the uncertainties of the market we are in, but I certainly feel very good right now based upon the last three weeks activities, as almost all of our markets have reopened.

John Lovallo II

Analyst, Bank of America Merrill Lynch

Q

Got it. Thank you very much.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

You're very welcome. Thank you.

Operator: Thank you. Our next question comes from Alan Ratner, Zelman & Associates. Please go ahead.

Alan Ratner

Analyst, Zelman & Associates

Q

Hey, guys. Good morning. Glad to hear you guys are all doing okay and thanks for all the color you've given so far on May. Doug, I'm just curious with that improvement you've seen the last three weeks. Can you extrapolate or expand on that a little bit more? Just curious if there's been any pricing actions that you guys look maybe at the end of April that would have spurred some of that activity? I know you were offering I think an interest rate incentive for a while, but just curious if you've taken any steps on the pricing front.

And then just more broadly, are you seeing any kind of unique nuances with where that demand is coming from? Is there a specific price point or perhaps region where activity has bounced back sharper than others or is it fairly widespread across the footprint?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Sure, Alan. My pleasure to answer your two questions. On pricing, no, we are not incentivizing. The only special we've run is on Quick Delivery Homes what we call our spec homes that we'll deliver by midsummer. For a while,

we were offering a 2.99% 30-year mortgage; it's interesting that the rate got down to 2.99%. So, there was no cost to us by the end of even marketing 2.99%. So that was the extent of any incentivizing anywhere. I'm actually pleased that in a couple of locations, let's call it 10 to 20 around the country, we've had some modest price increases over the last three to four weeks. A few have been new grand openings that have been very successful and others have been established communities that have a very strong demand. But in terms of running any special to drive the last three weeks of strong activity, absolutely not. And I'm not inclined to incentivize right now at all. I don't think we need to and I don't think this is the time to do that.

In terms of market strength recently, we continue to see very strong activity in Boise, Idaho in northern Virginia and Orlando. Seattle was very hot before March 15 and then of course slowed dramatically because the state was shut down to both construction and sales and now that Seattle has reopened, that market is back to being very, very strong. So we're encouraged there. The Texas markets of Houston, Dallas and Austin are all doing very well. Denver, Colorado has been extremely strong and then South Carolina, three new markets for us and Atlanta, a new market for us, have also been quite strong. So, that footprint is Southeast over through Texas, the Mountain States and Seattle, I think is sort of the ring, I'd say, has been the strongest for us.

Alan Ratner

Analyst, Zelman & Associates

Q

That's really helpful, Doug, appreciate that. And then just I guess on the price point and I guess a little bit more of a strategic question. I think initially, we were hearing from builders that entry level and spec products specifically was really most in demand and anybody that kind of had to leave an apartment, they were looking for something pretty quick to move into. So, I'm curious within your price point band, are you seeing relatively stronger activity at those more affordable offerings you do provide and has there been any thought about maybe adding a few more specs on the ground just to kind of satisfy that demand with resale inventory as tight as it's has been?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Sure, so our affordable luxury business, which we've been talking about a lot, increased year-over-year in the second quarter as we would have had expected for the reasons you gave. Our luxury business was flat and our, what we call, age-targeted and empty nester, the move-down market of the baby boomers was down. And we also expected that as that client was more inclined to shelter and be careful and also some of our active adult communities are in destination locations that require travel and obviously there hasn't been a whole lot of travel in the last few months.

So, affordable is up, luxury is flat, age-targeted and empty nester has been down. In terms of quick delivery, right now we have about 15% to 17% of our homes are in various stages of construction and we define a quick delivery as having come out of the ground. And we target that quick delivery product based on understanding that it should be more heavily loaded towards affordable luxury, it should be more heavily loaded towards townhomes and attached products and less loaded towards empty nester and age-targeted. That was even true pre-COVID-19 because we know that buyer, it being generally one of their last major home purchases, they want to customize that home. So we've always had the strategy to have less spec inventory in that niche. And we will continue – I'm very comfortable with that 15% to 18% quick-delivery range, it will continue to focus more on the lower-priced and attached communities, as we have strategically planned it in the past; I don't think that will change.

Alan Ratner

Analyst, Zelman & Associates

Q

Appreciate it. Thanks a lot and good luck and stay safe.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Thanks, you too.

A

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

Thanks, Alan.

A

Operator: Thank you. Next question is from Matthew Bouley, Barclays. Please go ahead.

Matthew Bouley

Analyst, Barclays Capital, Inc.

Hey, good morning. Thanks for taking the questions. I hope everyone is doing well. On the gross margin and mix, I think Marty, you mentioned that favorable mix was part of the strength in the second quarter. I guess, my question is number one, is that a comment, I guess, on just the overall decline in the North region closings, which obviously runs a little bit lower margin or is there something more specific than that? And number two, I guess, should we assume that there is, I guess, a continued tailwind to gross margins in the second perhaps for the same reason? Thank you.

Q

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

Well, with respect to the margin performance in the second quarter, the order in which I gave the rationales is the weighting relatively of the reasons. So it was price increases that we had in the past, it was cost control and then to much lesser extent, just some positive mix and it's tough to get into the specifics of whether it was the North or otherwise, so I won't. With respect to the future, I'm sorry, but as we've noted earlier and in our release, we're just not going to give any guidance. There are just too many variables in these uncertain times to go in that direction.

A

Matthew Bouley

Analyst, Barclays Capital, Inc.

Okay, fair enough. And then I guess secondly, I guess at a higher level, when you think about your exposure to these regions which have been more severely impacted by the lockdowns, there is the narrative that I'm sure we've all heard just around sort of that urban flight from some of these cities. Just curious if your sales folks have started to see any traffic from that specifically, just anything notable or needle-moving yet?

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Not yet. Again, travel is highly restricted. We are encouraged, as I've mentioned, by the significant increase in traffic and deposits in those markets that were closed through April.

A

Matthew Bouley

Analyst, Barclays Capital, Inc.

Okay, thanks. Appreciate it.

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

You're welcome. Thank you.

A

Operator: Thank you. Next question is from Stephen Kim, Evercore ISI. Please go ahead.

Stephen Kim

Analyst, Evercore ISI

Yeah, thanks a lot guys. Really encouraging commentary here. I just wanted to right upfront just address the question of deposits because actually a year ago, you made some commentary about May deposit activity I believe around this time and you indicated that you were seeing encouraging trends on the deposits and then ultimately your contracts were up for the month of May. So it doesn't look to me like your deposits faced a particularly easy comp in this first three weeks of May. So I was just – just you correct me if I'm wrong on that. My question relates to the age of your buyer. I was curious if you knew what percent roughly of our buyers are older than 60 years old and has this changed much in sort of the deposit activity or the contract activity that you've been seeing recently?

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Stephen, I have three people here looking through a whole bunch of paper, good thing we're together for this one. But I think we're probably going to have to get back to you with the answer on the percentage that are over 60. I will say that generally, our active adult communities are marketed to a younger active adult. With the amenities, the healthy lifestyle, our marketing campaigns, we like to find 55-year-olds that may look a little bit younger and are super-healthy and that's our clientele.

A

So we'll get you that number, but it is – sorry Gregg.

Gregg L. Ziegler

Treasurer & Senior Vice President, Toll Brothers, Inc.

Steve, if this is helpful, we don't do it at 60; we looked at it at 50 and older and we looked at our settlements and so for this quarter, 52% of our settlements had a buyer that was 50 or older and if we want to reference it from a year ago, Q2 2019, it was 49%, so it seems relatively consistent.

A

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

But there's a lot of families, young 50s, mid 50s that are still buying the move up house. I think what Stephen is getting at is the true active adult empty nester market, which really starts at 55 and goes from there. But we'll – I'm trying to buy time here and I'm not getting an answer, so we'll get back to you. And in terms of your first question about the comp, yes, it's a bit of a difficult comp, particularly the first week of May, last year and for those of you that have been following Toll for a long time, you'll recall that every April for many years, we've run a national sales event. And we generally get our vendors to participate and contribute upgrades at discounts. We market the heck out of it nationwide and that event occurred last year 2019 and ran through the first week of May.

A

And the last week of the event is always the biggest week for deposits because people know it's expiring and they got to get out. This year, we suspended that event. We did not run it in April. We are contemplating when we may run it. I'm feeling pretty good about the market right now, so stay tuned. But that certainly impacted the month of

April, even more, it magnified the impact of COVID-19. And that impact continued pretty dramatically into the first week of May. But since then, as I mentioned, not only did we have all of our markets reopening but for New York, but we had, as we mentioned, these three really strong weeks of deposits.

Stephen Kim

Analyst, Evercore ISI

Q

Yeah. So – yeah, that's really helpful. So, that 13% number is not really benefiting from a particularly easy comp in April, if anything, had a particularly difficult comp. I guess what I'm trying to get at...

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

And Stephen, I'm sorry. My apologies, just to complete it, for the month of May, to expand our three weeks from up 13% for three weeks, we are flat on deposits for the month, which goes to my commentary about the difficult comp of the first week both because we were closed in certain places and because it was up against last year's final week of our sales event.

Stephen Kim

Analyst, Evercore ISI

Q

Got it, yeah, that's really helpful, okay. So I guess where I was trying to go with my question, both in terms of calling out this dramatic difference between your contract and your deposits as well as the question on the age is it feels to me like what people are really wrestling with, with your business is, are we, is the higher end of the market and the market you serve, the customer you serve geographically as well as price points, has it been slower to respond, but is going to eventually mirror what we are seeing elsewhere in the housing market or is there anything structurally different about the market and the customer you serve, which would make your business unable to express the same kind of recovery that we've seen in many other places outside for many other builders and certainly this contract inflection would seem to be suggestive that you can see your markets fully participate just like every other segment of the market and geography.

So let me ask a broader question to you. Is there something that you see in the marketplace and in your customer base that we need to be cognizant of that will be somewhat semi-permanently impairing your ability to see the kind of recovery we would see elsewhere in the housing market?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

My strong answer is no. I feel very good about our business. Listen, coming right out of the March 2016 or the March 2014 nationwide emergency shutdown, we understand that for the first month, the first six weeks, while everybody was sheltering-in-place, it was those that were living in an apartment who still felt comfortable with their job security that jumped at the opportunity to buy a very affordable, completed, new spec home. And we understand that and we all saw that play out in the very short term and that's not our business, right, that's not what we do.

But our average house now is around \$800,000. We are focused on more and more affordable luxury. We are very focused on the South; we are focused on the Mountain States, we are focused on the West, you can see how the West and – excuse me, the Mountain States and the South have held up. And our business is evolving; we have been talking about that. I feel strongly that people are nesting and this is not short-term, there is no place like home. Home is your sanctuary today; it is the most important place in the world.

And the opportunity for us to continue to build on our brand the way we do it, offering the opportunity to customize the house through an organized upgrade process, design studio process, not everybody has to move in in the next month or two. That absolutely occurred quickly after this pandemic for the crowd I mentioned that was in the apartment, but people are still thinking about, I want a new home and I wanted to design it my way and I want it to be a great value. And that's what Toll Brothers is about today and I love our geographic footprint. I love how we've expanded our market segments; I love our brand and I truly believe that our business is primed to take advantage of all I've described in not just the short term, as we're seeing now in May, but longer term as more and more people want to move into the new home and do it their way.

Stephen Kim

Analyst, Evercore ISI

Q

Great, yeah, that expansion is going to be fun to watch. Thanks a lot guys.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Thank you, Stephen.

Operator: Thank you. The next question is from Michael Rehaut, JPMorgan Securities. Please go ahead.

Michael Rehaut

Analyst, JPMorgan Securities LLC

Q

Thanks, good morning, everyone. I hope everyone is safe and healthy out there. First question, I just wanted to circle back for a moment; there's been a lot of focus on some of the May data points you gave, which is obviously very helpful and appreciated. And given the different levels of disclosure you've had around deposits, just want to be clear – and obviously this is somewhat forward-looking, but you referred in your comments, your press release to the deposit-to-contract ratio remaining constant. So are we to take it that the recent strength in deposits, to the extent that it continues, the 13% growth over the last few weeks, are we to take it that you are, in effect, anticipating positive order growth for the month of June based on these conversion ratios holding steady?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Mike, I don't have that crystal ball. We're being fully transparent in giving you detailed data week by week. You understand our business, you understand our conversion ratios. I think we've been crystal clear on what has happened over the last three weeks and then I just answered Stephen's question on the first week of May. So today, we're basically flat for the month of May in outstanding deposits. And you can take it from there.

Michael Rehaut

Analyst, JPMorgan Securities LLC

Q

Okay, fair enough, Doug. Sorry for the direct question, but obviously I think there's a lot of focus on the data points; so I was trying to drill in a little bit there. I guess secondly, there's also been a lot of focus around different parts of the country in spec versus build-to-order and obviously makes a lot of sense that you guys are sticking to your knitting and also pivoting to a more moderate degree in different markets towards the affordable product.

As you look at your different markets and perhaps certain markets are showing better strength than others, is there any ability that you have to perhaps accelerate the development spend or the land spend in those markets that because of COVID-19 you think might actually have some increased demand or is that something that you're

kind of thinking about right now or is it more just going to be kind of take-it-as-it-comes and see how the things emerge over the next couple of quarters and go from there?

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

Hey, Mike. It's Marty, thanks for your question. In terms of specs and where we stand, I think a frame of reference as we've moved into more affordable luxury price points in certain geographies where spec building is appropriate might be the following: A year ago, we had around 1,300 specs and right now, we have close to 1,600 specs. So we have developed a few more specs and as we went through the darkest days of mid-March, we evaluated whether to stop specs or continue and candidly we did stop for a couple weeks and then said, get at it, and finished the ones that we had started and we are selectively starting new ones in light of the factors that you mentioned.

Michael Rehaut

Analyst, JPMorgan Securities LLC

Q

Right.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Yeah, I think – early on if we had a call late March or early April, if we had a quick-delivery home that was at foundation, we kept it at foundation. If it was being framed, we at least got it to the point where it was weather-tight, but then we waited and now fast-forward to early May, we told everyone continue with all spec inventory that has been started, whether it's at foundation, weather-tight or whatever stage, we certainly feel better about the market, let's keep the specs rolling and in selected locations, authority was granted with very senior level approval to build new spec inventory, but we're going to be very careful about it. It's going to be very, very market-specific and it's good to be price point-specific.

Mike, one clarification, I just misspoke and I want – again, we're trying to give you all the data points we can. I talked about the entire month of May with deposits being flat and then I said, outstanding deposits are flat; that is inaccurate. Outstanding deposit means anybody who is still under deposit, who we are working with, who has not either asked for their deposit back, which again is about 35% or going forward with an agreement, which is 65% and today, we are up 15% in outstanding deposits and I incorrectly said we were flat.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

So that's the pile of deposits that future agreements will come from.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

That we are working with, right.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

Yeah.

Michael Rehaut

Analyst, JPMorgan Securities LLC

All right, thank you. Appreciate it.

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

You're very welcome. Thank you.

A

Operator: Thank you. The next question is from Mike Dahl, RBC Capital Markets. Please go ahead.

Mike Dahl

Analyst, RBC Capital Markets LLC

Good morning, thanks for taking my questions. A few follow-ups on May. Doug, you gave the actual order agreements between – split out between your highly impacted markets and the other markets from mid-March through end of April. I was curious if you could give the same relative to the minus 37% for the total business. Do you have the split-out for your highly impacted versus other? And as part of that, maybe if I could just wrap in, you had a small acquisition in there; just could you help us quantify what Thrive added to both orders and deposits?

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Sure. So let's start with – now remember, the May agreements reflect generally April deposits, when those highly affected markets were still closed. I can try to help you with your question, which is how do the deposits look in May from those markets that have reopened? But let me give you what you asked and then I'll help you with the other part. From May 16 to April 30, the most highly impacted markets for agreements were New York City Living, down 96%; New Jersey Suburban, down 94%, it was closed, New York Suburban down 88%, it was basically closed, California, where Northern California was completely closed and LA County was closed, Orange County was somewhat open, was down 81%, Pennsylvania down 77%, also closed.

A

Now when you get into the May agreements, which we said to date are down 37%, all of those numbers improve a little bit because they reflect, call it, mid-April deposits, which were certainly better than late March deposits, the late March deposits reflect the April agreements, right, if you're following the three-week lag. So, for example, New York City Living wasn't down the 96% I mentioned, it was down 86%, New Jersey Suburban wasn't down the 94% I mentioned for April, it was down 73%. California wasn't down 81%, it was down 63%. Pennsylvania had a nice rebound; it was – from being down 77% in April, it went to only down 42% for those agreements in May.

But now let's fast-forward to the deposits in May when those markets reopened and with the exception of City Living, which had stayed closed, we are not allowed to show a unit, even in a finished building in New York City. You can't get by the doorman. The residents of the building just don't want people in the building. With that exception, all of those other markets have clawed back more than half of those reductions in agreement activity with May deposits. Guys, did that answer it?

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

I think it did, he had a question on Thrive as well. So...

A

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Yes, so – go ahead, Marty.

A

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

Thrive did not add any contracts in May. It had one deposit in May. There is one community open for sale associated with Thrive at this point; I remember it closed door in Q2.

A

Mike Dahl

Analyst, RBC Capital Markets LLC

Okay, that's really helpful, thank you for all the color around both the deposits and the agreements. So, then just a follow up and this isn't trying to get guidance, more just your thoughts. We're obviously in a unique period with so many of your large markets having gone from kind of full shutdown to various stages of partially open. And so, even if there's been some demand destruction, you're still trying to cram in a month and a half or two months' worth of demand potentially into a shorter time period. So, in your seat, I guess the question is when do you think you'll have sufficient visibility on whether this is some combination of push-out or pull-forward versus whether this is something more sustainable?

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

I think by mid-summer, that's just me. I said it in my prepared comments that I'm very encouraged, but I'm still cautious. Is this pent-up demand that came out quick or is there something more to it? Right now, it feels like there's something more to it, but it's going to take some time to fully appreciate. And I think the July, August, September timeframe when most states have moved from red to yellow to green and we know how many furloughs are coming back to work around the country and we know what different parts of the economy look like, we'll all have a much better idea, so that's where my head is on it.

A

Mike Dahl

Analyst, RBC Capital Markets LLC

Okay, thanks Doug.

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

It is important to remember the long-term importance of owning a home and that's why I go back to the way we do it, our brand, our opportunity to give you great value, while you can design it yourself and customize it yourself and we are going to continue to focus on our marketing campaigns that are all about: your home is your sanctuary. There is such a huge nesting going on in this country; we all feel it; we're all living it. And once we get through this and the world is back to normal, I'm really excited about where we're headed.

A

Operator: Thank you, the next question is from Susan Maklari of Goldman Sachs. Please go ahead.

Susan Maklari

Analyst, Goldman Sachs & Co. LLC

Thank you. Good morning, everyone.

Q

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

Good morning, Susan.

A

Susan Maklari

Analyst, Goldman Sachs & Co. LLC

My first question is just around input prices. Can you talk about what you've seen there? We've obviously seen lumber spike more recently. How sustainable are you thinking that is and how are you thinking about the outlook for some of the materials?

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Cost has been flat and we are hopeful that at least in the short term, there will be some opportunities to save a bit more. We'll see how that plays out long term. That of course is tied to my earlier comments about whether this is a short-term increase in demand or longer term, but we have been encouraged over the last year with costs being relatively flat.

A

You're right, lumber is up a little bit, but labor is down a little bit. So overall, I'm looking at some numbers Gregg just gave me, we were up – for Q2, costs were up just under \$2,000 a house, which for us is fairly nominal since our houses are big and a little more complicated. And as we talked about gross margin, we were able to push the selling price of the home quite a bit more than that.

Susan Maklari

Analyst, Goldman Sachs & Co. LLC

Okay, that's helpful. And then following up on that, can you just talk to any supply chain disruptions that you've seen? Has any of that been mitigated as things have come back and maybe especially just given how shut down some of your markets are, how should we think about the impact of that? I know Marty, you mentioned some delays on some fiscal third quarter deliveries in there, but can you just give us some sense of the supply chain and how things are working there?

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Sure, let's start in the beginning. The permitting, pulling a building permit, getting the house started has had some delays in some markets as building departments have closed. Now there were some work-arounds with some towns that allowed us to go digital. The inspections of the home by building inspectors in some cases was delayed. There was also some workarounds where we actually were able to do some Skype inspections with building inspectors. So, from a municipality or governmental perspective, we have experienced some delays and some of that in certain markets may continue a bit.

A

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

But we're encouraged that potentially some of those Skype inspections

A

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Long term.

A

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

...and some of those digital permitting may help us long-term...

A

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Absolutely.

A

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

...what's a bit of a cumbersome process.

A

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

There's no question that we are all, as an industry, going to see more efficiency in permitting, in inspections, in closings, going to digital closings with title and mortgage companies. I didn't know that you could notarize through DocuSign, right, I thought you had to put yourself in front of a notary and they had to watch your signature go down. Well, that's something that can now happen and it's going to be with us for a long time.

A

So, on the material front, in certain markets, we have absolutely lost a couple of weeks here and there. We have a cabinet company in Pennsylvania that was closed for the better part of two months. They were able to manufacture their components through their kitchen cabinets, but they couldn't assemble them, they couldn't put the door on the box of the kitchen cabinet because there were two plants and the second plant was closed by government regulation. So, we all as an industry have stories like that. Thankfully it's easing, but it will cause some stress in the shorter term, as Marty pointed out, for the next quarter because of some of the backlog that was built up that has to be worked through.

Labor availability, no impact. Labor is still good, social distancing on the jobsite, that will have a little bit of an impact. We have to spread our trades out, we have to be more vigilant, most trades are naturally spread out, but there are certain times during when the house is built, particularly when you get into the finishes, the finishing trades where a house can get a bit crowded and we're going to have to be a bit careful there; we may lose a little bit of time through that part of the process. So overall, we're managing it; it's going to get better. I think the impact is more short-term than long-term, but it is present.

Susan Maklari

Analyst, Goldman Sachs & Co. LLC

Okay, thanks for all that color and good luck with everything.

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Thank you, you too.

A

Operator: Thank you. Next question is from Truman Patterson of Wells Fargo. Please go ahead.

Truman Patterson

Analyst, Wells Fargo Securities

Q

Hi, good morning guys, thanks for taking my question. First, just wanted to follow up on labor a little bit, housing slowed, but it seems like it's rebounded recently. At the same time, we're seeing some mass layoffs across the US. Are you actually seeing labor availability improve as workers enter from other industries? And you mentioned that your labor costs were down. I would imagine that's probably occurred in the past two to three months? Is that correct that you've been able to renegotiate the labor wage rates?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Truman, the first half of your question, no, we have not seen labor move from other industries into homebuilding. And yes, labor, my reference to labor being down is over the last few months.

Truman Patterson

Analyst, Wells Fargo Securities

Q

Okay, great. Is there any way you could put a magnitude on that?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Pretty small. It's – yeah it looks like it's under \$1000 a house right now.

Truman Patterson

Analyst, Wells Fargo Securities

Q

Okay, okay thanks for that. And just a bigger picture question, the international, Asian buyer is one of the drivers of coastal California demand. I realize you guys have repositioned some of your product in California as well, so it might not 100% apply to you. But given the issues with COVID, the Chinese economy, the US economy, all these moving parts, how do you think this really plays out over the next couple of years? Do you expect that buyer to come back to the market or really remain absent for a while?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

So, you're right, we've repositioned ourselves in California. Most of the Asian buyers are Orange County and we have just a smaller presence right now in Orange County. In Southern California, we sell 22% of our homes to foreign buyers, that is not Asian, but that is – a lot of that is Asian...

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

...concentrated Asian, yes.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

It's concentrated Asian, but it's not all Asian and I think over the longer term, we will be fine. I think in the short term, obviously there are travel restrictions and other issues affecting Chinese-American relations; that will have an impact. Some of that was in effect before COVID. As we know, the Chinese government was tightening up on US investment. So we've felt that earlier and we had already repositioned ourselves a bit, but yes, I think short term, it's definitely an issue, but I think longer term, we should be fine. We have learned for many, many years

that Chinese love owning real estate in California and in the US and I'm optimistic as things settle out, we will be back to fairly normal times with selling some of our homes to primarily Chinese.

Truman Patterson

Analyst, Wells Fargo Securities

Okay, thank you.

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

You're welcome.

A

Operator: Thank you. The next question comes from Jack Micenko, SIG. Please go ahead.

Jack Micenko

Analyst, Susquehanna International Group, LLP

Hi, good afternoon everybody. Just couple questions, kind of got close to it, but I wanted to ask strategically, does the past, I guess, two, two and a half months change your view? I mean the company has been in transition geographically and product type wise for some time now. But wondering if the last two months maybe has made you think about more about accelerating or increasing the magnitude of that shift either geographically or by product type.

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

No Jack, I don't think it has changed our mindset that already existed to continue to move South, move West and diversify the product offerings with a bigger focus on affordable luxury. So, I think that was in play and we will continue to execute on that strategy.

A

Jack Micenko

Analyst, Susquehanna International Group, LLP

Okay. And then a different time, different place, I think you were talking about a 10% community count growth number this year. Curious, that number's probably not going to be achievable, but how much of the shortfall will be balance sheet conservatism and slowing growth and preserving cash and how much of it is, you can't build it, you're not allowed to in the state or the local market and then what does that look like sort of in the out-year?. Do we see that kind of push out into 2021 or – and if this year was a pretty nice growth rate planned for community count, I'm just wondering how much of that is sort of the environment and how much of that is sort of tapping the brakes coming out of sort of mid-March?

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Yeah, it's a good question. We had planned 32 community openings in Q2 and we opened 21. And the miss of 11 was primarily associated with communities that were scheduled to open in the second half of the quarter that we froze because of the pandemic. The good news is, we have the land; we've started the process of getting the marketing materials ready and the decision as to when they open will be ours in terms of how we feel about market conditions, pent-up demand. We pre-market through our online website concierge service many months in advance and get a very good indication of the amount of interest and a lot of that drives our strategy on when we open. And so we're not prepared to guide right now to what the full-year community count will be. We just have to

A

wait and see how the market conditions evolve. But we have the land and the community is ready when the market is ready.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

Yeah Jack, I think for communities, we would have planned to open the back half of this year, there is two buckets; those where we already own the land and so those will be, if not open this period, they'd be open a subsequent year. For those where we are contracted to buy finished lots and open up a community. As we mentioned, in many of those types of deals, we've put on pause until the market settles out and we will kind of re-underwrite those once we get closer to the revised timing as to whether we want to move forward or not or change the pricing of that land deal and move forward if we can.

Jack Micenko

Analyst, Susquehanna International Group, LLP

Q

Okay, thanks guys. Good luck.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Thank you.

Operator: Next question is from Jay McCanless, Wedbush Securities. Please go ahead.

Jay McCanless

Analyst, Wedbush Securities, Inc.

Q

Hey, good afternoon, thanks for taking my questions. So the deposits that you've taken so far in May, could you talk about how many of those are going to to-be-built homes versus quick-move homes and how does that ratio compare to your historical mix on contracts?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

It's around 20% quick-delivery, which is fairly consistent with the 15% to 18% of quick-delivery inventory that we have and again, remember our – when I say inventory, those aren't completed homes; those are homes from foundation all the way through to finish. So it's tracking fairly close to the mix we have of quick-delivery versus build-to-order.

Jay McCanless

Analyst, Wedbush Securities, Inc.

Q

I asked that question because you were talking earlier about signs of potential demand holding up. I would have frankly thought that mix of quick-delivery would've been a little bit higher, so that seems to be a positive read that your build-to-orders are holding up that well. What about...

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Yeah, I think that's right.

Jay McCanless

Analyst, Wedbush Securities, Inc.

Q

What about your cycle times, how much are you all having to push those out because of the OSHA rules, et cetera?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Yeah, I tried to answer that a few questions ago when I went through the permitting issues and the inspection issues and the social distancing on the jobsite. I mean, the good news is we're not seeing any labor issues. We're having here and there a few scattered material supply issues, but that's improving. I gave the example of the Pennsylvania cabinet company. I think our best guess right now is probably one to two weeks added construction cycle time because of social distancing on the jobsite and maybe you add another week or two of contingency or security for any issues that may come up with permitting, inspections or material supply. So let's just round that off to two to four weeks, is what we sort of conservatively built in as added time for construction. And that should improve over time as we get further from the closures we experienced in certain states.

Jay McCanless

Analyst, Wedbush Securities, Inc.

Q

Got it, thank you. I apologize for missing that.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

No worries.

Jay McCanless

Analyst, Wedbush Securities, Inc.

Q

One other quick question, I was encouraged to hear you guys are not doing incentives above and beyond the 2.99% offer that was emailed out. But what are you seeing from your competitors? How aggressive are you seeing, across the three different buckets you outlined earlier, what kind of incentives and pricing deals are you seeing your competitors throw out there?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

I'm pleased with – that most of our competitors are not incentivizing. I do think at a lower price point, with some finished spec inventory, if a house is completed, it needs to move and I think in that environment, you may see a bit more incentivizing, but where we build at our price point, I'm pleased that I'm not seeing much of it.

Jay McCanless

Analyst, Wedbush Securities, Inc.

Q

Great, thanks for taking my questions.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Thank you, you're very welcome.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

Thank you, Jay.

A

Operator: Next question comes from Jade Rahmani, KBW. Please go ahead.

Ryan Tomasello

Analyst, Keefe, Bruyette & Woods, Inc.

Good afternoon, everyone. This is Ryan Tomasello on for Jade. Just regarding Apartments and City Living, you gave some color in your prepared remarks on the former, but can you speak a bit more about how you're thinking about the outlook for those businesses post the dust settling? Can you remind us how much equity you currently have allocated in each of those segments?

Q

And you mentioned you will be closing a few apartment JVs in the second half of the year. I was wondering how much capital that relates to and what the intention is to do with those proceeds if you expect to reinvest those back into the Apartment business.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

Sure, I think with respect to the Apartment business, we have around \$700 million invested in that business and we hope to recoup \$400 million through the balance of the next 12 months or so through JV formations. With respect to City Living, we're actually at a good time in terms of where we have investments. We have around \$170 million net invested in existing inventory, active communities. We have another \$30 million in our couple off-balance sheet joint ventures and then we have some land inventory for projects that we have chosen not to start in this environment.

A

Ryan Tomasello

Analyst, Keefe, Bruyette & Woods, Inc.

And just in terms of the outlook, particularly in City Living post this environment becoming a bit more certain, if you expect City Living demand to be a big – continue to be a driver for the business?

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Yeah, I think short term we're going to be very cautious. Right now, we only have five buildings in City Living; three are completed and the other two are nearing completion. We do have some land for future buildings where we have not started any construction and right now, we're just sitting on the land. It's not just in New York. We have some land in Seattle and Philadelphia as two examples. So, as Marty said, I think we're at a good time in terms of our City Living business, which had been shrinking significantly.

A

And in those five buildings that I mentioned, which are in – two are in New Jersey, Hoboken, Jersey City and the other three are in Manhattan. They are all positioned sort of mid-market. We've talked about kind of \$2,000 a foot, \$1,800 a foot in New Jersey. They're down at \$1,000 a foot, and so they had been performing fairly well for us through what we all know has been a difficult few years in New York.

And short term, I think we're very realistic that it will take some time to see where New York City falls out on this and then longer term, I'm comforted by what I just described, which was limited inventory in these five buildings

that are all kind of mid-market. But longer term, we will be very cautious with our expansion of City Living in and around New York City until we have more clarity on where the long-term market stands. Today, only about 3% of our business is in Toll Brothers City Living.

Ryan Tomasello

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. And then just in terms of the land market, was wondering if you're seeing any noticeable adjustments in prices there, either positive or negative in your major markets over the past few months with the current environment?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Not yet, land sellers with – Marty gave the one exception in Washington – or Northern Virginia, we walked away from a significant deal because we couldn't reach new terms with a land seller. But virtually every other land seller nationwide has understood and agreed to extensions, whether that be an extension of a due diligence period before deposit money goes hard or whether that be extension of closing or extension of a nonrefundable payment that's necessary. But there really hasn't been a re-trading of price yet. So, I think sellers are understanding that we need more time, but they're not yet willing to talk discount on the underlying price and they're also not yet feeling distressed. We had a couple of isolated opportunities to chase some distress, but nothing of significance yet. So right now, we are just extending and amending. Wasn't that a bank term?

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

Not a good one.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Right, right. In the old days?

Ryan Tomasello

Analyst, Keefe, Bruyette & Woods, Inc.

Q

[indiscernible] (01:15:27).

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

I knew I didn't get it exactly right.

Operator: Thank you. Next question comes from Carl Reichardt of BTIG. Please go ahead.

Carl Reichardt, Jr.

Analyst, BTIG, LLC

Q

Thanks. Hi. guys. On buybacks, you've had a couple of [ph] – it appears (01:15:50), pretty explicit about suspending buybacks, you stopped in mid-March. But you sound more encouraged about business, good cash flow coming, the line is fine. What's your perspective now on where you are with share repurchases?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

It's still suspended. I don't think right now is – we don't have enough clarity yet. As Marty went through, our focus on our liquidity certainly in late March and early April, we drew the line. We repaid the line when it was clear that our banks were going to remain liquid with the help of the federal government and the Federal Reserve. But I think we'd like to continue to make sure that we have ample liquidity, a very strong balance sheet to take advantage of land opportunities that may come along if the markets feel more pain and if the markets continue to improve, then we'll be carefully back in the land-buying business and then maybe at that point, we focus on buybacks. But right now, I think it's smart business to continue to suspend that initiative.

Carl Reichardt, Jr.

Analyst, BTIG, LLC

Q

Right. Thanks, Doug. And then just Marty or Doug on the cost cuts, obviously never easy to lose teammates. Can you give us a little more detail on the \$50 million annualized, like where that's coming from, where the reductions were staff-wise or the other things like delayed IT spend, travel, where are you getting those cuts from? Thanks.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Sure. So before March 15 – and I think we even mentioned it a bit on our last call, we have been focused on efficiencies, tightening up the shop and we had already begun serious conversations about some companywide overhead cuts, employee cuts. And then when COVID-19 hit, that conversation not only accelerated, but we expanded the individuals and the initiatives and we've had – we permanently laid off about 600 employees. We have about 5,000 employees in the company and we furloughed about the same number, another 600.

I'd say three-quarters of the \$50 million is associated with the layoffs and another quarter will be associated with other initiatives that will make us more efficient. Carl, you mentioned a few; IT, travel, but there's many other things we're focused on. I think division offices around the country will probably be smaller going forward as we become – as we've learned how to effectively work a bit more remotely. So, there's many other initiatives like that. The cuts are permanent. Even when the market returns, we are learning how to be more efficient and those are permanent and I know Marty mentioned in his comments that we're continuing to look at how we're going to become even more efficient and that may lead to more opportunities for additional overhead cuts.

Carl Reichardt, Jr.

Analyst, BTIG, LLC

Q

Thanks very much, Doug.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

You're very welcome Carl, thanks.

Operator: Thank you. The next question comes from Alex Barron, Housing Research Center. Please go ahead.

Alex Barron

Analyst, Housing Research Center LLC

Q

Hey guys, thanks for taking the questions. I wanted to ask about – focus a little bit on cancellations. I imagine your cancellation rate was pretty low before the pandemic started and I imagine that the cancellations increased in the

March and April period. So, I'm curious if you guys – if that's the case, what were some of the reasons that you got more – further cancellations, was it job-loss related, was it just loss of confidence, people wanting to wait to see what happens and in those instances, do you guys keep the money or do you refund it?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

So, as we've talked about throughout this call, our increase in cancellations was very modest; we gave the reasons why. The average down payment is \$70,000. Our buyers become very emotionally attached to their home because they've customized it and generally our buyers are more affluent and they have better prospects for job security and they also have other wealth. So even through the 2007-2011 timeframe, our cancellation rate stayed much lower than other builders for those reasons I just gave. So, we are encouraged. Do we keep the money? Yes, we keep the money; sort of a tragedy. I think we're a very compassionate company; so, there's always circumstances where we return the money. But we are building your home to your specifications with a lot of custom changes and we are entitled to keep that \$70,000 for that custom home and that holds up. We have lots of experience and that is our position.

Alex Barron

Analyst, Housing Research Center LLC

Q

Okay. And if I could ask another one, have you guys seen an improvement, I guess, in the last three weeks, like lower cancellation rate? And if I could sneak another one, what percentage of those highly impacted markets you cited, New York, New Jersey, Pennsylvania, et cetera, what percentage of your business did that represent before, I guess, this whole thing started?

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

So, the cancellation rate is the same, and I again I have to emphasize again it has stayed low and we gave that information as to the percentage, so Marty, go ahead.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

I think it was 40% of contracts and 50% of backlog.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Yeah, 40% of community.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

A

Communities – communities, excuse me.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

So those highly impacted states that stayed closed until early May represented 40% of our communities that were open for sale and 50% of the value of our backlog.

Alex Barron

Analyst, Housing Research Center LLC

Okay, sorry I missed that, okay guys, thanks.

Q

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Oh, no problem at all, it's been a long call.

A

Operator: This concludes our question and answer session. I'd now like to turn the conference over to Mr. Douglas Yearley for closing remarks. Please go ahead.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Nick, I thank you very much. I thank everyone for your interest and support. Have a great summer and stay well. Thank you.

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

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