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# Toll Brothers, Inc. (TOL)

## Q2 2024 Earnings Call


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# MANAGEMENT DISCUSSION SECTION

**Operator**: Good morning, and welcome to the Toll Brothers Second 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. [Operator Instructions] Please note, today's event is being recorded.

I would now like to turn the conference over to Douglas Yearley, CEO. Please go ahead, sir.

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

Thank you, Rocco. Good morning. Welcome and thank you all for joining us. 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 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.

With me today are Marty Connor, Chief Financial Officer; Rob Parahus, President and Chief Operating Officer; Fred Cooper, Senior VP of Finance and Investor Relations; Wendy Marlett, Chief Marketing Officer; and Gregg Ziegler, Senior VP and Treasurer.

Before I begin, I would like to take a moment to acknowledge the passing of Don Horton, Chairman and Founder of D.R. Horton. Like our founder, Bob Toll, D.R. was a pioneer and an icon of the industry, who helped shape how


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we all do business today. We extend our deepest sympathies to the Horton family and the entire D.R. Horton organization.

Turning to our second quarter results, I'm very pleased with our strong performance in the quarter. We delivered 2,641 homes at an average price of approximately $1 million, generating record second quarter home sales revenues of $2.65 billion, up 6% compared to last year, and $185 million better than the midpoint of our guidance.

We also signed 3,041 net agreements for $2.94 billion, up 30% in units and 29% in total dollars compared to last year. Solid demand has continued into the start of our third quarter. We have had a really good first three weeks of May.

Our adjusted gross margin was 28.2% in the second quarter, 60 basis points better than guidance, and SG&A expense as a percentage of home sales revenues was 9.0%, 70 basis points better than guidance. Both benefited from strong cost controls and greater leverage of fixed costs on higher home sales revenues.

Joint venture, land sales and other income was approximately $204 million in the quarter, most of which was generated by the land sale we discussed last quarter. As a reminder, in February, we sold a parcel of land in Northern Virginia to a data center developer. That transaction generated $181 million of net cash and $175 million in pre-tax land sale gains.

All of this resulted in pre-tax income of approximately $650 million in the second quarter and record earnings of $4.55 per diluted share, a 60% increase over the $2.85 per share we earned last year. Adjusting for the land sale benefit, we earned $3.38 per diluted share, up 19% from last year.

With continued strong demand for our homes and better-than-projected second quarter results, we are raising our full year 2024 revenue and earnings guidance. At the midpoint of our guidance, we now expect to deliver 10,600 homes at an average price of approximately $965,000, which would result in $10.23 billion of revenue, nearly $500 million or 5% better than our previous guidance.

We continue to expect a full year adjusted gross margin of 28.0%, which translates to an additional $137 million of gross profit on our increased revenue guide. And we expect an SG&A margin of 9.6%, 20 basis points better than our previous guidance. This guidance would result in an operating margin of over 18%, earnings per share of approximately $14, and a return on beginning equity of approximately 22%.

Our outstanding results in the first half of the fiscal year and the increase in our guidance for the full year are being driven by execution of the strategies that we've outlined on recent calls. To take advantage of the healthy demand and persistent lack of inventory that characterizes this market, we have both widened our price points to include more affordable luxury homes and increased our supply of spec homes, which has helped us grow market share.

This also enables us to reduce cycle times, improve inventory turns, and leverage our fixed costs, driving revenue growth and higher operating margins. With these strategies firmly in place and producing results, and with our more capital efficient land strategy, we are confident that we can continue to generate attractive returns well into the future.

Turning to market conditions, demand has proven resilient even as rates increased from 6.75% to 7.5% through the quarter. Sales were evenly spread across the second quarter with about 1,000 net signed contracts each


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month. As I mentioned earlier, we have seen strong demand continue through the first three weeks of May, which is encouraging, and it's nice to see rates dropping over the past week.

Geographically, we saw broad-based and healthy demand across our entire footprint. We saw solid demand from Boston through Atlanta, especially in New Jersey. Texas, California, Boise, Idaho, and Colorado were also strong performers.

Demand was also solid across all of our product lines. Sales of our luxury homes were a little bit stronger compared to the first quarter with approximately 37% of units and 53% of dollars. Affordable luxury was 44% of units and 31% of dollars, and active adult was 19% and 16%, respectively.

We raised net price after incentives in about 60% of our communities, leading to an approximate $10,000 net price increase across the company. While mortgage rate buy-downs are heavily marketed and offered nationwide, very few of our buyers use incentive dollars to buy down their rates. The vast majority of our customers can qualify for a mortgage without a buy-down, and they prefer to use any incentives offered on Design Studio upgrades or to reduce their closing costs. We continue to be very pleased with our luxury focus as we are benefiting from a financially healthy consumer, strong demand, and limited competition.

With the widening of our product lines, approximately 30% of our customers are first-time homebuyers. Most of these buyers are millennials, many of whom have waited later in life to form families and have accumulated greater wealth when they buy their first home. Some are benefiting from the greatest wealth transfer in US history from boomer parents who want to see their kids enjoy the fruits of their success and help them financially.

Approximately 27% of our buyers paid all cash in the second quarter, up from 25% in the first quarter and our long-term average of approximately 20%. The LTVs for buyers who took a mortgage was approximately 69% in the quarter. So, for the 73% of our buyers who took a mortgage, on average, they put down 31%. These metrics include that 30% of our customers who were first-time buyers and highlight the financial strength and affluence of our entire customer base. In fact, in the second quarter, 20% of our affordable luxury buyers, many of whom are first-time buyers, paid all cash with an LTV of 74% for those who did get a mortgage.

We are pleased that our cancellation rate in the second quarter remained low at 2.8% of beginning backlog. We are also benefiting from the growing difference in quality between new and resale homes. The median age of an existing home in the US is now over 40 years old. Approximately 60% of existing homes were built before 1980 and 35% were built before 1970, making new homes even more attractive. They are built better, require less maintenance, are less expensive to insure, are more energy efficient, and include features that today's buyer wants. Many are also part of communities that have spectacular amenities. All of these factors are helping to fuel a flight to new homes that we believe will continue even if rates come down and the resale market unlocks. As good as our business is now, we look forward to and will welcome lower rates.

During the quarter, we continued to execute on our spec strategy. Specs represented approximately 54% of orders and 46% of deliveries in the second quarter, allowing us to meet the strong demand from buyers who choose a quicker move-in. As a reminder, we sell our specs at various stages of construction from foundation to finished home. This allows some of our spec buyers the opportunity to visit our Design Studios and personalize their homes with finishes that match their tastes. So, choice, a very important pillar of Toll Brothers, is still part of our spec strategy.

Looking forward, we continue to expect community count growth to help drive results in fiscal 2024 and beyond. At second quarter end, we were operating from 386 communities, 1 more than the 385 we guided to last quarter.


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We remain on target to reach our year-end guidance of approximately 410 communities, which would be an approximate 10% increase versus fiscal year-end 2023.

We control all the land we need to support continued growth in fiscal 2025 and 2026. At second quarter end, we controlled approximately 72,000 lots, 48% of which were optioned and 42% of which were contracted for prior to 2021. This land position allows us to be highly selective and disciplined as we assess new land opportunities.

We continue to be pleased with the quantity and quality of land deals we review each week. We are seeing a healthy flow of deals that meet our rigorous underwriting standards, which are focused on both margins and returns. And we continue to structure terms in more capital efficient ways in order to enhance returns.

Turning to the balance sheet, at quarter end, we held approximately $1 billion of cash and cash equivalents, and our net debt to capital ratio was 18.7%, with no significant near-term debt maturities. We have also been generating strong operating cash flows, which we expect to continue well into the future. This provides us plenty of opportunity to both grow our business and return capital to shareholders.

During the quarter, we repurchased $181 million of common stock and increased our quarterly dividend by 10%. Returning cash to stockholders will continue to be a very important part of our strategy well into the future.

With that, let me turn it over to Marty.

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## Martin P. Connor

*Chief Financial Officer, Toll Brothers, Inc.*

Thanks, Doug. We had a terrific second quarter, beating our guidance for deliveries, homebuilding revenue, adjusted gross margin, SG&A, and earnings. Our strategy is playing out nicely in this environment, and we are raising our full year revenue and earnings guidance. In the quarter, we delivered 2,641 homes and generated homebuilding revenues of $2.65 billion, both up by approximately 6% compared to last year and both second quarter records.

The average price of homes delivered in the quarter was approximately $1 million. At the midpoint, we delivered 191 more homes than our guidance for $185 million of home sales revenue. We signed 3,041 net agreements for $2.94 billion in the quarter, up 30% in units and 29% in dollars compared to the second quarter of fiscal year 2023. Both agreements and dollars were up over last year in every one of our geographic regions.

The average price of contracts signed in the quarter was approximately $967,000, down about 1% compared to last year and down 4.4% sequentially. This decline was due to product and geographic mix changes driven by our strategy of expanding our price points and building more spec homes, which we expect will lead to a continued modest drop in price over the next few quarters, but also revenue and earnings growth.

Our second quarter adjusted gross margin was 28.2% compared to 28.3% in the second quarter of 2023, and 60 basis points better than guidance. Our Q2 gross margin exceeded our guidance primarily due to strong cost control and increased leverage from higher-than-projected revenues. Positive mix versus projection also played a role, but to a smaller extent.

While we continue to project a full year adjusted gross margin of 28%, we have increased our revenue guidance by approximately $500 million at the midpoint and improved our SG&A guidance by 20 basis points.


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For the third quarter, we project an adjusted gross margin of 27.7%, implying a fourth quarter gross margin of 27.4%. As Doug mentioned, 54% of homes sold in the second quarter were specs, and we now expect more than half our deliveries in our second half to be specs. Having more spec homes available for delivery in the late summer and early fall, we expect, will allow us to meet the demand from many of our buyers who want to move in when schools open.

Our spec homes generally carry a lower margin compared to our build-to-order homes. In the second quarter, the adjusted gross margin for our spec homes delivered was 26.1%, compared to 29.8% for build-to-order homes delivered.

We typically build spec homes on lower premium home sites, saving higher premium sites for our build-to-order customers, who place a higher value on them and will also spend more on upgrades. We also tend to offer higher incentives on completed spec homes. But the advantage to our spec business is that we can build faster with margins that are still strong, and we are able to meet the demand from buyers who want to move in sooner.

We believe this is the right strategy and that we can achieve overall gross margins in the high 20% range, while we grow the business faster, improve operating margin, generate strong cash flow, and achieve consistently high returns on equity.

Turning back to the P&L statement, write-offs in our home sales gross margin totaled $28.4 million in the quarter, as compared to $11.1 million in the second quarter of 2023. SG&A, as a percentage of revenue, was 9.0% in the second quarter, compared to 9.1% in the same quarter one year ago. And this was 70 basis points better than guidance, again reflecting our focus on cost controls and leverage from higher-than-expected home sales revenue.

Year-over-year, total G&A dollars were essentially flat, despite healthy increases in community count, settlements and agreements, and the impact of overall cost inflation. We continue to focus intently on ways to increase productivity and operate more efficiently.

Second quarter JV land sales and other income was $204 million versus approximately $1 million in the same quarter last year. As Doug mentioned, approximately $175 million of this was attributable to the gain we recognized on the sale of land to a data center developer. The remaining approximately $30 million was primarily attributable to increased interest income and a $21 million gain on the sale of an apartment living asset.

JV land sales and other income also included $5 million of pre-development write-offs in the apartment living business, as we decided not to pursue certain deals in the current capital-constrained environment for multifamily.

Our tax rate in the second quarter was approximately 25.9%, basically in line with our guidance of 25.8%. We ended the second quarter with over $2.7 billion of liquidity, including approximately $1 billion of cash and $1.7 billion of availability under our revolving bank credit facility. Our net debt to capital ratio was 18.7% at second quarter end. We have no significant maturities of our long-term debt until fiscal 2026 when $350 million of notes come due in November 2025.

Our community count at quarter end was 386 compared to our guide of 385. We expect 400 at the end of the third quarter and reaffirm 410 by the end of the fiscal year. We are projecting fiscal 2024 third quarter deliveries of 2,750 to 2,850 homes with an average delivered price between $950,000 and $960,000.


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For full fiscal year 2024, we are increasing our projected deliveries to be between 10,400 and 10,800 homes with an average price between $960,000 and $970,000. These are increases of 350 homes and $15,000 per home at the midpoint, representing approximately $500 million in additional revenue. We expect interest and cost of sales to be approximately 1.3% in the third quarter and for the full year.

Third quarter SG&A as a percentage of home sales revenues is expected to be approximately 9.2%. For the full year, we expect it to be 9.6%, an improvement of 20 basis points compared to our previous guidance.

Other income, income from unconsolidated entities and land sales gross profit in the third quarter is expected to break even. We continue to project $260 million for the full year. Much of the remaining $48 million of full year joint venture land sale and other income is projected to come from sales of our interest in certain stabilized apartment communities developed by Toll Brothers Apartment Living in joint venture with various partners.

We project the third quarter tax rate to be approximately 26% and the full year rate to be approximately 25.5%. Our weighted average share count is expected to be approximately $105 million for the third quarter and for the full year. This assumes we repurchase $500 million of common stock in the year, or another $320 million in the second half of the year on top of the $180 million we repurchased in the first half.

As Doug mentioned, with our updated guidance, we now expect to earn approximately $14 per diluted share in fiscal 2024 with an operating margin over 18%. This would result in a full year return on beginning equity of approximately 22% and would put our year-end book value per share at approximately $76.50.

Now, let me turn it back to Doug.

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### Douglas C. Yearley, Jr.

*Chairman & Chief Executive Officer, Toll Brothers, Inc.*

Thank you, Marty. Before I begin to open it up for questions, I'd like to thank all of our Toll Brothers employees for a great first half of 2024. I'm so proud of your dedication, hard work, and commitment to our customers, which are key drivers to our long-term success.

I'd also like to announce that beginning in June, Gregg Ziegler will be assuming additional responsibilities as Head of Investor Relations. Gregg should be a familiar name to all of you. He has been with the company for over 20 years and is our senior VP and Treasurer.

He will be taking the reins from Fred Cooper, who has been our distinguished Head of IR since he joined the company over 30 years ago in 1993. Fred is transitioning to the new role of Senior VP of Strategic Partnerships. We are excited that we will be able to continue to benefit from Fred's wisdom while he concentrates on developing and expanding the many relationships he has helped foster with our debt, equity, and other partners over the years. Congratulations to both, Gregg and Fred.

Now, let's open it up to your questions. Rocco?


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# QUESTION AND ANSWER SECTION

**Operator**: Yes, sir. 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. [Operator Instructions] Today's 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, as always. Congrats to Gregg and Fred, and to the rest of the team. Wanted to...

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

A

[ph] Thanks, Steve (00:27:11).

**Stephen S. Kim**
*Analyst, Evercore ISI*

Q

...ask a – yeah, I wanted to ask a couple of questions related to, I guess, your growth and your margins. Let's start with the margins. You mentioned in your opening remarks that the spec homes that you build tend to be built on home sites with lower lot premiums, I think you said, and as a result, the gross margin is somewhat lower, as well as the fact that you also will incentivize them sometimes more.

But I was wondering if you could disaggregate that for us, because if you're building homes – these specs on home sites with lower lot premiums, even if you didn't build them on a spec basis, they would probably still generate a somewhat lower margin is what I'm thinking. So, curious, how much is spec building for you actually driving a lower margin on an apples-to-apples basis, do you think, taking out that issue?

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

A

Yeah. So, let me start at the beginning of your question and just take you through the business model. So, right now, we're running at about 50% spec, as we talked about. I think, long term, particularly if rates come down and the resale markets open up a bit, we've kind of targeted 40% to 50% as a long-term appropriate business model for the percent that will be spec. We define a spec as a foundation in the ground. It's a little earlier than many other builders.

We sell about a third of our spec up until when the house is framed. We sell another third of the spec between framing and when the finishes go in. And then the final third of the specs we sell when they are completed. The higher incentive tends to be on the completed specs. We are not incentivizing nearly as much. In fact, it's quite similar to the build-to-order incentive when the home is sold either as it's being framed or between drywall and the finishes. And we think that's a good business model because there's a lot of people that want to move in sooner, and we now have the inventory for them.

We also strategically plan when we start specs, thinking about when they will be completed and when the buyers want the house. So, there are more specs that get started in time to be completed in the summer and early fall


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months because we know many buyers, particularly those with kids, and most of our buyers have kids, want to move-in in the summer and the early fall as schools are opening. So, that's all part of the strategy.

And so, we've always expected and we've discussed that we will be a bit more spec-heavy in the second half of the year than in the first half in terms of deliveries. And those homes have a little bit lower margin. The reason they have a lower margin is because of three things. One, we tend to build them on the generic lot, the less valuable lot. So, an average spec may carry a lot premium of $25,000 where the build-to-order business has a lot premium of $50,000 or higher.

We also put less in the house in terms of upgrades. And as you know, our upgrade business through our Design Studio is accretive to margin. We get about a 40% margin out of the Design Studio. But we're cautious. We don't want to overload a spec and be outside or above the market. So, that is part of the strategy.

And then the third reason is if the house gets to completion, we do incentivize it a bit more. We have built in, we think, very conservative incentives for the balance of homes we need spec, so we need to sell and still deliver by October. And there's about 6,000 deliveries between now and the end of the year, half of, call it, 11,000, plus or minus, and about a quarter of those, or 1,500, are unsold specs that are being constructed right now.

Some will sell in the next few months with modest incentive, but some may be sold when they're completed late in the summer, and we are budgeting for a higher incentive. We don't know where that incentive will be. It could be higher than our budget. It could be lower than our budget. We are encouraged by the start to May, which has been very strong. We are encouraged by rates coming down. So, we are certainly hopeful that we won't use all the incentivized – or all the budgeted incentives, but we'll just have to see how that plays out.

As to your main question, which is aren't we just substituting a spec home with the same margin as a build-to-order? Not quite, because I think we are being more conservative than the market would be when they step up and they get to the Design Studio and they fall in love with all the finishes and they put more into the house than we are putting in because we want to make sure we sell that spec and we don't overdo it.

So, it's a fair point. There is certainly lower margin and lower lot premium lots because the lot premium is 100% margin. And there's lower margin when you put less upgrades in a home because of the accretive nature of the upgrade business. But I think our spec strategy is to be a bit more conservative than the client buying a build-to-order on that lot.

**Stephen S. Kim**
*Analyst, Evercore ISI*

Q

Great. Yeah. So, I mean, what I'm hearing from you is that the apples-to-apples, it's probably less than the 200 to 250 basis point lower gross margin versus BTO that you've talked about on a pure apples-to-apples basis, but it is still lower, for sure.

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

A

Yes.

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

A

Yes.


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**Stephen S. Kim**
*Analyst, Evercore ISI*

That's probably a fair way to say it. Okay. Good. All right. So, second question relates to the M&A landscape. I'm curious if you could give us your assessment of the M&A landscape, specifically as it relates to Toll Brothers and your growth plans, how it fits in. We're hearing that private builders are finding it tougher and tougher to compete with the likes of publics like – such as yourself, but also the pool of prospective buyers is pretty robust right now, particularly with the Japanese interest. And at the same time, you have been talking about moving more land-light and having that be an integral part of your strategy going forward.

So, with all of those – those three major pieces, I'm curious if you could give us your general assessment of the M&A landscape. How interested are you in tapping the M&A pool to grow geographically or grow across different price points and things of that nature?

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

Sure. So, what we're actually seeing more from the smaller builders who are facing some capital crunch is land deals that they have tied up, they've processed approvals on, they thought about building homes on, they're having a hard time finding the regional banks to finance them. And while they can't make a full profit they would have made had they built homes, they can make a fair profit by flipping the land to us. And so, we're seeing quite a few deals like that out of the smaller, more local and regional builders.

In terms of M&A, it's very active. There's a lot of deals out there. We're in action. We look at every deal. We have a seasoned team that's dedicated to M&A. That's all they do. There's nothing to report. Frankly, there's nothing that's that exciting to us. We're really happy with the geographic footprint, really happy. There's very few new markets we're looking at. We're growing this company by getting bigger with wider price ranges than the markets we're in, where we know we're under-serving most of the markets we are in.

You pay a premium to buy a builder. It's a lot harder to pay that premium when you're in a market with a brand, with employees, with land, with contractors, with realtor relations and you're cooking. You pay that premium when you want to enter a new market. We did it 15 times in this company over the years as we were on a geographic growth mode. But right now, we love the footprint. We're getting bigger where we are. It doesn't mean M&A is off the table, but it's going to be much harder to pencil and we're going to be more careful.

**Operator**: Thank you. And our next question today comes from John Lovallo with UBS. Please go ahead.

**John Lovallo**
*Analyst, UBS Securities LLC*

Good morning, guys. Thank you for taking my question. The first one, and I may have misheard this, so please correct me if I'm wrong, but I think you may have talked about gross margins settling in kind of the 27% to 28% range. And if so, I'm just curious kind of what's contemplated in this. Spec deliveries increased here, lot prices are going up. What are sort of the positive offsets from the fiscal fourth quarter exit rate of, call it, 27.4%?

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

Yeah, John, I think it's – that range we're comfortable with, the 27% to 28% long term, we think, is the right range for our business model. Remember, we're building houses faster. Our SG&A is coming down, so don't lose sight


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of the operating margin, which is going up, even with the gross margin in that range, and that's obviously very important to us. We've been on this strategy of widening price point, coming down with more affordable luxury, focusing on the affluent first-time millennial, doing more and more active adults, building more spec, particularly at some of the lower price points. That strategy has now been with us for several years.

It's pretty much fully implemented. So while we think average delivered price may come down a little bit more, we think it's going to settle in the low-900s. We think gross margin should settle in the 27% to 28% range, and we're just very comfortable with that business model. The spec business is allowing us to capture a bigger part of the market, not just in terms of price, but in terms of buyers that want to move in faster, and it's giving us opportunity to build houses faster. And so when we combine that at a slightly lower margin with the build-to-order business that is still driving very high margins for all the reasons we are giving, we think that allows more growth.

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

Yeah, John, gross margin is obviously a very key metric for us, but we can't ignore the fact that we're trying to generate high return on equity. And if there is a balance between gross margin and revenue growth, we'll work that balance. An example is a land banking arrangement, where the cost of that land ultimately is a bit higher, thus putting a bit of downside pressure on gross margin for that community. But it allows us to grow revenue and have more capital to allocate to new deals, buybacks, debt repurchase, dividends, et cetera. So, it's a balancing act, and I think we've done a nice job of balancing here as we've been able to continue to maintain pretty high industry leading gross margins while also generating very strong return on equity.

**John Lovallo**
*Analyst, UBS Securities LLC*
Q

Okay. That's helpful. And then maybe just sticking on the cost side, which was very strong in the quarter, I mean, SG&A as a percentage of sales, I think, is expected to tick up about 20 basis points quarter-over-quarter, despite the slightly higher revenue. What's driving sort of the uptick here in SG&A? And how should we sort of think about that as we move forward?

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

Some of it's just the inflationary pressures. Some of it's incentives on some of our spec homes that are given to the brokerage community. And we see more brokers involved in the spec home sales than we do in the build-to-order sales. So, there's additional cost in marketing right now, and I think that's the basis.

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

We also have quite a few communities that will be opening in the second half of the year. There's always upfront community opening costs where communities have not yet generated revenue. And so I think part of it, Marty, is that also.

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

Absolutely.


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**Operator**: Thank you. And our next question today comes from Alan Ratner with Zelman & Associates. Please go ahead.

**Alan Ratner**
*Analyst, Zelman & Associates*

Q

Hey, guys. Good morning. Congrats on a great quarter, and thanks for all the helpful colors so far. First question, Doug, I was listening to your comments on some of the market commentary there, and I think one market you left out was Florida. And I know we've seen, at least in some of the markets in Florida, some pretty decent increases in resale inventory off of the trough levels of late. So, I'm curious, specific to Florida, but I guess across your entire footprint, in areas where resale inventory has begun to inflect higher, how is that impacting your business? Are you seeing the need for additional incentives? Are you seeing absorption slow at all? Just talk to that trend would be great.

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

A

Sure. Every one of our markets in Florida is in the top half of our list on rating performance. I didn't highlight Florida in my opening comments, because they're not top-five markets at the moment, and I tried to limit my comments to the best of the best. Florida East, which is small for us, called the Fort Lauderdale to Vero Beach corridor, is very good. We are encouraged because May has been very strong throughout Florida. We are keeping an eye on inventory. It has increased modestly in some of our markets, Jacksonville, Orlando is two examples, but we don't see it impacting our business.

So, I would grade Florida a B plus. I wouldn't give it an A, but I wouldn't give it a B minus. I think it's a solid, good market, and we're going to keep growing down there. And like I said, the last three weeks have been very good. So, no worries about what's going on down in the Sunshine State.

**Alan Ratner**
*Analyst, Zelman & Associates*

Q

Got it. Appreciate that info there. Second, on kind of the NAR settlement and, I guess, more broadly, your relationship with the brokerage community right now, can you talk to how you view the relationship there? What percentage of your transactions are used in a co-broke? Do you think of that brokerage community as a vehicle to attract more traffic? Do you kind of flex commission rates there to any extent? And where do you see that going forward post-settlement?

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

A

Sure. So, about 65% of our sales involve a realtor, a broker. The brokerage community is very important to Toll Brothers. We take great care of them. We market to them regularly. I think they like coming – bringing their clients to our communities. The business is changing. Co-ops are coming down industry-wide. We're just beginning to see it. We're not going to be a leader. We're going to be a follower. We are already bringing brokerage commissions down in many markets around the country, we think that will continue, but we will not be an outlier.

Right now, the brokerage commission for us around the country is in the range of 2% to 2.5%. It was 2.5% to 3%. There are some markets that are going to flat fee. I think the industry – you're going to see more and more builders moving to flat fee and getting away from a percentage. So, it's very fluid, but it is definitely a tailwind on the S component of SG&A, and we're just in the early stages.


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**Operator**: Thank you. And our next question today comes from Mike Dahl with RBC Capital Markets. Please go ahead.

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**Mike Dahl**
*Analyst, RBC Capital Markets LLC*

Q

Good morning. Congrats to Gregg and Fred. Thanks for all the comprehensive information so far. Just back on the gross margin in the near term, I mean, the margin performance has been exceptional, so that notwithstanding, I think if we look at the trajectory that's implied, you beat the second quarter, held the guide, so it is implying slightly weaker. Doug, everything you're saying sounds, on balance, more positive.

We've seen the same pricing trends you're alluding to in terms of pretty broad increases that you've implemented. The spec closing mix has already been elevated, as you talked about, in the 2Q level, so a little increased spec doesn't seem like it's going to move the needle that much on margin. So, maybe just help us bridge the gap a little bit more on just kind of after such a strong 2Q performance, why the back half margins would still trend down, call it, like 80 basis points, 70 basis points, by the time you get to 4Q versus 2Q.

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

A

Thanks, Mike. As Doug kind of hinted at, we forecast approximately 4,500 homes in backlog to deliver in our second half, along with another 1,500 home – unsold generally lower margin spec homes. Remember, a large number of those 4,500 backlog homes are also specs that have been sold and have not yet been completed and delivered. The spec deliveries in our second half will far exceed 50% of total deliveries. And as we've said, they generally carry lower margins.

So despite some recent margin beats, as we look at those 4,500 homes, the concentration of specs in them, the additional 1,500 specs still to be sold, we feel prudent to hold our gross margin guidance at 28% for the full year.

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**Mike Dahl**
*Analyst, RBC Capital Markets LLC*

Q

And then, just as a point of clarity, Marty, does that assume – I know you said it baked in kind of higher incentives on specs, so does that assume that the spec gross margin will be lower in the second half than it was in the first half?

And then, my follow-up question is, when you think about that long-term gross margin guide, you've obviously tightened up your kind of algorithm for thinking about the total margin and return that allows you to underwrite a deal. It still seems like you're finding success getting to that high-20s margin on new deals, which is a little bit surprising given the amount of capital out there chasing land.

And so, I guess, just talk a little bit about that kind of ability to continue to underwrite. And as you're pushing things into land banking, ultimately, what percent of those deals are still self-developed, and maybe that's still a delta that's allowing you to really capture both.

---

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

A

There's a lot there, Mike.

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**Mike Dahl**
*Analyst, RBC Capital Markets LLC*
Q

[ph] I had to ask (00:47:41)...

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

Yeah. Let me see how I can address that. I think our spec margin in the back half of the year is expected to be a little bit lower than it was in the first half of the year, because the first half of the year was particularly benefited with strong spec gross margin in the first quarter, and that came out of the Pacific region where we just don't expect that to continue.

As it relates to underwriting and elevated standards, you're right, we are able to find deals. There is a bit of capital out there chasing deals, but maybe not as much as you might think at our price points and at our deal size. We'll do 40-lot deals. We'll do 50-lot deals. We're advantaged compared to the smaller, less capitalized builders who we compete with for those deals. And as Doug mentioned, we're actually getting a number of deals from some of the smaller, less capitalized builders as they can't close on all the deals they have out there. So, we're encouraged by what we're seeing there.

In terms of land banking, I think it's probably a good rule of thumb to say 25% of our deals are land banked. We continue to be encouraged by the depth and the permanence of that land banking market or the perceived permanence of that land banking market, so that number may go up. That puts a little pressure on gross margin, but as we've said before, really enhances returns and growth.

**Operator**: Thank you.

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

Was there another question in there?

A

He's asking about sustainability of margin, how you're underwriting land today.

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

Okay. Yeah, our underwriting is rigorous, and we are not compromising margin in that underwriting. So, we would expect to continue to achieve the 27% to 28% we talked about earlier.

**Operator**: Thank you. And our next question comes from Rafe Jadrosich with Bank of America. Please go ahead.

**Rafe Jadrosich**
*Analyst, BofA Securities, Inc.*
Q

Hi. Good morning. Thanks for taking my question. If I look at the lot count, since the beginning of 2023, it's been relatively stable kind of in the low-70,000 range. But over that time period, you've added about, I think, 70 new


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communities. How do you think about the level of land spend and community count growth going forward? And then when would you need to start to see lots growing to keep up your long-term growth targets? Are we talking about years or quarters? Like how long can you sustain the community count growth at this level of lot count?

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

So, as I mentioned, we have the land controlled to grow community count in 2025 and 2026. And we're seeing 10 to 25 deals a week. And some of those are very, very long entitlement processes, but many of them will be able to deliver houses or at least sell houses over the next few years, which means the communities could open. So, we are on plan to grow community count 10% in 2024 over 2023. And we are confident we can continue that type of community count growth based on the land we control and the deal flow we see.

So, 70,000 lots, when you're building 10,000, 11,000, 12,000, 13,000, 14,000 homes a year, as we continue to grow this company, is putting us in great shape and allowing us to be diligent and conservative and careful as we continue to look at new land opportunities. So, land is about the least of my worries here. We have terrific teams. We have a great brand. Sellers want to sell to us. Towns want us to build our homes in their towns.

The type of deals we're seeing is widening dramatically. I talked about smaller builders selling us land. I can't tell you the number of suburban office complexes that are half leased up, that are being sold to be torn down and redeveloped into townhomes. There's all sorts of new deals that we didn't see years ago based on the nature of today's market.

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

And new deal structures, as we've encouraged our land teams to get creative in deferring payment terms, we've seen a few deals where we don't pay for the land until the home closes.

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

Right.

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

And we've seen more profit participation arrangements where there might be an upfront payment for the land and then an additional payment at closing. And we're seeing more seller take back financing terms. So while we are still at this 50/50 roughly split between owned and optioned, don't be misled by that, because a lot of our payments are actually happening very late for that land that we may already own. And that really helps us with the cash flow and it helps us with the return on equity.

**Rafe Jadrosich**
*Analyst, BofA Securities, Inc.*
Q

Got it. Thank you. That's helpful. And then the SG&A, you mentioned earlier, it's down pretty material. I think on a year-over-year basis, you're up $10 million, even if you pull out the land sales, on $160 million of higher home sales. Can you give us more color on like where you're getting the leverage and how sustainable that is going forward if there's additional opportunity? Thank you.


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

Yeah. As I mentioned in the prepared remarks, our general and administrative dollars expended are flat year-over-year. So, S has gone up a little bit with the volume of additional revenue and a little bit more broker usage. But the G&A for the team around this operation has been flat, and we're getting more done with the same amount of people or even less people despite community count growth. We're increasing productivity. We've completed implementation of new ERP systems, customer relationship management systems, and human resource systems, and we're starting to reap the benefits from some of those technological investments.

**Operator**: Thank you. And our next question comes from Sam Reid with Wells Fargo. Please go ahead.

**Sam Reid**
*Analyst, Wells Fargo Securities LLC*
Q

Awesome. Thanks, guys. Wanted to talk order volumes really quickly. I know you don't guide on orders, but could you just give us some high-level context on how orders should theoretically trend in Q3 and Q4? And I guess what I'm getting at here is, should we see a departure from the seasonal cadence as you mix deeper into spec? Thanks.

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

Sure. So, I mentioned that we're really happy with three weeks of May. It's only three weeks, but we are trending higher than the historic numbers would suggest. Third quarter is usually down about 15% from the second quarter if you look back in history. And we're doing much better than that for these three weeks.

I think you're right. We don't guide to sales, but 2.4 sales per community per month, we're very comfortable with right now with how this quarter has begun, and that's better than normal seasonal trends in the beginning of the third quarter. So, I think that's the best flavor I can give you on it.

**Sam Reid**
*Analyst, Wells Fargo Securities LLC*
Q

No, that helps. And then, maybe pivoting really quickly to land. I know you've already touched on some of this, but I wanted to get a sense for the visibility you have into your land pipeline, because it sounds like you pretty much have a good idea as to what's going to happen in 2025 and 2026. So, the question here is sort of do you have any view on how we should be modeling lot cost inflation over those next few years? Thanks.

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

So, right now, it's been running 5% to 10%, maybe probably closer to 5%, up over the last year or so. And I think that's a fair – if you're going to put it in a model, I think 5% is probably a fair number.

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

It's important to reiterate that 42% of the lots that we own and control were priced for, contracted for, prior to 2021, which is kind of when the land market started to...


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

Right.

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

...reap the benefits of COVID and the demand we saw in COVID.

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

That's great.

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

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

Rocco, thank you very much. You were terrific. Thanks, everyone. We appreciate all your interest and support. We're always here to answer any questions you may have. And I hope you have a wonderful Memorial Day and the start of a great summer. Thank you.

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

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