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Toll Brothers, Inc. (TOL)

Q2 2026 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Toll Brothers Second Quarter Fiscal Year 2026 Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] The company is planning to end the call at 9:30 when the market opens. During the Q&A, please limit yourself to one question and one follow-up. Please note this event is being recorded.

I would now like to turn the conference over to Doug Yearley, Executive Chairman. Please go ahead.

Douglas C. Yearley, Jr.
Executive Chairman, Toll Brothers, Inc.

Thank you, Bailey. Good morning. Welcome and thank you all for joining us. With me today are Karl Mistry, Chief Executive Officer; Gregg Ziegler, Chief Financial Officer; Rob Parahus, President and Chief Operating Officer; and Wendy Marlett, Chief Marketing Officer. We are also joined today by Seth Ring, who will succeed Rob as President and Chief Operating Officer when Rob retires on June 30 and transitions to his new role as a senior advisor to the company.

Rob has been an invaluable leader and contributor to the company's growth and transformation over the past four years, and I wish him well in his retirement. He has also done a great job of helping to mentor the next generation of leadership, working closely with Seth to prepare him for his new role. Seth is a proven leader and industry

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veteran who, in his own right, with over 20 years of experience with the company, is just terrific. He is the perfect successor to Rob, and I'm excited to watch as he partners with Karl and Gregg to help lead this company into the future.

During today's call, I will provide a brief overview of our results in the quarter, discuss the market at a macro level and touch on our strategic initiatives. Karl will focus on our operational results and provide a deeper dive on conditions across our markets. And as usual, Gregg will provide a detailed review of our financial results in the quarter and discuss guidance for the balance of the year.

Before we start, however, I will provide the usual cautionary notice that many statements on this call are forward-looking based on assumptions about the economy, world events, housing and financial markets, interest rates, the availability of labor and materials, inflation, and many other factors beyond our control that could significantly affect future results. Please read our statement on forward-looking information in our earnings release of last night and on our website to better understand the risks associated with our forward-looking statements.

We are very pleased with our second quarter results. We beat guidance on both the top and bottom lines, and posted another quarter of strong margins. Based on our first half performance, we are raising our full year guidance across all key homebuilding metrics. Our results in the second quarter reflect our unique position as America's luxury homebuilder, as well as the success of our strategies of expanding our geographies, product lines, and price points. Our results also reflect the skills and experience of our teams, who continue to respond to a challenging demand environment with discipline, effectively balancing pace, price and incentives to drive sales while maximizing returns. We are, quite simply, a more efficient and less cyclical homebuilder. Even in a difficult market, our business continues to perform well.

In the second quarter, our orders were up 7% gross and flat on a per community basis. This trend has continued into the first three weeks of our third quarter, where overall deposits are up modestly year-over-year and flat per community. In this environment, we are pleased to be serving a more affluent customer base, a segment of the housing market that has proven more resilient despite the challenges facing the broader market. Overall, our buyers are less sensitive to affordability pressures as they have benefited from years of income growth, stock market gains, and home equity appreciation.

Serving this market is in our DNA. We have spent nearly 60 years building and perfecting the business model required to meet the high standards of the luxury segment of the new home market. Through the desirable locations of our communities, the distinctive architecture of our homes, the unrivaled choice we provide in our Design Studios and the extraordinary customer experience we deliver, we have set our business apart. Our performance in the second quarter and over the past few years highlights the strengths of our differentiated business.

Finally, I note that in our second quarter, we repurchased $175 million of our common stock, bringing our year-to-date total to approximately $226 million, and we raised our quarterly dividend. We continue to target $650 million of share repurchases in fiscal 2026.

Our balance sheet remains very healthy. We have ample liquidity, significant operating cash flows, low net debt, and a strong investment-grade credit rating. Our solid financial position and healthy cash flows will enable us to continue investing in the future growth of our business, while also returning capital to our stockholders.

With that, I will turn the call over to Karl.

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Karl K. Mistry

Chief Executive Officer, Toll Brothers, Inc.

Thank you, Doug, and good morning, everyone. I would also like to extend my congratulations to Rob and Seth. Rob has been an incredible mentor to both me and Seth. We've learned so much at his side, and we look forward to building on the strong foundation that Rob, along with Doug, Bob and many others have built at Toll Brothers.

As Doug mentioned, our second quarter results were quite strong. In the quarter, we delivered 2,491 homes at an average price of $1,009,000, generating $2.5 billion of homebuilding revenue, or approximately $110 million above the midpoint of our guidance. Our adjusted gross margin was 26.2% in the quarter or 70 basis points better than guidance. And our SG&A expense, as a percentage of homebuilding revenues, was 10.3% or 40 basis points better than guidance.

We earned $260.6 million in the quarter or $2.72 per diluted share, an $0.18 beat relative to the midpoint of our guidance. In addition, we signed 2,834 net agreements in the quarter for $2.8 billion, up 7% in units and 8% in dollars. This increase was driven by the successful execution of our growth strategy over the past several years.

At quarter end, we were selling from 459 communities versus 421 one-year earlier and 386 just two years ago. We remain focused on opening new communities across the country and expect to end the year with 480 to 490 selling communities, including the communities we acquired in the Buffington Homes transaction, which closed earlier this month. We plan to grow community count at a similar 8% to 10% rate in fiscal 2027 and beyond, and we currently own or control sufficient land to do so.

We are very excited to enter northwest Arkansas with the acquisition of Buffington Homes. The home of Walmart and a host of terrific other companies, the Fayetteville/Bentonville market is vibrant and growing. Buffington Homes is the leading builder of luxury homes in the area, and it is a great fit for Toll Brothers. We look forward to leveraging their local expertise and strong land position to scale their business well into the future.

Turning to market trends. As Doug mentioned, the demand environment remained challenging in the second quarter and through the first three weeks of our third quarter. Against this backdrop, we are pleased that we were able to increase sales by 7% year-over-year, keep our per community sales pace flat, and maintain our margins in the quarter. Geographically, Florida was a bright spot in the quarter, with improved demand in all our markets in the state. Boston, all the way down to South Carolina, continued to perform well, as did Boise and Las Vegas in our Mountain region, and Austin, Texas in the South. Weaker markets included Atlanta, San Antonio, Seattle, Portland, and San Francisco.

Among our buyer segments, our luxury move-up business continued to perform the best. In the second quarter, our move-up business accounted for 62% of home sales revenues, up from 59% in the first quarter. Luxury first-time was 22%, and move-down was 16%. Our luxury move-up business has the highest margin among our buyer segments, so we are very pleased that it remains the largest part of our business.

As Doug mentioned in the quarter, we continue to operate with discipline, effectively balancing sales pace, price and incentives to drive sales while maximizing returns. We are pleased that our average incentive for new contracts in the second quarter remained flat at 8% of the gross sales price, the fourth consecutive quarter it has remained in this range. This is a testament to the immense appeal of our brand and the desirability of our homes and communities. It also speaks to the financial strength of our customers, who continue to demonstrate their desire to invest in new homes. Consistent with the past several quarters, approximately 23% of our buyers paid all cash in the second quarter, and the loan to value for buyers who took a mortgage was approximately 69%, also consistent with recent quarters.

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We are also benefiting from the breadth of our offerings, which is the widest in the industry and includes a balanced mix of build-to-order and spec homes. In the quarter, spec homes represented approximately 51% of deliveries and 41% of home sales revenues, which is broadly consistent with the range that we have targeted and maintained over the past few years. We are very comfortable with our delivery mix in this 50/50 range. It is important to remember that we sell our specs at various stages of construction. Although the mix can change from quarter to quarter, on average, approximately one-third of our specs sell before framing is completed. The margin profile for these homes is very similar to the 30% adjusted gross margin we routinely achieve on our build-to-order homes.

Our goal is to sell our specs as early in the construction cycle as possible. Incentives are generally lower on specs that are sold earlier, and there is greater opportunity for our customers to visit our Design Studios and personalize our homes with finishes that match their taste. The ability to customize remains an important competitive advantage for Toll Brothers, as Design Studio upgrades tend to be highly accretive to our margins. In the second quarter, Design Studio upgrades, structural options, and lot premiums averaged $219,000, or 25% of our average base sales price.

Given our focus on selling spec homes earlier in the construction process, I'm pleased to report that, in the first half of fiscal 2026, we reduced the number of finished specs in our inventory by 28%. We held two finished specs per community at second quarter end versus 2.8 at the end of fiscal 2025. In the second quarter, we also continued to benefit from improved production efficiencies. For our build-to-order homes, our cycle time improved to approximately nine months. The cycle time for our spec homes is generally about one month shorter than build-to-order homes. Overall, our building costs remained flat in the quarter, even with the cost of lumber rising in the period.

Turning to land, at second quarter end, we owned or controlled approximately 76,800 lots, 58% of which were optioned. This existing lot position allows us to maintain our highly disciplined approach to acquiring and developing land, including our rigorous underwriting standards. When buying land, we actively seek out acquisition and development opportunities that improve our capital efficiency while achieving prudent and balanced financing structures. Where possible, we favor seller financing, joint ventures, and traditional option arrangements, but we also utilize land banking when it makes sense to do so.

I would also point out that, because we are a luxury builder buying land at the corner of Main and Main, where not as many of the big public and private builders play, we often find there are fewer bidders at the table when we are pursuing deals. This is one of our competitive advantages. In many markets, we often compete for land against smaller custom builders who do not have the same financial strength or access to capital that we enjoy. In addition, for larger master plan communities, our recognized luxury brand serves to elevate the community, which can present us with more opportunities. Combined, all of these factors put us in a favorable position when buying land, helping us improve returns.

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

Gregg L. Ziegler

Chief Financial Officer, Toll Brothers, Inc.

Thanks, Karl. As mentioned, in the second quarter, we delivered 2,491 homes at an average price of $1,009,000, generating home sales revenue of $2.5 billion. We earned $350.4 million before taxes and $260.6 million after, or $2.72 per diluted share. We exceeded the midpoint of our guidance for both home deliveries and average delivered price, which was primarily due to favorable mix out of our Pacific region, better than expected

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performance in Florida, and a greater contribution from our luxury move-up business. We signed 2,834 net agreements for $2.8 billion in the quarter, up 7% in units and 8% in dollars compared to the second quarter of fiscal year 2025. The average price of contracts signed in the quarter was approximately $990,600, up 1% compared to the second quarter of fiscal 2025.

Our second quarter adjusted gross margin was 26.2%, 70 basis points better than our guidance of 25.5%. Our gross margin benefited from the favorable mix from our Pacific region, Florida, and our luxury move-up business that I mentioned earlier, as well as continued improvement in operating efficiencies across our business. Write-offs in our home sales gross margin totaled $32.5 million in the quarter, approximately $20 million of these related to predevelopment costs and option write-offs on deals we dropped that no longer met our underwriting standards. The remainder was associated with a handful of operating communities in different markets around the country.

SG&A, as a percentage of revenue, was 10.3% in the second quarter compared to our guidance of 10.7%. The 40-basis-point beat relative to our guidance was due primarily to greater fixed cost leverage from higher home sales revenues, as well as moderately lower selling costs compared to forecast. Joint venture, land sales and other income was $9.3 million in the second quarter, compared to $29.0 million in the second quarter of last year and our breakeven guidance.

Our cancellation rate was 2.9% of beginning quarter backlog, as compared to 2.8% in the prior-year period. As the percentage of signed contracts in the second quarter, the cancellation rate was 4.8% versus 6.2% in last year's second quarter. We are pleased with our industry-low cancellation rate. It highlights the attachment our buyers develop while customizing their new homes in our Design Studios, as well as the significant financial commitment they make in the form of a down payment.

Our tax rate in the second quarter was 25.6%, which was 40 basis points better than our guidance. We ended the second quarter with approximately $3.3 billion of liquidity, including $1.1 billion of cash and $2.2 billion of availability under our revolving bank credit facility. Our net debt-to-capital ratio was 15.4% at second quarter end, compared to 19.8% one year ago.

Turning to our guidance. I will remind you that our projections are subject to all the caveats regarding forward-looking statements included in our earnings release. We are projecting fiscal 2026 third quarter deliveries of approximately 2,600 to 2,700 homes with an average delivered price between $965,000 and $985,000. For the full fiscal year, we are increasing the low end of our guidance range by 100 homes, and we are increasing the projected average delivered price by $12,500 at the midpoint. We now project deliveries of between 10,400 and 10,700 homes, with an average price between $985,000 and $1 million.

We're also increasing our full year adjusted gross margin guidance by 10 basis points to 26.1%, reflecting our outperformance through the first half of the year. We project a third quarter margin of 25.25%. Our third quarter and full year adjusted gross margin guidance reflect the mix we now expect over the next six months and implies a fourth quarter adjusted gross margin of approximately 26.3%. We are confident in this projection.

Embedded in our backlog is a greater concentration in our fourth quarter of higher-margin move-up luxury and spec homes sold earlier in the construction cycle relative to our third quarter. We expect interest in cost of sales to be approximately 1.1% in the third quarter and for the full year.

We project third quarter SG&A, as a percentage of home sales revenue, to be approximately 10.0%. For the full year, we are improving our guidance by 15 basis points and now expect a full year SG&A margin of 10.1%.

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Other income, income from unconsolidated entities and land sales gross profit in the third quarter, is expected to be $5 million. We now project $120 million for the full year, of which we have already realized $81 million. Included in our second half projection is the sale of several stabilized apartment projects. We project the third quarter tax rate to be approximately 26.0%, and the full year rate to be approximately 25.5%.

Based on land we currently own or control, we expect our community count of between 480 and 490 at fiscal year-end, an 8% to 10% increase versus the 446 at fiscal year-end 2025. We are projecting a community count of 475 communities at the end of the third quarter.

Our weighted average share count is expected to be approximately 95 million for the third quarter and the full year. This assumes we repurchase our target of $650 million of common stock for the full year.

Now, let me turn the call back to Karl.

Karl K. Mistry

Chief Executive Officer, Toll Brothers, Inc.

Thank you, Gregg. Before we open it up for questions, I'd like to thank our Toll Brothers' employees for their hard work in the first half of 2026. I'm proud of your commitment to our customers and dedication to our business, which are key drivers to our long-term success.

Bailey, I think, with that, we can open it up to questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. During the Q&A, please limit yourself to one question and one follow-up. [Operator Instructions] Our first question comes from Mike Dahl with RBC Capital Analyst (sic) [RBC Capital Markets]. Please go ahead.

Michael Dahl

Analyst, RBC Capital Markets LLC

Q

Good morning. Thanks for taking my questions. Nice results in a tough environment, and congrats to all of you who are seeing your roles kind of shift and evolve. I wanted to get one of the obvious things kind of out of the way. Appreciate the details you gave on recent deposit trends. Just given everything is so fluid in rates and some of the macro dynamics, can you give a little more color on what you're seeing from traffic, what you're hearing from buyers? I know you mentioned the deposits. How are the conversion rates to orders? And then in the – with your spec specifically, is there any difference in buyer behavior or trends you're seeing, the ability to sell some of those specs at an earlier stage and over the past month or so?

Karl K. Mistry

Chief Executive Officer, Toll Brothers, Inc.

A

Yeah. Thanks, Mike. It's Karl. I appreciate the question. Let's just – let's talk about the demand piece and what we're hearing. So, demand was really consistent throughout the quarter and has remained the same way in the first few weeks of May. April was our strongest month, but, I think, as we prepared in the script, sort of similar to last year on a per community basis. And I think we're hearing the same thing on the floor that we've heard now for

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some time. Customers are still waiting to make a decision. Conversions are taking a little bit longer. I think we've shared in the past it's tied a bit to consumer confidence at our price point. But overall, I think given the backdrop and the current environment, we're really happy to be flat, frankly, and again, consistent throughout the quarter and early in May.

Michael Dahl
Analyst, RBC Capital Markets LLC

Q

Okay. Appreciate that, Karl. And then my follow-up question, in terms of kind of the margin dynamics, appreciate you guys always have some big moving pieces in terms of mix. So, maybe just, again, help us understand a little more in terms of kind of the – maybe bucket out the mix impacts, 2Q versus 3Q. And then that 4Q dynamic, if you could go into any more detail on maybe quantifying that mix of kind of luxury or Pacific versus what you've previously seen, and if there is any difference in incentives assumed, or if you're just kind of assuming incentives on specs kind of hold flat through the balance of the year?

Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.

A

Okay. That's a big question, Mike. So, I'm going to start it, and I'll let Gregg get into the Q3 and Q4. And as it relates to the margin dynamics and the buckets as we outlined in the script, the QMI, the spec business was just over 50% of deliveries, about 45% of revenue. And if you think about our gross margin, our full year called around 26%, we're still – it's several hundred basis points better on the build-to-order business and the spec mix when you take into account the different stages of construction in which we sell them. And we mentioned we still get a chance to sell a lot of them early enough to get our customers to the studio. But when you put all that together, the QMI mix is several hundred basis points lower, and that range ebbs and flows from quarter to quarter, and that's what unfolded in Q2.

Gregg L. Ziegler
Chief Financial Officer, Toll Brothers, Inc.

A

Yeah. Hey, Mike, it's Gregg. So, as we roll forward to Q3, I think we'll see some changes in the mix. We probably have a little bit of negative mix from our Pacific – I'll give you some regions, like our Pacific region, or Mid-Atlantic, or South region, or some geographic areas where we'll see that change. And on the buyer segment side, we probably have a little bit of our luxury move-up into the mix into Q3, and this is causing the lower outcome for our Q3 gross margin. As well as some of the specs that we sold at a later stage, they're actually going to deliver here in Q3. And so, that's another impact onto Q3. And then we had this dynamic between Q2 and Q3 that Karl just walked you through. There was just some timing associated with settlements, especially some of the higher-margin settlements coming out of the Pacific region.

So, then we have to roll you forward to Q4, right? So, Q4, as I said earlier in the script, is that we expect to rebound up to 26.3%. So, that's about 110 basis points improvement over Q3. So, here, we'll see a little bit of a reversal of some of that mix I just mentioned to you for Q3. That means areas like the Pacific or the North on the geographies will have some positive mix in Q4. And our luxury move-up business will also have some higher density of settlements in Q4. So, that will be accretive to that Q4 gross margin.

And then lastly, I'll call out that from the spec standpoint, we have some specs that we sold at an earlier stage that we'll end up delivering in Q4. And so, they tend to have a higher gross margin the earlier we sell them. And so, that will also help the gross margin in Q4. So, I think that's the bridge to take you through the year.

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

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Stephen Kim
Analyst, Evercore ISI

Q

Yeah. Thanks very much, guys. If I could just follow up on Mike's question there, the second one. So, the setup, it sounds – I'm particularly interested in what might happen sort of beyond just this year. It sounds like what you're saying is that the 3Q lower margin and the 4Q higher margin, it really reflects sort of a normalization, it sounds like, in 4Q. And I just want to make sure that that was correct, that you don't see 4Q as sort of benefiting unduly from maybe a higher mix of early specs or customized homes, but rather it's more like those were factors that were negatively impacting 3Q and 4Q is a normalization. So, just as we think about what things are going to look like into the front part of 2027, I just want to level set whether that 4Q number is, in fact, kind of in your view, kind of a normalized mix for the company going forward.

Gregg L. Ziegler
Chief Financial Officer, Toll Brothers, Inc.

A

Yeah. Stephen, thanks for the question. Yeah, we're not prepared to say that Q4 GM is an exit rate that you should expect as you roll into the first half of 2027. However, it is important to note that there's a certain seasonality to our spec strategy in terms of the timing of when they'll deliver, the timing of when they tend to get sold. So, you're seeing it here play out in fiscal 2026. So, in Q2, we sold a bunch of later-stage specs in the construction cycle, later stages in the construction cycle. They then deliver in our Q3, which ends July 31, as our client looks to get into their home ahead of the school year. Then during Q3 and late Q2, we'll also see that we're selling some of the specs at an earlier stage of construction that will then deliver in our Q4 through October 31. So, there's that seasonality that will happen. As you roll forward into Q1 and Q2, I think we will just have to look back to what you saw from us in fiscal 2026 in terms of expectations there.

Stephen Kim
Analyst, Evercore ISI

Q

Okay. So, let me just clean that up, clean up my question a little bit if I could then, Gregg. I understand that there are seasonal aspects, but there's obviously also changing – changes in the market and selling conditions as we have in an unpredictable manner. And really, what I'm trying to figure out is, if you take out the seasonal, the normal seasonal kind of effects, I'm really trying to get at whether or not the 4Q number is, in your view, sort of a normal 4Q kind of distribution of closings with the mix of BTO versus specs, and early-stage specs, and the geographic, and all that. That's what I'm really trying to get a sense for. Is 4Q, in your view, kind of a normalized 4Q kind of level, taking seasonality into account? Yeah. So, that's basically the question that I have.

Gregg L. Ziegler
Chief Financial Officer, Toll Brothers, Inc.

A

Yeah, Steve, I think you have it right.

Operator: Our next question will come from John Lovallo with UBS. Please go ahead.

Spencer Kaufman
Analyst, UBS Securities LLC

Q

Hey, guys. Good morning. This is Spencer Kaufman on for John. Appreciate the questions. Maybe to start, most of the builders this earnings season ended up taking down their delivery outlooks for the year while you guys slightly raised yours. And I was just curious if you thought this was more of a function of your buyer being a little bit more insulated from some of the volatility in rates and not as concerned about their financial situation, or were you just being a little bit conservative earlier in the year? How should we sort of think about the slight raise there?

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Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.

A

Yeah, thanks for the question. I think you're right on this last point. It is definitely – this luxury segment of the market, which we mentioned is about 60% of our revenue, is doing better. So, that feels better right now. Our performance so far in the first half, we've done well. And the visibility into our backlog for the back half, I think coupled with the acquisition of Buffington, which was a modest improvement in units for the year, gave us the confidence to raise our settlement guide.

Spencer Kaufman
Analyst, UBS Securities LLC

Q

Okay. Understood. And maybe just thinking about the share repurchase target for this year of $650 million. What is your appetite to maybe do a little bit more than that, just given where the stock is currently trading and the strength of your balance sheet?

Gregg L. Ziegler
Chief Financial Officer, Toll Brothers, Inc.

A

Hey, it's Gregg. Yeah, we're not prepared to change our guidance. We just reaffirmed it at $650 million. But of course, we tend to do more in the second half of the year. And so, we will be paying close attention as we exit our blackout period in terms of how much we want to do.

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

Rafe Jadrosich
Analyst, BofA Securities, Inc.

Q

Hi. Good morning. Thanks for taking my questions. How many – when you look at your backlog, how many of the homes that are in your backlog today do you expect to deliver in fiscal 2026 versus what's going to fall in fiscal 2027? And I guess ask sort of another way, in the second half delivery guide, what is yet to be sold?

Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.

A

Yeah, Rafe, thanks for the question. The answer is about 4,100 of our backlog of about 5,400 we expect to close in the back half of 2026. So, that implies when you put together the updated full year guidance, you need about 2,000 specs to both sell and settle in the back half, and that's what's informed of our guide.

Rafe Jadrosich
Analyst, BofA Securities, Inc.

Q

Great. Thank you. That's really helpful. And then you mentioned earlier that stick and brick costs were flattish sequentially even though there's been some increase in lumber. Obviously, we've seen a lot of price increases announcements and diesel costs are up. How are you thinking about stick and brick through the sort of balance of the year or even out into 2027, where all the homes you're starting today are going to get actually delivered? What are you sort of expecting in terms of inflation and your ability to push back?

Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.

A

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Yeah, Rafe, I think the full year guide, we still – we have a high level of confidence. The vast majority of those homes, as we just outlined for you, are well underway, and our teams have done a great job keeping our costs flat and even, as our commentary implied, down in a lot of circumstances to offset some of the lumber prices. So, we've seen very modest impacts, if any, from tariffs. We are hearing about some of the oil and fuel surcharges, but we have been able to fend them off to this point. So, it's too early to tell you how it's going to impact 2027, but we remain confident in our guide in 2026.

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

Sam Reid
Analyst, Wells Fargo Securities LLC

Q

Thanks so much, guys. I wanted to touch on the incentive bucket first. Obviously, done quite well keeping that at 8% for the past four consecutive quarters. Just wanting to dig a little deeper on that. Are there any changes in the composition of those incentives within that 8%? One of your peers I know is doing more forward commitments on some of their move-up homes. Just curious if you're doing something similar on some of your later-stage specs. Would just love some more context on that 8% incentive load.

Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.

A

Hey, Sam. It's Karl. Good question. On the forward commitment and the mortgage programs, I think we've outlined for this group before, we offer these programs. If you were to head to our website today, you would see a rate program. It's great for traffic. We don't see a lot of scale come from those programs. But I think it speaks to our customer, again, not necessarily doing those programs to qualify to move into these homes. They're making this decision by choice.

We're really proud that the incentive has remained consistent. Our build-to-order margin is meaningfully lower than the 8%. It's, over the years, been in that 3% to 5% range. And so, our QMI business – and it evolves quarter-to-quarter depending on the mix of QMIs, what stage they're sold at. But they are a few hundred basis points higher than the 8%, and it's allowed us to be consistent here.

Sam Reid
Analyst, Wells Fargo Securities LLC

Q

All makes sense. I'm glad to hear the consistency. Maybe switching gears on the selling costs. I picked up in the prepared remarks that that was one of the reasons why SG&A came in better than expected. Maybe just unpack that a little bit more. Any differences in terms of inside commissions, outside commissions, broker attach we should be mindful of? Thanks.

Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.

A

Yeah.

Gregg L. Ziegler
Chief Financial Officer, Toll Brothers, Inc.

A

Hey, Sam. It's Gregg. Yeah, for Q2, our SG&A was a bit lower. We did call out our SG&A as having some different factors in there. And generally, we'd say, on the advertising side, we showed a lot of discipline there to cut some costs. And then, on the outside broker commissions, that rate came down just a little bit.

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

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Thanks for taking my question. Good morning, everyone, and congrats on the results. First, and I apologize if I missed this more broadly, but the Buffington acquisition, I was wondering if you could go through some of the key stats there about annual closings, ASP and land position in terms of the lots that you were able to acquire, or control additional lots. And I guess with the midpoint, I believe 50 closings raise for the full year guidance, if that kind of squares with Buffington's contribution?

Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.

A

Yeah. Thanks, Mike. I'll just say again, we're super happy to have met this team and worked with them to complete this acquisition. They are the luxury builder in northwest Arkansas, so it's just a perfect fit for us. The acquisition, I'll give you some of the details. It's approximately 1,500 lots that are in their pipeline. This is a group that builds like us in quite a range from the $400,000s up to over $1 million. As it relates to anticipated settlements, I think 50 this year is probably a good number. That could vary. It could be a little less; it could be a little more. But we felt good. Buffington was part of that decision to raise the full year settlement guide.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Great. No, that makes sense, and appreciate the details there. Secondly, the lower selling cost, I just wanted to follow up on that question. I guess, curious on two things. First, of the 40 bp beat, can we think of it roughly equally split between leverage and these less advertising and lower outside brokerage?

And secondly, on the slightly less advertising and lower outside brokerage, is that something that we could expect to continue or maybe even increase over the next 12 to 18 months? And specifically, I'm wondering if it's, in some ways, reflective of a market that's stabilizing in your view and maybe requires less dollars or resources to generate the same amount of incoming orders?

Douglas C. Yearley, Jr.
Executive Chairman, Toll Brothers, Inc.

A

Hey, Mike. It's Doug. Here's an easy answer. Yes, in all regards. We are more efficient, and we're very encouraged by what our marketing group can do to continue to drive sales in what has been a bit of a difficult market. So yes, we're excited for where this is headed.

Operator: Our next question comes from Trevor Allinson with Wolfe Research. Please go ahead.

Trevor Allinson
Analyst, Wolfe Research LLC

Q

Hi, good morning. Thank you for taking my questions. I want to ask a follow up on M&A following your purchase of Buffington Homes in Arkansas. What other markets ranked high on your priority list for entry? And then, can you just talk broadly about your appetite for additional M&A in the current environment?

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Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.
A

Hey, Trevor. It's Karl. We've done an incredible job, I think, with Doug's leadership over the last 10 years of dotting the map. We're very, very happy with our geography and excited that we think we can be bigger and have a higher market ranking in a lot of these places, which we're doing every year with our community count growth.

To your question about the remaining spots on the map, there are parts of the Midwest where we don't have a footprint today. Indianapolis, Minneapolis are two spots that come to mind. And again, the places we can be, we can be much, much bigger than we are. I think we'll continue to do this type of acquisition like you saw with Buffington in northwest Arkansas. We've now done 16 acquisitions over the last 32 years. They've all been – but for the exception of Shapell, which was a really incredible transformational acquisition, the rest have been about this size, these bolt-on, good fit, strategic acquisitions. And that will remain our focus. I don't anticipate any transformative M&A in the near term.

Trevor Allinson
Analyst, Wolfe Research LLC
Q

Okay. It makes sense. Thanks for that, Karl. And then second question is following up on the commentary about selling specs earlier in the construction process. Does the volatility in mortgage rates we've seen recently impact your ability, just given the uncertainty that it creates for the consumer to continue to sell earlier in the construction cycle, or you're still finding success in that initiative here over the last several weeks, even with rates moving around quite a bit? Thanks.

Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.
A

Trevor, the rates have not had an impact in that regard at all. We really like how we've been able to build this business to offer these specs at various stages of construction and still offer choice. And at least for our consumer, at our price point, we're not seeing the recent rate sensitivity changing those dynamics.

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

And, Trevor, let me weigh in here, and it relates back to Steve Kim's question on Q4 margin and what we can read into that for 2027 and beyond. As Karl mentioned earlier in his prepared comments, we have been working hard on reducing our finished spec count. We took it down 28% through a lot of hard work, and it did require some more incentives, as we talked about. Finished homes ready to deliver in this environment for all builders is requiring, in many markets, more incentives because of those market dynamics out there, not everywhere, but in many markets. And we are delighted that we were able to bring the finished spec count down by 28%, taking it from 2.8 finished homes per community to two with those added incentives, with that initiative, and still beat gross margin guide. And I compliment the team for doing that. We are now in a much better position at two specs per community. And I think, now, we're very focused.

Even if we have to incentivize a little more to sell a home early in construction, it's better to do that, have enough time for the client to go to the Design Studio, spend a bunch of money there, which is highly accretive. Our Design Studios run at a 40-plus gross margin. So, it's better to throw a little more incentive early than wait for the house to get to the end, have a bigger incentive, and not have the accretion coming out of the Design Studio. And we're in a really good place right now.

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We also have more luxury move-up. Our entire business, of course, is luxury, even first-time. And our first-time homes are $700,000, $800,000. People do go even then and spend money in the Design Studio. But the move-up luxury, which is doing really well, we're seeing more and more deals for move-up. We're focused more and more on move-up. And when you combine that end of the business in really good shape with high margin, with good deal flow, and less finished specs in our communities, and more focus on selling them earlier, I think what you're seeing coming out of Q4, without any guide for 2027 and beyond, is somewhat indicative of where this business now sits longer term.

Operator: Our next question comes from Alan Ratner with Zelman. Please go ahead.

Alan Ratner
Analyst, Zelman & Associates
Q

Hey, guys. Good morning.

Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.
A

Yeah.

Alan Ratner
Analyst, Zelman & Associates
Q

Congrats on a really strong quarter in a tough environment. Karl, my first question just on some of your market color. I would love to dig in a little bit more on a couple of callouts you made in Austin and Florida being some of your relative bright spots in the quarter. And those are two areas that I think have been more challenging over the last several years coming out of the pandemic. And I'm just curious if you feel like the relative strength you're seeing there is more company-specific, maybe based on your product positioning or communities or pricing strategy, or do you feel like both Florida and Austin might have hit an inflection point from a broader market perspective, and conditions seem to be stabilizing there across the board?

Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.
A

Yeah. Thank you, Alan. I think the answer is maybe a little bit of both. But I want to talk to you about those two markets, and I'll be able to tell you some stories about what we do and why we think it's working well for us right now. In Florida, you have heard, I think, from the group of builders that things have firmed up a bit, inventories have come down. But we have some exceptional locations, and it's because we are willing to build luxury homes, this move-up segment of our business, at scale. And I touched on it a little bit in the prepared remarks. That is a smaller table of bidders when that land is purchased, because fewer builders want the business from $2 million to $3 million, as an example, in West Palm Beach in Florida. We opened a community there late last year, selling homes at about $3 million on average at about two a month, and we have gross margins there in the low 30s. And that's one of many examples like that today in Florida.

In Austin, I think it's maybe even a better story. That is a market where the headlines certainly would lead you to believe it's soft. And we've had an exceptional quarter and really first half in Austin, a credit to that team. We opened a community, Alan, in the Brushy Creek area, just north Austin, almost $1.5 million average sales price. And this is a community that's opened up with almost no new home competition within this zip code and school district. Again, not a unique characteristic for what we do, and that is also producing gross margins in the low 30s. So, I think both of those markets might be seeing green shoots from all builders. But specifically, what we do and what we do well is performing better, and it's creating this contrast from our peers.

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Alan Ratner
Analyst, Zelman & Associates

Q

That's really helpful color. I appreciate that. Second question, on land banking, you brought that up in your prepared comments. And just looking at your share of controlled lots, the 58%, obviously up quite a bit over the last four or five years. Are you able to drill in deeper and quantify exactly what percentage of your portfolio is land-banked, and has that been increasing significantly over the last year or two? I guess there is obviously a lot of focus on whether the higher costs associated with land banking are going to start to filter through to builder margins. And I'm curious if you feel like there's any mixed headwind associated with that coming up in the future.

Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.

A

Yeah, Alan, about 20% of our revenue this year is going to come from communities that were land-banked. As you look into our pipeline of lots, about 30% of those are either optioned or land-banked. I'm sorry. 30% of the option lots are land-banked. So, it's likely to move up modestly. I think, and again we laid it out in the script, because of the nature of the land that we buy, our first turn is to work with sellers to get seller financing or some other favorable structures instead of turning to the land banking market first. This guy sitting next to me, Doug, has taught us, over the years, the importance of balancing margin with returns. And so, we continue to execute on that well. And with the deal flow we see and the opportunities to structure them with sellers, this 20% to 30% for the future feels about right.

Operator: Our next question comes from Jay McCanless with Citizens. Please go ahead.

Jay McCanless
Analyst, Citizens JMP Securities LLC

Q

Hey. Good morning, everyone. Doug, if you could talk a little more about some of the deal flow you're seeing in luxury move-up, and is that deal flow getting better at some of the smaller builders or either falling by the wayside or can't get the capital to take those deals down?

Douglas C. Yearley, Jr.
Executive Chairman, Toll Brothers, Inc.

A

Yes, you described it exactly right. Our business was built on move-up luxury, and we did a great job in the last decade of widening geographies and widening price points and product. We talked about we go from $400,000 to [ph] $10 million (00:53:16). We have over 40 Design Studios that serve all our clients, where they can go and spend a couple hundred thousand dollars on all the beautiful finishes. And so, the core move-up business where the buyers are more affluent, they have equity in their homes, they've done well in the stock market, they have job security and wage growth. They are primed to continue to feed that core business, which, again, is about 60% of what we do.

And so, our land teams, while always focused on move-up, have been charged in the last few years. Okay, thanks, guys. You did a great job of finding luxury first-time. You did a great job of finding luxury move-down. Now, let's double down on the core business, which is highly profitable, has a great demographic and affluent buyer profile. And so, it's a combination of our internal effort to focus those teams even more than ever with, as you described, good deal flow with less competition because the corner of Main and Main, they tend to be very nuanced deals in difficult towns that are complicated to get entitled. The land planning, the creativity that may have to go into a piece, that is the unique piece and not the next farm down the road, these are all the pieces of

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expertise that we bring. And we have the cash, so we can distinguish ourselves in the land buying. And we're seeing more and more of those opportunities, and we're very excited about it.

Jay McCanless
Analyst, Citizens JMP Securities LLC

Q

Okay. That's great. Thank you, Doug. And then the second question I had, we saw on Monday from the NAHB, it looks like builder confidence had a nice jump, traffic had a nice jump. I think you guys talked about it, what you've seen in May already. But I guess, is that – with the builder confidence and the traffic numbers, is that in line with what you guys are seeing, and is it pretty well spread nationally?

Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.

A

Yeah, Jay, I think it's still too early to tell. I'd lean back into the commentary that we've seen, May has looked a lot like April. April was the strongest month in the quarter. Traffic, web and foot traffic are up on a year-over-year basis, but in line with last year on a per community basis.

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

Douglas C. Yearley, Jr.
Executive Chairman, Toll Brothers, Inc.

Thank you, Bailey. You were terrific. Thanks, everyone for your interest and great questions. Karl, and Gregg, and the entire team are always here to accommodate you with any individual questions or follow-up you may have. Have a wonderful Memorial Day weekend, and we look forward to continuing our dialogue about our great company. Thanks so much. Take care.

Karl K. Mistry
Chief Executive Officer, Toll Brothers, Inc.

Thank you.

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

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