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Toll Brothers, Inc. (TOL)

Q3 2026 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Toll Brothers Third Quarter Fiscal Year 2026 Conference Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] The company is planning to end the call at 9:30 when the markets open. During the question-and-answer, 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, Betsy. Good morning. Welcome, and thank you all for joining us. With me today are Karl Mistry, Chief Executive Officer; Gregg Ziegler, Chief Financial Officer; and Seth Ring, President and Chief Operating Officer.

During today's call, I will provide a brief overview of our third quarter results and current market conditions, Karl will discuss our operating performance and trends across our markets, and Gregg will review our financial results and our outlook.

Before we begin, please note 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 pleased with our third quarter performance. In a challenging housing market, we continue to produce solid results. We delivered 2,662 homes and generated $2.6 billion of home sales revenue, exceeding the midpoint of our guidance in both units and dollars. Adjusted gross margin was 25.6%, or 35 basis points better than guidance, and we generated $280.1 million of earnings, or $2.97 per diluted share, which also beat guidance. Net signed contracts increased 5% compared to the third quarter of last year.

Demand from luxury buyers remained relatively resilient, and we continue to benefit from the expansion of our community count. While orders improved, the overall sales environment remained subdued, with low consumer confidence and elevated mortgage rates continuing to weigh on demand. Consistent with our long-standing approach, we continue to prioritize price discipline and margin performance over sales pace, a strategy that we believe is particularly important in the current environment. We also remain focused on our luxury move-up customer and build-to-order business, where, as the nation's leading builder of luxury homes, we are uniquely positioned to serve affluent buyers across a wide range of markets and product offerings.

Over our nearly 60-year history, we have built a tremendous brand and a differentiated business model, with advantages that include highly desirable community locations, distinctive home designs, extensive personalization opportunities, and exceptional customer experiences. These strengths have helped us attract a customer base with greater financial resilience, one that is less affected by affordability challenges due to higher income levels, substantial existing home equity, and sizable stock portfolios.

Our third quarter results further demonstrate the strength of our business model. Our strategy is durable precisely because it is built on differentiated capabilities that enable us to create value even when market conditions are less favorable. And while we remain focused on executing in the current environment, we are well positioned to accelerate growth, margins and returns when market conditions eventually improve.

During the quarter, we returned approximately $231 million to stockholders through dividends and share repurchases, while continuing to continuing to invest in the growth of our business through disciplined investments in new land. We continue to project significant operating cash flow in 2026 and are increasing our projected stock repurchases for the year to $700 million, up from our previous projection of $650 million. We remain on track to deliver 8% to 10% community count growth in fiscal 2026, which will be our third consecutive year of 8% to 10% growth. Our existing land position supports similar community count growth in fiscal 2027 and beyond.

Finally, I note that our balance sheet remains very strong, with ample liquidity, low leverage, and substantial operating cash flows. Our financial strength will enable us to continue investing in growth while returning capital to our stockholders.

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

Karl K. Mistry

Chief Executive Officer & Director, Toll Brothers, Inc.

Thank you, Doug, and good morning, everyone. As Doug mentioned, our third quarter results were solid. We beat on both the top and bottom lines and positioned the company to deliver another year of healthy profitability and returns in fiscal 2026. Our adjusted gross margin was 25.6% in the quarter, or 35 basis points better than guidance, reflecting the disciplined execution of our sales strategy and our more efficient operations.

We signed 2,508 net agreements in the quarter for $2.5 billion, up 5% in units and 4% in dollars. This increase was once again driven by the successful execution of our growth strategy. At quarter end, we were selling from 471 communities versus 420 at the end of the third quarter of fiscal 2025. We remain focused on opening new communities across the country and continue to expect to end the year with 480 to 490 selling communities.

Based on our strong year-to-date performance and our outlook for the fourth quarter, we are reaffirming all of our full year guidance metrics, including an adjusted gross margin of 26.1% and home sales revenues of approximately $10.5 billion. In addition, we now expect our average delivery price to be between $995,000 million and $1 million for the full year. At the midpoint of our settlement's guidance, this increase is expected to generate approximately $53 million of additional revenue over prior guidance.

Turning to market trends. As Doug mentioned, the demand environment remained challenging in the third quarter. These conditions have continued through the first 2.5 weeks of our fourth quarter. Against this backdrop, we are pleased that we were able to increase sales by 5% year-over-year, modestly reduce incentives, and maintain our margins in the quarter. Geographically, stronger markets included Florida; Boston through the Carolinas; Boise, Idaho; Las Vegas and Reno in Nevada; and Denver, Colorado. More challenging markets included Atlanta, Seattle, Portland, San Francisco, and Texas.

Among our buyer segments, our luxury move-up business continued to perform the best and, as Doug mentioned, we are leaning into this core segment, where we see great deal flow that meets our high underwriting standards. Our move-up business accounted for approximately 61% of home sales revenues in our third quarter, while our luxury first-time and move-down businesses represented approximately 23% and 16%, respectively. Not only does our luxury move-up business remain the largest contributor to revenues, but it also generates the highest margin among our buyer segments. Importantly, in this market, the higher the price of our homes, the lower the incentive as a percentage of sales price. The continued strength of our luxury business reflects the resiliency of our affluent customer base, the desirability of our communities and product offerings, and the appeal of the Toll Brothers brand.

We also continue to carefully manage spec starts to align with demand on a community-by-community basis, while actively managing the composition of our spec inventory. During the third quarter, we continued to reduce our inventory of spec homes. At quarter end, finished specs average 1.9 homes per community, down from 2 at the end of the second quarter and 2.8 at the start of fiscal year 2026.

As a reminder, the margin profile of spec homes sold before framing is completed is significantly higher than the margin on finished specs. Our objective is to sell spec homes as early as possible in the construction cycle, when incentives are typically lower and customers have greater opportunities to personalize their homes at our Design Studios. Personalization remains an important competitive advantage for Toll Brothers, as Design Studio upgrades are highly accretive to margins. Overall, upgrades, structural options, and lot premiums averaged $207,000, or 24% of our average base sales price in the quarter.

As Doug mentioned, during the quarter, we continued to carefully balance sales pace, pricing, and incentives to drive sales while maximizing returns. Incentives on our net signed contracts averaged approximately 7.5% of gross sales price in the quarter, down modestly from approximately 8% over the past year and consistent with our strategy of selling specs earlier in the construction cycle when buyers can still personalize their homes in our Design Studios. Approximately 25% of our buyers paid all cash in the quarter. Among buyers who financed their purchase, the average loan-to-value was approximately 69%, highlighting the financial strength of our customer base.

In the third quarter, we continued to realize the benefits of production improvements, and our cycle time for build-to-order homes remained stable at approximately nine months. Cycle time for our spec homes is generally about one month shorter than build-to-order homes. Overall, our building costs remained relatively flat in the quarter, even as the cost of the lumber rose during the period.

Turning to land. At third quarter end, we owned or controlled approximately 75,500 lots, 58% of which were optioned. We spent approximately $452 million on land acquisition in the quarter. We remain focused on securing high-quality land at attractive returns, with a continued emphasis on capital efficiency and rigorous underwriting standards.

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

Gregg L. Ziegler

Chief Financial Officer, Toll Brothers, Inc.

Thanks, Karl. As mentioned in the third quarter, we delivered 2,662 homes and generated home sales revenue of $2.65 billion. We earned $374.8 million before taxes and $280.1 million after, or $2.97 per diluted share. The average delivery price of homes in the quarter was approximately $996,000, above the high end of our guidance range and driven primarily by mix, including a greater than expected proportion of luxury move-up and Pacific deliveries. We signed 2,508 net agreements for $2.5 billion in the quarter, up 5% in units and 4% in dollars, compared to the third quarter of fiscal 2025. The average price of contract signed in the quarter was approximately $1,003,000, versus $1,010,000 in the third quarter of fiscal 2025.

Our third quarter adjusted gross margin was 25.6%, or 35 basis points better than our guidance of 25.25%. The outperformance was also driven by mix, as well as continued benefits from improved operating efficiencies across the business. Write-offs in our home sales gross margin totaled $17.7 million in the quarter. Approximately $5 million of these related to predevelopment costs and option write-offs on deals we dropped that no longer met our underwriting standards.

SG&A as a percentage of revenue was 10.0% in the third quarter, in line with our guidance. Joint venture, land sales, and other income was $6 million in the third quarter, compared to $15 million in the third quarter of last year and our guidance of $5 million. Our cancellation rate was 2.6% of beginning quarter backlog, as compared to 3.2% in the prior-year period. As a percentage of signed contracts in the third quarter, cancellation rate was 5.4% versus 7.5% in last year's third quarter. We are pleased with our industry-low cancellation rate. It highlights the attachment our buyers develop while personalizing their new homes in our Design Studios, as well as the financial commitment they make in the form of a significant down payment.

Our tax rate in the third quarter was 25.3%, compared to guidance of 26.0%. We ended the third quarter with approximately $3.3 billion of liquidity, including $1.1 billion of cash and $2.2 billion of availability under a revolving bank credit facility. Our net-debt-to-capital ratio was 15.6% at third quarter end, compared to 19.3% one year ago.

Turning to our guidance. I will remind you that our projections are subject to all of the caveats regarding forward-looking statements included in our earnings release. We are projecting fiscal 2026 fourth quarter deliveries of 3,450 to 3,550 homes, with an average delivered price between $995,000 million and $1,005,000 million. For the full year, we are narrowing our settlement range and increasing our average delivered price range. We now project between 10,500 and 10,600 delivered homes at an average price between $995,000 and $1 million, which equates to an approximate $53 million increase in our full year home sales revenue guidance.

We continue to expect a full year adjusted gross margin of 26.1% and project a fourth quarter margin of 26.0%. We expect interest in cost of sales to be approximately 1.1% in the fourth quarter and for the full year. We project fourth quarter SG&A as a percentage of wholesale revenues to be approximately 8.1%. For the full year, we continue to project an SG&A margin of 10.1%.

Other income. Income from unconsolidated entities and land sales gross profit in the fourth quarter is expected to be approximately $30 million and approximately $120 million for the full year. We project the fourth quarter tax rate to be approximately 26.0% and the full year rate to be approximately 25.2%. We expect our community count to be between 480 and 490 at fiscal year-end and 8% to 10% increase versus the 446 at fiscal year-end 2025. Weighted average share count is expected to be approximately $94 million for the fourth quarter and $95 million for the full year. These amounts reflect our increased projection of $700 million of share repurchases for the full year. Through the end of our third quarter, we have already completed $433 million of share repurchases.

Now, let me turn the call back to Karl.

Karl K. Mistry

Chief Executive Officer & Director, Toll Brothers, Inc.

Thank you, Gregg. And before I open it up for questions. Last month, we marked an exciting milestone for Toll Brothers, celebrating our 40th anniversary as a publicly traded company on the New York Stock Exchange. I'd like to thank all of our Toll employees for their contributions over the years. It is their passion for our business, dedication to our luxury brand, and commitment to our customers that will ensure our continued success.

Betsy, 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. As a reminder, the company is planning to end the call at 9:30 when the market opens. During the question-and-answer, please limit yourself to one question and one follow-up. [Operator Instructions] The first question today comes from John Lovallo with UBS. Please go ahead.

John Lovallo
Analyst, UBS Securities LLC

Q

Morning, guys. Thanks for taking my questions. The first one is, your outlook implies a 30%-plus quarter-over-quarter increase in deliveries at the midpoint, and that's going to drive about a 40-basis-point increase in gross margin sequentially. Now, understanding that you've exceeded your gross margin outlook in 15 consecutive quarters by an average of 65 basis points on average, I mean, how much conservatism is baked in here given just the uncertainty in the macro?

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

A

Hey, John. Good morning. It's Karl. Let us talk a little bit about Q – you mentioned Q4 and how we're going to get to the number. I'll let Gregg talk about the margin. 2,700 of our projected 3,500 homes for the midpoint of the quarter will come from backlog. So, those are scheduled and already in our backlog, which leaves 800 homes that need to sell and settle within the quarter. We have about 900 finished specs. Many of those will be part of that 800, and then nearly 1,000 behind those that are at a stage of construction where they can also close by the end of Q4. So, we feel great about the 3,500 number. Gregg, you want to talk about the margin?

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

A

Yeah. John, thanks for asking about Q4 gross margin. The dynamics at play there are that we think we're going to have a little positive mix coming out of certain regions, to be specific, our North and our Pacific region. In the buyer segment side, it looks like we'll have a little bit more luxury move-up settlements. Also, we talked about this last quarter, but the specs that are going to deliver in Q4, we sold them at an earlier stage of construction. And as Karl mentioned in his prepared remarks, that is helpful to gross margins. So, those are the dynamics at play for Q4.

John Lovallo
Analyst, UBS Securities LLC

Q

Okay. Understood. And then on the 8% to 10% community count growth expected this year, but also now into fiscal year 2027 and beyond, I mean, I guess the question is, what would sort of derail this expected growth? I mean, in other words, if the market were to remain soft next year, which is not our expectation, would you pull back on community count growth at all, or is that plan pretty much in place?

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

A

No, John. We feel very good about the 8% to 10%. Many of those communities are well underway, in a lot of cases, model homes under construction. The current market environment would not lead us to modify that. Even a softening market, we're committed to getting these communities open.

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

Stephen Kim
Analyst, Evercore ISI

Q

Yeah. Thanks very much, guys. Appreciate all the color so far. I guess my first question relates to your land supply. Your own lot count has continued its steady decline on a year-over-year basis, even as your community count has continued to grow. I'm curious, how much lower do you think you can take that owned lot count given your continued growth plans?

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

A

Thanks for the question, Steve. Yeah, we're happy with the progress that we've moved that back. Our owned land after backlog is sort of in this 1.5- to 2-year range. And I think the reason we've been able to execute this way is a couple of things. We have been land banking now for a few years, still carefully and modestly. But as you know, that contributes to more in the optioned and controlled bucket versus owned. And then being who we are, oftentimes at a less competitive table acquiring land, we're able to get seller financing. And that has also contributed to us being able to be more efficient with all of our land acquisitions. So, it's both of those factors.

Stephen Kim
Analyst, Evercore ISI

Q

Yeah. That's great. So, in other words, I assume you're saying basically you think you can continue to take it down, I just want to be clear, on an absolute lot basis.

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

A

Yeah. I think that's right. As a company grows on an absolute lot basis, it may turn the other way. But the 1.5- to 2-year range of owned, we feel good about.

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

Alan Ratner
Analyst, Zelman & Associates

Q

Hey, guys. Good morning. Nice quarter.

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

A

Good morning.

Alan Ratner
Analyst, Zelman & Associates

Q

So, obviously, given your commentary, it sounds like luxury move-up is still an outperformer for you guys. The last month or two, it seems like there's been a few headlines out there suggesting the K-shaped economy might be coming to an end. And talking to some move-up builders, anecdotally, we're hearing a little bit more chatter about buyers either having difficulties selling an existing house or just concerns about equity embedded in their existing home. So, I'm just curious, over the last month or two, have you seen any even incremental shifts suggesting that that outperformance we've been seeing for the last several years at luxury might be coming to an end or at least softening a little bit?

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

Thanks, Alan. It's Karl again. The short answer is no. We haven't seen any sort of material change. As we outlined, 25% of the buyers still paying cash, 70% loan-to-value. It's extremely sticky. We've actually been able to – in about 30% of our communities, we're able to raise prices in the quarter. So, we feel really good about where we are. We've worked hard to build an infrastructure here so we can build in these unique locations. And the rest of the things we outlined in our script around choice and architecture and the customer experience give us that differentiated edge even over the custom builder community. So, our buyer's holding in there.

Alan Ratner
Analyst, Zelman & Associates
Q

That's great to hear. And can you just refresh my memory how you guys handle contingent sales? So, if a buyer has an existing home to sell, how you treat that both from an accounting standpoint and whether you refund deposits if they ultimately can't sell their house?

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

Yeah. We do not offer the traditional home sale contingencies you're referencing. We don't do that at all. So, if we have a finished spec and a customer puts money down on a home that might close in 30 days, internally, we look at that as a contingency, even though that money is not refundable. But from an accounting perspective, it is not an agreement in our system until that home is closed.

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

Mike Dahl
Analyst, RBC Capital Markets LLC
Q

Hi. Thanks for taking my questions. Just to delve in a little bit more on the current dynamics, you mentioned the challenging market conditions and the first couple of weeks of the quarter have remained challenging. Can you just give us a flavor for maybe some quantification around that through the quarter and August? And especially, the last couple of years, you've had kind of an abnormal sequential uptick in your sales pace in 4Q versus 3Q. And I think, normally, it's down more like low double digits sequentially. So, just if you could help us a little bit more on how we're supposed to interpret that, that would be great.

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

Yeah. Hey, Mike. It's Karl again. So, I'll give you a little bit on Q3. We saw the typical step-up within the quarter. So, May to June was better. June to July was better. After the 4th, there's generally a little bit of a pop in July. And while there was, it was a little bit more muted. Certainly, the mortgage rate's ticking higher in July, consumer confidence going the other direction and, I'll call it, renewed geopolitical uncertainty. We had greater expectations for July. And that has – we've sort of continued on so far in Q4. But I'd caution you to draw too much of a conclusion there. We're 2, 2.5 weeks into August, and so it's just too early.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Okay. Understood. And then just shifting gears to the margin side, appreciate the efforts in terms of the mix of specs and then the overall mix dynamics and the incentives seem to be suggesting that there's some momentum there. When you think about kind of the, I guess, two parts, the beat in the quarter and then 4Q guide, it's slightly light of where you previously expected. How much of that is a mix dynamic in terms of kind of pulling forward some stuff into 3Q, and how much is potentially in light of, the past month or so, maybe a bit more of a reduction in expectations on what those spec margins may provide in fourth quarter?

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

A

Hey, Mike, it's Gregg. Thanks for that question. It's the former. It's really just timing of settlements. All the dynamics we laid out for you 90 days ago on how we thought the second half of fiscal 2026 would play out remain intact. It's just that we had some timing differences in terms of when some of the – whether it was geographic or buyer segment or spec settlements actually hit in Q3 or now expect to hit in Q4. That's the real reconciliation.

Operator: The 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. First, can you just talk about the impact from Buffington in the quarter and what's expected in the fiscal fourth quarter? I think you had some communities that opened. I'm not sure if there were any sales and if there's any impact from absorption from that. And is there any purchase accounting in the gross margin?

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

A

Hey, Rafe. We are super excited about Buffington. They joined our team in May. We've had a typical summer. They have contributed with about half a dozen open communities. I think the guys are confirming. I think it was around 30 sales in the quarter, maybe 25 settlements. I think we're expecting a little bit better than that in Q4.

[indiscernible] (00:29:36)

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

A

And then your last point on purchase accounting, yes, purchase accounting will have that drag on the gross margin, which is factored into the guidance.

Rafe Jadrosich
Analyst, BofA Securities, Inc.

Q

Okay. Thank you. That's helpful. And then on the starts outlook, it looked like the fiscal third quarter or at least pre-footing was up, I think, over 30% year-over-year. This is pretty big acceleration. Can you just talk about what's driving that, like why you accelerated, and then what's expected for the fiscal fourth quarter?

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

Yeah. Rafe, as we outlined it, we still manage this on a community-by-community basis and week-to-week. And I think, over time, we continue to improve and refine our process here. So, we outlined we have reduced finished specs, which we're now down to 1.9. We're very happy with that because we're now sort of towards the end of the selling season and the end of the summer. And so, you begin building specs again to get ready for spring. As you know, our spring selling season starts in mid-January and is going to go through Memorial Day. So, some of that is timing to meet seasonality of demand.

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

Sam Reid
Analyst, Wells Fargo Securities LLC
Q

Hi. Thanks so much, guys. I wanted to drill down a little bit more on some margin topics. You mentioned that there was a bit of a pullback, it sounds like, in incentives. Some of that sounds like it's mixed, but could you also talk to perhaps any tweaks in your incentive buckets that might also be influencing that?

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

Hey, Sam, it's Gregg. Yeah, no real tweaks in the incentive bucket, meaning our buyers are not taking mortgage buy downs with any greater velocity or anything like that. So, there's nothing really that changed there. Sometimes, around that overall incentive that appears to us can be around mix of settlements and which home sites were sold with which incentive, but no big shifts there.

Sam Reid
Analyst, Wells Fargo Securities LLC
Q

That helps. And then maybe switching gears to lot costs, just some early perspective on what lot costs could potentially look like into next year, lot cost inflation, I guess, I should say. You've got some good visibility based on some of the communities that you're opening. So, would just love some perspective on the type of lot inflation we should be potentially on the lookout for.

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

Yeah, Sam, I'll give you some detail here to help. About 70% of our land spend so far year-to-date has been in our sort of core luxury segment, and we like it there. Those are the deals that are working. The land inflation question is a tough one for us because we don't buy a lot of commoditized land, nor do we buy too much land in master planned communities phase after phase after phase where we can point to a prior year or prior years and look at inflation. So, hard for us to say, partially because we have very low competition for most of our land.

Operator: The 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. SG&A has been hovering in the 9% to 10% range for the last several years. That's a bit better than where it was pre-COVID. But you also have some good community count growth coming online next year and then also in years after that, it sounds like. So, how do you expect SG&A to trend over the next couple of years? Is 9% to 10% a good range for you, or what's the right level of SG&A moving forward?

Karl K. Mistry A

Chief Executive Officer & Director, Toll Brothers, Inc.

Hey, Trevor. Yeah, I think that's right, 9% to 10%. We built this company to build more homes than we are today with the infrastructure and people we have in place. So, the 10 percentage that you see today is in an environment where absorptions are below our historical average. So, in a more normal environment, I think we could be squarely in the 9s. But I'm really pleased with the effort the team has put forward to get us to where we are.

Trevor Allinson Q

Analyst, Wolfe Research LLC

Okay. Thanks for that color, Karl. And then, second question on vertical costs. I think the general commentary from most builders have been they've been able to push back on some of these building products price increases. So, maybe excluding lumber, have you all also been able to fend off the price increases? And for products that you have either annual or multiyear contracts for, is there a risk for a bigger step-up in pricing once those contracts roll over, which potentially could drive some input cost inflation for you guys into 2027? Thanks.

Seth J. Ring A

President, Chief Operating Officer & Director, Toll Brothers, Inc.

Hey, Trevor, this is Seth. Our build costs are flat. Lumber is slightly up and a potential headwind, but those costs increases have been offset with other modest reductions. And so far, we've headed off other longer-term cost increases. So, build costs are flat is our response there, Trevor.

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

Jay McCanless Q

Analyst, Citizens Bank

Hey, good morning, everyone. Thinking about community count for next year, anything from a geographic standpoint worth calling out, either a little heavier mix on luxury move-up or more focus on the Pacific or the North segment?

Karl K. Mistry A

Chief Executive Officer & Director, Toll Brothers, Inc.

Yeah. Jay, next year, we have more concentration in our community openings in the South and the Mountain regions, where we've been investing for some time. We're excited about that. These are markets where people have been moving, where we have great operational performance. And I do think the luxury segment is going to continue to go up. Sort of our move-up core business as a percentage looks like it's going to climb next year as a percentage of our community openings.

Jay McCanless Q

Analyst, Citizens Bank

Okay. That's great. Thank you. And then second question I had, just thinking about development costs, higher diesel costs, et cetera, what are you all starting to see there on the horizontal development side? Any type of cost increases, fuel surcharges, anything we need to think about from a gross margin perspective?

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

A

Jay, surprisingly quiet. We have not heard too much about it from our land development teams. I would characterize that as flat as well.

Operator: The next question comes from Ryan Gilbert with BTIG. Please go ahead.

Ryan Gilbert
Analyst, BTIG LLC

Q

Hi. Thanks. Good morning guys. I wanted to ask about spec mix, and apologize if I missed this, but I think generally you've been targeting around 50/50 spec versus build-to-order, but I heard more of a focus potentially on build-to-order. So, should we expect that mix to shift more to build-to-order in the quarters ahead?

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

A

Ryan, we're about – 52% of settlements in the quarter were spec that represented about 44% of revenues. We've messaged before, we're happy with this 50/50 mix. It's going to flex up a few percent in either direction. Again, we build this up at the ground level, community by community. So, I don't think you can read too much into a longer-term change. We'll manage it week-to-week and quarter-to-quarter.

Ryan Gilbert
Analyst, BTIG LLC

Q

Okay. Great. And then order growth in the North has been growing at a pretty substantial pace. It seemed like it decelerated a bit in the third quarter. Anything to call out in terms of why orders would be decelerating there?

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

A

No. Nothing specifically. I think they're a victim of their outperformance over some time. They're still the best absorbing region by far. We're very proud of our footprint here in our backyard and the teams that are building it. And so, it's still doing great. It's just it's their relative performance why it's modestly down.

Operator: The next question comes from Susan Maklari with Goldman Sachs. Please go ahead.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Thank you. Good morning, everyone.

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

A

Morning.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

My first question – good morning. My first question is on the capital allocation side. It's nice to hear you incrementally raising the guide for the buybacks as we get into the end of this year. Can you just talk generally about how you're thinking of capital allocation and shareholder returns as we start to think about fiscal 2027?

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

A

Sure, Susan. First and foremost, for us, we still have the opportunity to grow our business. And you've seen that reflected in our community count growth now for several years and our guidance for next year and, we think, beyond. So, first and foremost, as we think about capital allocation, it is growth. It's smart growth. It's profitable growth. And that will continue to be our focus, where we know we have a lot of opportunity. I think, after that, we've worked really hard to build a balance sheet we're very proud of. And so, our leverage is down materially over the last several years. And we're just in a very good place. And then with the balance, the cash flow from operations that we generate, we've been able to repurchase shares and, this year, fortunately, been able to improve that guidance down to $700 million. And then our dividend, which has now been around for some time, is there and continues to grow on an annual basis. So, that's how I think about the ladder there of capital allocation. But first and foremost, it's smart profitable growth.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Okay. That's helpful. And then, maybe thinking more broadly, one of the trends that we're seeing within the industry overall is more of your peers are moving into the build-to-order and a relatively higher price point, just given the macro and the state of the consumer. Can you talk about how you're able to leverage or establish presence in that kind of an operating strategy, and what that means for Toll as we think about the evolving landscape?

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

A

Hey, Susan, this is Doug. I'm going to take this one. I've enjoyed listening to these guys answer all the questions, and I guess it's a good one for me to step in on. We've heard this in the past. The other builders that tend to focus on production at a lower price point and really think about merchant homebuilding have on occasion, when market conditions suggest they should, move up in price. And respectfully, to my good friends in the industry, over time, the tail goes between the legs, and they run back down to entry.

It is a very difficult business. We have spent 60 years differentiating ourselves. We have the brand in the industry. We have 45-plus Design Studios in every market that are spectacular, where our clients go and are blown away by all the choices they have to customize their homes. We know how to buy land at the corner of Main and Main in very special locations. And so, I totally understand it. I understand that our buyer is able to weather this more difficult market because of their affluence and their strength, but we have no concerns whatsoever. We will continue to differentiate ourselves and continue doing the business that we have always done and will continue to do.

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

Alex Barron
Analyst, Housing Research Center, LLC

Q

Yeah, thanks and good morning, guys. Yeah, I was hoping you could expand on Buffington and M&A in general. How did you find this opportunity, and how do you think in general about M&A for Toll Brothers going forward?

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

A

Hey, Alex. Buffington, again, we're super excited. We got to spend some time there in the spring and understand Northwest Arkansas. I think we were a great fit for that team for a couple reasons. Higher average sales price, they were sort of the luxury segment in the market, and that was certainly attractive to us. And so, when the introduction was made, it felt right for them as well. We did not have an operation in Arkansas. So, we were fortunately able to bring on all of those employees and our colleagues.

And so, we like that type of bolt-on M&A, which we have done now for 30 years. I think we're up to 16 of these acquisitions that we've done over 30 years. And we like that size kind of bolt-on. It certainly seems, as evidenced by some of the very large transactions and a few of our mid-cap friends moving to the private sector, that consolidation in the industry is here and could continue. We like our playbook of careful bolt-on opportunities with companies that complement our brand and are executing well today. So, you shouldn't see any difference from us as it relates to M&A. We like how we've been doing it.

Alex Barron
Analyst, Housing Research Center, LLC

Q

Great. And when it comes to the trend for incentives and margins, what's your outlook, I guess, as far as your crystal ball can tell you?

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

A

It's Doug again. We're running at a 2026 margin with an ROE that we're very proud of in what is a tough market. And we're now four years in to a tough market. Our incentives at 7.5% or 8% are elevated. Our sales pace per community is below historic norms and below the high-20s, even into low-30s that we've achieved in the past. The move-up and build-to-order business is, at the moment, running at a significantly lower incentive, but not as low as it was in a better market. And so, I look at where we're operating today in this difficult market, achieving the ROE we're achieving, achieving the gross margin at 26%. I know we're getting closer to the end of this cycle. I've been doing this for 36 years, and these cycles run and time is on our side, because four years in is long. I know every cycle has its own dynamics.

But as I said to the guys yesterday, that light at the end of the tunnel, I am sure, is not a train coming at us anymore, but it is light. I just can't tell you when we're going to get there. But when we do and when those incentives come back closer to historic norms and when those sales paces go back up higher to more historic norms, this margin and these returns are going to grow. So, we are in a really good position. We have the land to show community count growth. We are operating so efficiently. It is really an exciting time, not for today selling the house necessarily, but for where we are headed and how we are positioned. And so, I am not here to call the bottom, but I am really proud of the returns we are generating in a tough market. And look out when things improve.

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

Matthew Bouley
Analyst, Barclays Capital, Inc.
Q

Morning, everyone. Thank you for taking the questions. I wanted to ask on the gross margins into 2027, to the extent you are willing to outline some expectations. I mean, even without a hard guy, just any, I guess, detail on sort of the pluses and minuses across mix that we should consider into 2027? I heard you earlier on the spec mix expectations. But whether it's regional mix, community mix, land, lot costs, and everything you just talked about on incentives, any kind of way to sort of point the direction into early 2027. Thank you.

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

Hey, Matt, it's Karl. I don't think we're ready to do any sort of nod to 2027 just yet. I understand your question. I pointed what we've said before, and maybe building on Doug's commentary there, we think, in a normal environment, 26% to 28% gross margin is now how this company is built. We structurally changed how we started our underwriting and new land acquisition over 10 years ago. That has now been in place and is contributing to our outperformance today. But as far as giving you specifics for next year, we're not ready to do that.

Matthew Bouley
Analyst, Barclays Capital, Inc.
Q

Okay. Fair enough. And then secondly just on ASP. Obviously, kind of looking at the backlog where it is, and it looked like obviously fairly stable, if not growing order price this quarter. But as you look out into 2027, thinking same similar type of question around the mix side of it, communities, and regions, et cetera, is there a view that the order or, excuse me, the delivered ASP can continue to grow similar to the way it has in 2026?

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

Yeah, I think we will share that. I think it builds on what I said earlier about our community openings next year, some of where they're located, and with a higher percentage of luxury. We do think that 2027 could be up.

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

Jason Sabshon
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Hi. This is Jason Sabshon on for Jade. Thanks for taking the questions. I'm sorry, just to hit on the 8% to 10% community count growth that you expect to continue into 2027, how much of that would you expect to translate to stronger delivery growth? Should we view them in isolation or as correlated? Thanks.

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

Hey, Jason, it's Gregg. That one's really hard because we're – we can't give you guidance on what that throughput per community might look like. It's all back to the comments that Doug and Karl have mentioned on how excited we are for how well positioned the company is. And as the market improves over time, then we'll see that through our results.

Jason Sabshon
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Great. Thanks. And then just on mix, as you continue to emphasize luxury move-up, it'd be helpful to quantify, like, the differences in gross margin, the spread between the various segments, and luxury move-up to first-time and move-down. Thanks.

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

A

Yeah. Jason, I think that's – we're going to get some homework and get back to you on that. What I will – what we will say, and I touched on this during the script, as price goes up, our incentive as a percentage of home price goes down. And so, we are outperforming from a margin perspective with the business that built this company, which is move-up, core move-up luxury. And so, directionally, that we know to be the case, but we'll have to get back to you if you want a further breakdown.

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

A

I think it's important to point out, and it goes back to my earlier question about other builders, focusing a little bit more on the move-up business, our average luxury move-up home is selling for $1.35 million, and that's 61% of our business. And that is the business that built this company. And we are seeing more and more land opportunities for that niche, which is so important to us. And more of that, of course, is build-to-order than it is spec. While we do spec some move-up, of course, naturally, more of the spec occurs at the lower price point. So, when the other builders talk about wanting to get into move-up, and I know many of them already do some move-up, I don't think they have in their minds $1.35 million as their average move-up price. And so, even as they move up or as they want to spend more of the pie in that part of the business, it's really not approaching the land that we are buying because it really comes down to who are we competing with for the land that we want to buy to grow our business.

And so, I think we are – our move-up is just a different business than the move-up that the others are even contemplating spending more time in. And that business is growing for us as we see more and more of those land opportunities. It is the highest margin. We are more and more focused on it. There's less competition for that land. Towns want us to build it because of how we operate. So, we're a bit more accepted into difficult towns because we are Toll with our brand. And so, I just think it's important to clarify that that's a big number, $1.35 million for 60%, and a growing part of our business.

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

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

No. That's it, Betsy. Thank you, everybody, for an interest in our company. Have a great rest of your summer, and we'll talk to you again at the end of the year.

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