Corrected Transcript

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Toll Brothers, Inc. (TOL)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Toll Brothers' Third Quarter Fiscal Year 2024 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 Douglas Yearley, CEO. Please go ahead.

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

Thank you, Dave.

Good morning. Welcome and thank you for joining us. With me today are Marty Connor, Chief Financial Officer; Rob Parahus, President and Chief Operating Officer; Wendy Marlett, Chief Marketing Officer; and Gregg Ziegler, Senior VP, Treasurer and our Head of Investor Relations.

As usual, I caution you 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

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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 had another terrific quarter and are very pleased with our fiscal third quarter results. We delivered 2,814 homes at an average price of $968,000, generating record third quarter home sale revenues of $2.72 billion. Our adjusted gross margin of 28.8% exceeded guidance by 110 basis points primarily due to greater efficiencies in our home building operations as well as favorable mix. Our SG&A expense was 9.0% of home sale revenues or 20 basis points better than guidance. Outperformance in both the top line and in our margin drove earnings of $3.60 per diluted share, keeping us on track to deliver another great year for Toll Brothers.

In the third quarter, we signed 2,490 net contracts for $2.4 billion, up approximately 11% in both units and dollars compared to last year's third quarter. On a per-community basis, we sold at a pace of 2.1 homes per month, down slightly versus the 2.2 pace we sold in last year's third quarter. Demand in our third quarter was uneven. May started out strong but slowed into and through June. July was the strongest month in the quarter, especially in the latter half of the month. We have seen this strength continue into the first three weeks of August. With mortgage rates at their lowest point in a year and trending lower, favorable demographics and continued imbalance in the supply and demand of homes for sale, we are optimistic that demand for new homes will remain solid through the end of fiscal 2024 and into 2025. We are encouraged by demand trends we have seen across the country and also across our buyer segments.

Markets where we saw particular strength in the quarter included New Jersey, Pennsylvania, Metro DC, South Carolina, Atlanta, Boise, Las Vegas and all of California. Price adjustments in the quarter were community and market-dependent. We raised prices in some communities and lowered it in others. Overall, pricing was flat compared to the second quarter and incentives continued to run approximately 5.5% of our average sales price.

As I noted earlier, we are optimistic that market conditions will remain positive for home builders into the foreseeable future. The underlying drivers of demand remain firmly in place, including favorable demographics driven by millennials, many of whom are buying their first home later in life when they have higher incomes and accumulated wealth. Older millennials are now hitting their 40s which should provide a tailwind for our luxury move-up business over the next decade. In addition, baby boomers are moving into new homes as they retire and adjust their lifestyles.

There also continues to be an underbilled and aging stock of homes for sale, with the undersupply exacerbated by the lock-in effect of higher rates which is keeping resale inventory at historically low levels. But even as interest rates move lower, we believe the supply of homes will remain challenged due to nearly 15 years of underproduction. Lower rates alone will not fully address the chronic undersupply of housing. The past several years have proven how impactful these fundamentals are, with demand for new homes remaining solid in the face of a sharp rise in mortgage rates and a prolonged period in which rates have remained elevated. As a large well-capitalized home builder, we have benefited from and performed very well in this environment, with sales up 25% year-to-date. We would clearly welcome lower rates and are excited by the prospect of a normalizing housing market.

Our strategy of widening our geographies and price points to include more affordable homes and increasing our supply of spec homes has helped us meet demand while becoming a more efficient home builder. As we have expanded and come down in price, we now have the widest variety of product and the widest range of price of any of the builders, which presents us with a great opportunity to grow our core home building business in our 60 markets across the country. Our spec homes represented approximately 54% of orders and 49% of deliveries in the third quarter. We continue to target about 50% of our business as spec, with continued strong demand from

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buyers who are looking for quicker move-ins. As a reminder, we define a spec as any home without a buyer that has a foundation port. We sell our specs at various stages of construction which provides many of our buyers the opportunity to personalize their homes at one of our 40 Design Studios nationwide. This offers our spec buyers a degree of choice which is a key pillar in the Toll Brothers buying experience while providing us with a faster and more efficient construction schedule.

At third quarter-end, our backlog stood at $7.1 billion and 6,769 homes. Our cancellation rate as a percentage of backlog was 2.4% in the third quarter, down from 2.8% in our second quarter and consistent with our long-term average of 2.3%. Our industry-low cancellation rate is due to the significant upfront downpayments our buyers make, as well as the emotional attachment they form as they personalize their homes with us.

Our buyers also tend to be more affluent. Approximately 28% of our buyers paid all cash in the third quarter, consistent with our second quarter and significantly above our long-term average of approximately 20%. The loan-to-value ratio for buyers who took a mortgage was approximately 69%. So, for the 72% of our buyers who took a mortgage, on average, they put down 31%. These metrics highlight the financial strength and affluence of our entire customer base. We continue to see modest improvement in our construction cycle times consistent with our focus on product and process optimization and our increase in fast-return spec homes. We remain hyper-focused on continuing to improve our construction times as we move forward, which should further benefit our already strong cash flows.

We are on target to reach our goal of operating from 410 communities by fiscal year-end which would represent 11% growth compared to the 370 communities we are operating from at the start of the year. We plan to continue growing community count next year and we have sufficient land under control to do it. At quarter-end, we owned or controlled 72,700 lots, half of which were controlled and the other half owned. Excluding the 6,769 lots in our backlog, our controlled land represents 55% of our lots. This land position provides us with sufficient lots needed for growth in fiscal 2025 and beyond and allows us to continue to be selective, disciplined and focused on efficiency when we assess new land opportunities. Our underwriting standards for new land continues to incorporate stringent thresholds for both margins and returns. And we continue to seek out land acquisition and development opportunities that allow us to be more capital-efficient, including through increased use of option arrangements, land banks, joint ventures and similar structures that allow us to defer payments and lot takedowns.

This focus on capital efficiency and returns extends beyond our land and other operations. It also includes our efforts to more programmatically return capital to our stockholders. Since the start of our third quarter, we've repurchased $246 million of our common stock, bringing our year-to-date repurchases to $427 million at an average price of approximately $119 per share. We also paid over $70 million in dividends year-to-date. So far this year, we've repurchased approximately 3% of our year-end diluted share count. And since 2016, we've bought back approximately one-half of the company.

Given our outstanding year-to-date financial performance, including strong operating cash flows, we are raising our buyback expectations for the full year from $500 million to $600 million. Dividends and buybacks will continue to be an important part of our capital allocation strategy and a key factor in maintaining an attractive return on equity. We now expect our return on beginning equity to be approximately 22.5% this year. This will be the third year in a row that we generate an ROE over 20%.

With that, I will turn it over to Marty.

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Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

Thanks, Doug.

Good morning, everyone. Thanks for being with us.

It was a great quarter. We earned $504 million before taxes and $375 million after, or $3.60 of earnings per diluted share, well above the earnings we guided to last quarter. Home sale revenues were $2.72 billion in the quarter, a third quarter record and an increase of 2% compared to one year ago. We delivered 2,814 homes in the quarter, up 11.5% year-over-year. This unit growth is a direct outcome of our strategies of broadening our price points and increasing our supply of spec homes.

Based on our third quarter results and our expectations for the fourth quarter, we are raising our full-year deliveries guidance. We now expect to deliver between 10,650 and 10,750 homes, an increase of 100 homes at the midpoint of our previous guidance. We are also increasing our guidance for full-year average delivered price by $10,000 to $975,000. This translates to a home building revenue projection of between $10.4 billion and $10.5 billion for the full year, or over $200 million of additional revenue compared to the midpoint of our previous guidance.

We signed 2,490 net contracts in the third quarter for $2.4 billion, up approximately 11% in dollars and units. The average price of contracts signed in the quarter was approximately $967,000 which was about flat compared to both the third quarter of last year and the second quarter of this year. Our third quarter adjusted gross margin was 28.8% compared to 29.3% in the third quarter of 2023, and this was 110-basis points better than we had projected. The outperformance to guide was due primarily to greater efficiency in our home building operations as well as favorable mix. With the outperformance in our third quarter, we are raising our full-year adjusted gross margin guidance from 28.0% to 28.3%. We are now projecting a fourth quarter adjusted gross margin of 27.5%, a 10 basis point increase compared to our previous implied guidance.

SG&A as a percentage of revenue was 9.0% in the third quarter compared to 8.6% in the third quarter of last year, and this was 20 basis points better than we had projected for this quarter. Year-over-year, we modestly reduced G&A expenses in terms of total dollars, but this reduction was offset by higher selling expenses due in part to increased community openings. As we've pointed out before, we've been very focused on becoming more efficient and we are seeing the benefits of that efficiency continue to flow through our results. For the fourth quarter, we expect SG&A expense to be 8.6% of home sales revenues and, for the full year, we now expect it to be 9.4%. This represents a 20-basis point improvement over our previous guidance.

Third quarter joint venture, land sales, and other income was $1 million, which is consistent with our breakeven guidance. We continue to expect our full-year joint venture, land sales, and other income to be approximately $260 million, implying approximately $47 million in the fourth quarter.

Our tax rate in the quarter was 25.6%. We expect our fourth quarter tax rate to be 26% which would bring the full-year rate to approximately 25.4%. We expect interest and cost of sales to be approximately 1.3% in the fourth quarter and for the full year as we continue to benefit from our reduced leverage.

As Doug mentioned, we are maintaining our community count guidance of approximately 410 communities open for sale by fiscal year-end. This would represent approximately 11% growth from the 370 communities we began the year with. We plan to continue growing community account in fiscal year 2025 and have the land to do it.

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Turning to the balance sheet, we finished the quarter with a net debt-to-capital ratio of 19.6%, $893 million in cash and equivalents, and $1.8 billion available under our $1.96 billion revolving bank credit facility. We have no significant bank or senior debt maturities until November 2025. All of this provides us with ample flexibility to both grow our business and return capital to stockholders as we continue to focus on generating attractive returns. Our weighted average share count is expected to be approximately $104.75 million for the full year and $102.5 million for the fourth quarter. As Doug noted, we've increased our share repurchase guidance to approximately $600 million of repurchases this year, implying approximately $175 million of buybacks in the fourth quarter.

Putting this all together, we now expect to earn between $14.50 and $14.75 per diluted share in fiscal 2024. We expect to achieve a full-year return on beginning equity of approximately 22.5% and we expect our book value at year-end to be over $76.50. This would cap off another great year for Toll Brothers.

Now, let me turn it back to Doug.

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

Thank you, Marty.

Before I open it up for questions, I'd like to recognize the hard work of all of our Toll employees. It is their passion for our business, dedication to our luxury brand, and commitment to our customers that will ensure our continued success.

Dave, let's 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 Q&A, please limit yourself to one question and one follow-up. [Operator Instructions] Our first question comes from Stephen Kim with Evercore ISI. Please, go ahead.

Stephen S. Kim
Analyst, Evercore ISI

Q

Yeah. Thanks very much, guys. Appreciate all the color so far and good job in the quarter. Wanted to ask – sure, yeah. I wanted to ask you about profitability. And I was intrigued by your comment about greater efficiency in the home building operations. Wanted to just sort of get a sense of if you could elaborate there? And that seems to imply that there's a degree of sustainability to the strength that we're seeing in your margins. And so, I know you haven't given guidance here for 2025 but it would be helpful for, I think, us to hear you comment on the, call it, the 17.5% operating margin you're generating this year. How sustainable do you think that is generally? Is that a number that you think is inflated by any particular variables or is that a level that you sort of as you look forward across your business over the next several years, is that a level that you sort of feel is a reasonable level to use as kind of a base?

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

A

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Thanks, Steve. Great question. The quick answer is, yes, we believe that operating margin you referenced is sustainable. We are targeting long-term with this new business model of a very wide price point, a very wide geography, about 50% spec, more and more affordable luxury communities, a longer-term gross margin in the 27% to 28% range. And as we become more efficient on the SG&A line, which you've seen over the last couple of years, we think that operating margin long-term is definitely sustainable.

Stephen S. Kim
Analyst, Evercore ISI

Q

Well, that's super clear. So appreciate that and that's obviously very encouraging. Was wondering if you could talk a little bit about your – a little bit more about your spec model. What was the actual number of specs both finished and in total specs that you had in the quarter? And then, I had a follow-up regarding about that level.

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

A

At the end of the quarter, Steve, we had around 3,400 specs, around 750 of those were at CO or beyond or 1.8 per community.

Stephen S. Kim
Analyst, Evercore ISI

Q

That's interesting, okay. So, you had about 8.5 per community total but finished was, you said, below two. Those levels of specs, is that a number that we – are those numbers per community what we can also expect going forward or do you see this changing, like growing perhaps as we go forward?

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

A

Stephen, we're starting a spec essentially for every home we sell, so the starts and specs. Starts include one BTO and one spec, kind of 50/50.

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

A

BTO is build-to-order.

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

A

Yeah. And I think we've hit a bit...

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

A

Not Bachman-Turner Overdrive, for the older people on the call.

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

A

So, we are taking care of business here, Doug. So, I think we've hit a bit of an equilibrium point here on our up to 50% spec strategy. Now, that'll vary a little bit in terms of settlements or sales quarter-to-quarter. But strategically, we've kind of hit our equilibrium point here. Okay [indiscernible] (00:23:45)

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

And it's important that I know we talked – I know, Steve, we talked about it before, as you know, but we – choice at Toll Brothers is still alive and well. It's still very important, not just on the build-to-order business but we do hope that at least half of the spec buyers are buying early enough that they have enough time to pick some level of finishes. If you buy it very early, you can hit that Design Studio and truly customize the inside of your home. If you buy it a little bit later, you have some opportunity for flooring, for kitchen cabinets, for countertops. And then, of course, there are some as we described that get to the end can be delivered quickly for that buyer that wants a faster move-in. So, we do define the spec as a foundation in the ground without a buyer and we market accordingly so that choice is still a big part of that business model. That also drives a little bit more margin because, as you know, the upgrades through the Design Studio tend to be accretive to the company margin.

Stephen S. Kim
Analyst, Evercore ISI
Q

Yeah, absolutely. And the level of finished specs here per community is very encouraging. I would say below two per community. That's not at all an unusually high number, so it's very clear that your process is working. So, great. Well, appreciate all the color. Thanks very much.

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

Thank you.

Operator: And the next question comes from John Lovallo with UBS. Please, go ahead.

John Lovallo
Analyst, UBS Securities LLC
Q

Morning, guys. Thanks for taking my questions as well. Maybe just following up on...

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

Hi, John.

John Lovallo
Analyst, UBS Securities LLC
Q

Hey. Hi, how are you? Maybe just following up on Steve's question. Your backlog has continued to kind of get worked down over the past few years. I mean, how confident are you that improved cycle times and this increased spec level can continue to drive delivery growth as we move into 2025?

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

We're very confident. We're doing it right now. And the more – as we talked about it, we can keep the spec at about 50/50. Those houses are being built faster. We're able to deliver them quicker. The conversion rate on our backlog has come down and will continue to come down as this – excuse me, will continue to go up. My apologies. We will turn houses faster. You know what I meant. And as the spec business continues to mature, we get better at it. We turn these houses faster. You're going to – can see an improvement in that conversion.

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John Lovallo
Analyst, UBS Securities LLC

Q

Makes sense. And then, moving on to the fourth quarter gross margin, what would drive the expected 140 basis points sequential decline from the third quarter? I mean is this the reverse of the positive mixed impact in the third quarter? And what specifically was that mix impact? Was it geographic? Was it product? Or spec versus BTO? Thank you.

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

A

Sure. So, let's remember, we raised guidance for Q4 gross margin. Yes, when you compare it to the blowout gross margin of Q3, the gap there is bigger. Q3, as we mentioned, was 110 basis points better than guide. Because of mix, we had more high-margin homes delivering in the Pacific and the South. And we had less spec homes delivering than we had anticipated. That reverses a bit in the fourth quarter where we will have less high margin homes delivering from the South and the Pacific. And by the way, the entire South and Pacific is not necessarily high-margin. It is certain communities within the South and the Pacific that have this higher margin where we had more of those deliver Q3 and less of those in Q4, and we will have about 60% of our deliveries in the fourth quarter be spec.

So, with our business running from, we now have homes from the mid-300s to over $5 million. We have gross margins that have a very large range. We have a few communities with 10% gross margin and we have communities with 50% gross margin. And so, when you look at our business quarter-to-quarter, there may be a little bit more variation naturally than some of the other builders that have a much tighter range of price point and margin. And so, there's a little bit more variety there as you just saw on the third quarter and as we've guided to in Q4. But overall, that 27% to 28% long-term margin, while there could be some modest variation quarter-to-quarter, we're very comfortable with where this business is headed.

Operator: And the next question comes from Alan Ratner with Zelman & Associates. Please, go ahead.

Alan Ratner
Analyst, Zelman & Associates

Q

Hey, guys. Good morning. Nice quarter, and thanks for all the helpful detail so far.

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

A

Thanks, Alan.

Alan Ratner
Analyst, Zelman & Associates

Q

Doug, I'd love to drill in on that pricing. Your comments suggest pricing was pretty flattish in the quarter, plus or minus, depending on the community. I'm curious, as you kind of sit here three weeks into August, you sound pretty encouraged by the recent activity. Have you started to or have you seen any ability to begin either dialing back incentives now that rates are a bit lower, maybe pulling back on some of the rate buy-downs, or even start to begin raising prices again, or is it still premature to do that given the choppiness?

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

A

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Yeah. So, it was a bit of a choppy quarter as we and other builders have talked about. I went through the cadence. First, the beginning of May pretty much up to our call, things were looking pretty good. And then, the last week of May through all of June, definitely saw a slowdown. And we saw an accelerating pickup in July with the end of July being the best, and that has continued into August. We did run a spec event in the month of July, so we increased incentives modestly in July in some communities on specs, particularly those specs that might have been further along in construction. However, in July, we did raise prices on our build-to-order homes. So, the overall effect was pretty much flat. But as we sit here in the third week of August, traffic is up, the quality of traffic is improved. Rates are now down. We're sitting on a [ph] 6.625% (00:30:54) lowest rate in a year, 30-year no-point mortgage, with a feeling that those rates are going to come down further. So, we are seeing a bit more pricing power right now. We are being careful because mid-August is not normally the time to aggressively raise prices as families are just closing down summer houses and getting kids into school and taking a deep breath. But in the fall, we generally do see an improvement in activity. And with how things are lined up with where the rates we think will go and where we currently have higher quality traffic, we are encouraged that we think we will have more pricing power as we head into the fall.

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

The other thing to note, Alan, is that to the extent buy-downs are part of our incentive offerings, they are less expensive for us to accomplish now in the lower rate environment.

Alan Ratner
Analyst, Zelman & Associates
Q

Yeah, I was going to follow up on that, Marty. So, thank you for adding that. So, when you say less expensive, are you buying down the rate to lesser magnitude because you don't need to solve for a lower rate, or is it actually to buy down that same whatever it is, 50 basis points, 100 basis points because it's actually costing you less? And if so, can you quantify that?

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

It's costing less. So, our typical buy-down deal around the country is to buy your rate down to [ph] 4.375% (00:32:24). That's the number we had. And so, when you buy from [ph] 7% to 4.375% (00:32:29), it's more expensive than when you buy from [ph] 6.625% to 4.375% (00:32:32). Marty, the amount of that, not to put you on the spot, but he did ask the question...

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

It's around 5% to 6% of the mortgage amount to buy it down. Remember, that [ph] 4.375% (00:32:45) is a one-year.

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

Yeah.

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

It reverts to [ph] 5.375% (00:32:49) for the balance of the 29 years.

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Alan Ratner
Analyst, Zelman & Associates
Q

Right.

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

And as we've spoken before, it's a great marketing gag, it drives traffic, but we don't actually sell a lot of it. People tend to take a pass on that version of the incentive and they take the 5.5% average incentive we have in the company and have a lot of fun in our Design Studios with it and increase the finishes in the home. That goes to the affluent nature of our client. They're not rate-dependent. They don't need that lower rate to qualify. They recognize rates will probably come down so they may be overpaying because, in a year or two, they could probably refi and so they'd rather permanently improve their home through their lifestyle through the Design Studio with those incentive dollars.

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

Thanks, Alan.

Operator: And the next question comes from Michael Rehaut with JPMorgan. Please, go ahead.

Michael Rehaut
Analyst, JPMorgan Securities LLC
Q

Hi, thanks. I appreciate you taking my questions. Good morning, everyone. Congrats on the quarter.

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

Great. Thanks Mike.

Michael Rehaut
Analyst, JPMorgan Securities LLC
Q

I wanted to dial in a little bit about your – over the years now, I guess, over the last year or two, your shift towards spec being 50% and how that kind of fits in with your prior or still, to some degree, ongoing preference of price over pace. This quarter, it was pretty interesting in that you probably had a relative to prior buildings reporting a little bit more of a gap between at least our estimates of order growth and what you put out, and probably one of the stronger gross margins relative to our estimates. And I think that's generally consistent with how you operate in more temporary periods of softness where maybe volume or orders fall off a little bit more and you hold on to the margin. At the same time, you're shifting in this more of a spec model or happier business spec. There are points where you're going to have to, as you did in this quarter, increase incentives if your specs build up a little too much. And so, I'm wondering going forward how investors should think about that balance? And if there's going to be points where perhaps you're going to be a little more sensitive to pace if softness is going to go past a quarter or two? And if that would drive any greater degrees of variability in your gross margin relative to the past?

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

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So, Mike, I think it's fair to say that we may be a little bit more focused on price than pace compared to the other builders that have more of a spec business and they have product that they need to move. But to steal a line from my good friend, Ryan Marshall at Pulte, we are not margin-proud. It is a balance. We are definitely focused on top line growth. We are also focused on this 27% to 28% gross margin that we believe is sustainable long term. We are also focused on becoming more and more efficient, lower SG&A, higher operating margin long-term. We also, as I talked about, are very aware of our spec inventory, what stage of construction it is at, when we need to put it on the market, how we can make more margin if we sell it earlier. And so, we have agent reports of all that spec. We focus on how far along it is. If it gets too heavy on the back-end, which it hasn't because of this business model, then yes, on occasion, we might have to be a bit more aggressive. But that is not something that I think you need to worry about. The business is working. The spec strategy is maturing. We are just about at a point where we have hit the equilibrium of long-term 50% spec, 50% build-to-order. And the business plan is in place. But yes, there is a little more focus for us on price and margin but we are not, by any means, margin-proud. And as we talked about, we ran a spec event in July. Modest, modest increase in the incentive on the spec business which allowed us to sell a few more, but it was at the same time when we could raise prices on the build-to-order. So, in the end, it all worked out. And it's that mix between spec and build-to-order that I think we're getting really good at and we are very confident in that long-term margin. And there you have it.

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

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Morning. Thanks for taking my questions.

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

A

Hi, Mike.

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

A

Hi, Mike.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Hey. So, just to keep going on kind of the margin and the spec and all the mix dynamics. I guess, when you think about the 4Q gross margin, understanding that you took it up a little prior – versus your prior, you're talking about kind of running that promotion which may have lifted incentives. At the same time, Steve followed up on your comments about efficiency, which does seem more sustainable and unclear why that would go away in the immediate term. So, can you just help us understand in terms of maybe just the incentive load that's projected to be in your fourth quarter deliveries versus your third quarter deliveries? And then, I know that your spec margins can vary quite a bit regionally as well, so maybe if you could let us know kind of on a like-for-like basis what you think that spec versus BTO margin is going to run at in your fourth quarter versus what it's been here today?

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

A

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So, our incentive is about 5.5% of the delivered price of our homes. That comes out to about $50,000 to $55,000. Simple math on houses that are in the $950 range. That was Q3, and we believe that will be the same incentive in Q4.

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

A

I don't think the margin differential is going to be very incentive-sensitive between Q3 and Q4. It's mix-related.

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

A

Right. And so, remember and we talked about how, for Q4, we think we'll have about 60% of our homes spec. That doesn't mean we incentivize the whole bunch to sell those and that's what's hurting the margin. We tend to build spec on what I'll call the more average lot in a community. We tend to save the very high premium lots, the special lots overlooking the 18th green with beautiful woods in the backyard, with a beautiful lake in the backyard for the build-to-order business. Because that client is more affluent, they want to put a lot of upgrades into their dream home. They want that dream home on the best lot we have. And we let them run wild in the Design Studio, and that margin tends to be higher. So, when you think about the spec margin, you shouldn't be comparing it to the build-to-order margin. You need to recognize that the spec is generally built on a more average lot, lower lot premium. And that client generally, even if it was a build-to-order home on that lot, would not spend as much in the Design Studio. And we know the Design Studio is margin-accretive. So, while we may have to incentivize a little bit more to move that spec home on that average lot if it gets towards the end and is unsold, it is a small difference between that margin and what the margin would be had it been a build-to-order.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

[indiscernible] (00:41:55)

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

A

Our average margin for the quarter was 28.8%. Build-to-orders were above that. The specs were below that.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

[indiscernible] (00:42:09)

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

A

The specs were probably 100 to 200 points below that average, and the build-to-orders were 100 to 200 points above that average.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Okay, yeah. I was kind of triangulating back to make sure it was that pure mix dynamic versus something under the surface that's incremental [ph] back (00:42:26). So, thank you for that.

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

I could have answered your question and just said mix. Sorry for wasting four minutes.

Mike Dahl
Analyst, RBC Capital Markets LLC
Q

No, no. That was the color that we were looking for. And then, just thinking about seasonality, typically, you'd still keep seeing order pace decline in the fourth quarter. Obviously, you just came through a weird and challenging third quarter, and you're talking about potential acceleration in trends coming out of July. Any help you want to provide in terms of level-setting? I think typically, your pace would be down kind of low-double-digits sequentially in 4Q versus 3Q. Should we be expecting kind of on seasonal trends above/below based on what you're seeing so far?

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

So, you're right. Good work there. Our fourth quarter is typically, orders are typically about 10% lower than Q3. And we're confident we're going to do better than that. We think we'll – our best guess three weeks in is that we may be flat to Q3 versus down 10%.

Operator: And 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. First one, just wanted to touch on geography. You guys laid out some of the better-performing markets. I don't believe you mentioned any markets in Florida or Texas. Those have clearly gotten a lot of attention over the last few months. Can you comment on how demand in those markets has trended relative to your business overall?

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

Sure. Texas has had a good August, a good end of July and good August. Different stories in different markets in Texas. Austin has some elevated inventory. We're not feeling it directly, but there's a bit of an overhang in that market as there's conversation around inventory. And Dallas and Houston, there are not inventory issues. I think there was just a lot of price increases over the last few years. And so, there was a little bit of sticker shock and maybe some buyers taking a little bit of a pause, but that seems to be working itself out. As for the last month, we've seen pretty significant improvement in our action in the state of Texas. Florida – and by the way, the Texas margin, even when we saw things that were a bit slower last quarter, that margin held up and was above our company's average.

Florida sits at our company average margin. It has been a bit softer. There have been some elevated inventory levels in Florida West, which is very small for us which is I call it Southwest, and in the Tampa market. The East Coast – Jacksonville, Orlando, and then for us down in the Jupiter, Palm Beach, Boca Raton area – has done a bit better. It's really hard to gauge Florida in the summer months. We'll have to see how we do as the market comes back in October and November. But Florida's okay. We're selling houses. We're at company average margin.

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

Actually, at company average agreements per community as well.

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

Right.

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

But I think that's down from where Florida had been performing for the few years before that.

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

Well said. We just opened last weekend our first community in the Panhandle, and we killed it. We took 10 sales our first weekend in August, so that's exciting. So, feeling a lot better about Texas and feeling a bit better about Florida is the best way to describe it.

Trevor Allinson
Analyst, Wolfe Research LLC
Q

Okay, thank you for that. That's definitely encouraging. Sounds like things are definitely trending in the right direction there. And then, a question on SG&A. You've talked about that moving down to 9% longer-term due to some tech initiatives [audio gap] (00:47:15) by 2025 or is that more of a longer-term type of SG&A level? And then, for 4Q specifically, looks like you've got it stepping down nicely sequentially. Should we think of that as just being leverage or is there anything else driving that? Thanks.

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

We're growing this company without adding people. We're becoming more efficient. We changed our operations in the field. We moved away from our legacy project manager system to where we have stack leads that run land acquisition, land development, construction sales, et cetera, community openings. And that organizational structure is allowing us to grow much more efficiently. And so, on the G&A front, we're very confident we can do more without spending more dollars. On the S side, the S has actually been up a little bit but that's variable. We're paying our inside sales agents a little bit more. We have 65% of our sales involve a third-party realtor. We're spending a little bit more money on marketing and advertising. But overall, there is leverage as we grow on flat G&A. And the S will just move with sales and we'll just see how that goes, particularly with the new rules around broker commissions.

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

And I think, Trevor, we're going to be essentially flat in terms of G&A dollars spent in 2024 versus 2023 and deliver roughly 10% to 12% more homes and have 10% to 11% more communities. So, we're pretty proud of that. The S is showing the variable nature of the commissions and staffing out at the job sites at the communities for the sales teams, and it's also showing a little bit more expenditures for marketing.

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Operator: The next question comes from Rafe Jadrosich with Bank of America. Go ahead, please.

Rafe Jadrosich
Analyst, BofA Securities, Inc.

Q

Hi, good morning. It's Rafe. Thanks for taking my question. So...

[indiscernible] (00:49:52)

Rafe Jadrosich
Analyst, BofA Securities, Inc.

Q

...follow up on some earlier questions on sort of the deliveries versus orders going forward. You've had three straight years of deliveries tracking above orders and that's partially been because of the increase in spec. How do we think about deliveries relative to orders going forward here? Like would you anticipate spec to outgrow the BTO business in terms of deliveries as we go into 2025?

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

A

I don't think so. I think the nuance may be that – and we haven't really looked at this, the nuance may be that the bill build-to-orders generally concentrate more in the luxury, more in the bigger homes, have a few months longer build cycle, and the spec homes have a shorter build cycle. And so, when we start one for one like we have been, there is a potential for the build-to-orders to fall below 50% long-term, but probably not from a revenue perspective.

Rafe Jadrosich
Analyst, BofA Securities, Inc.

Q

Got it, okay. That's helpful. Then, do you think deliveries can continue to outpace orders going forward?

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

A

No, they will reach equilibrium pretty soon here.

Rafe Jadrosich
Analyst, BofA Securities, Inc.

Q

Okay. And then, the second question just on you increased the buyback guidance for the year. Can you talk about kind of what drove that decision? And, Doug, I think you said programmatic capital return, which I don't think you've sort of said in the past. So, has there been any change here or how should we think about capital return and buyback going forward?

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

A

So, we expect free cash flow of $800 million to $1 billion. That's up a little bit because of our strong performance. And we want to continue to reward our shareholders, return capital to our shareholders. We are very focused on return on equity. We know one of the main levers of keeping return on equity high is having a robust programmatic stock buyback program in addition, of course, to how quickly we can build and turn houses and how efficiently we can buy land. And so, it seemed like a great time to take the $500 million up to the $600 million because of our performance and the additional free cash flow that we have. Going forward, you will continue as

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we talked about going back to 2016, you will continue to see us programmatically, regularly and consistently and predictably buy our company's stock back.

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

Yeah. I think our use of the term programmatic probably goes back a year or two at this point, but we're not going to eliminate the opportunity to be opportunistic.

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

Right.

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

We just hope we don't have it.

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

Sam Reid
Analyst, Wells Fargo Securities LLC
Q

Awesome. Thanks, guys. Appreciate the color you gave on order cadence into the fourth quarter. Just want to piggyback off of some of those questions. Are you looking to run any targeted promos in the fourth quarter that might be helping that better versus seasonal trend relative to the third quarter, in addition to the benefits you might be seeing from selling more specs and just lower overall rates?

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

No. We always run sales events, some are local, some are regional, some are national. They're on the calendar already. They're no different than prior years. We do traditionally have a national sales event in the month of September, that's occurred for many years, that will occur again. But beyond that, there is nothing out of the ordinary. And I do caution, we don't like to guide on sales. And so, when I said we think we'll be better than down 10%, we're thinking more consistent with what we did in Q3. That's not a limiter to me. I'm hopeful, as rates come down, the market improves, we continue to open new communities that we could have a roaring fall. I'm not predicting that but I don't want you to think we're giving some guidance right now on sales, because we don't do that. And let's get a good market, let's get this thing cooking, and let's blow out sales. That's how I approach this business, and we'll have to see where it is. But where we are three weeks in, with the communities we have open, with those we know that are opening, with the quality of traffic, I just wanted to suggest that the normal number of down 10% doesn't feel right. It feels like it should be at or, in my hope, better than Q3.

Sam Reid
Analyst, Wells Fargo Securities LLC
Q

Yeah, that certainly helps. Then, maybe this is a little ambitious here, but I want to quickly talk 2025 just from a very high-level standpoint. You've got some good visibility into your land pipeline and the types of communities you're going to be delivering. So, to that end, do you have any sense as to what kind of community count growth we might be on track to see, especially if you look to potentially grow 5% to 10% over the long-term?

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

A

I like that number. I'm with you, 5% to 10%. More to come in December.

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

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

Dave, thank you very much. You were terrific.

Thanks, everyone, for your interest and support. Have a wonderful end of your summer. We are here always to answer any questions you may have and we look forward to seeing all of you soon. Thanks. Take care.

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

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