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TOL - Q3 2018 Toll Brothers Inc Earnings Call

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OVERVIEW:

TOL reported 3Q18 revenues of \$1.91b.



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PRESENTATION

Operator

Good morning, and welcome to the Toll Brothers Third Quarter 2018 Earnings Conference Call. (Operator Instructions) 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 - Toll Brothers, Inc. - CEO & Director

Thank you, Anita. Welcome, and thank you for joining us. I'm Doug Yearley, CEO. With me today are Rick Hartman, President and COO; Marty Connor, Chief Financial Officer; Fred Cooper, Senior VP of Finance and Investor Relations; Kira Sterling, Chief Marketing Officer; Mike Snyder, Chief Planning Officer; Gregg Ziegler, Senior VP and Treasurer; and Don Salmon, President of TBI Mortgage.

Bob Toll was not joining us on the call today as he and 15 Toll family members representing 3 generations of Tolls are on an end-of-summer trip to Alaska. We wish him great weather and great fun.

Before I begin, I ask you to read the statement on forward-looking information in today's release and on our website. I caution you that many statements on this call are forward-looking based on assumptions about the economy, world events, housing and financial markets and many other factors beyond our control that could significantly affect future results.

Those listening on the Web can e-mail questions to DYearley@tollbrothers.com.

We completed fiscal year 2018's third quarter on July 31 with excellent results. Earnings per share rose 45% and net income rose 30%. Pretax income rose 24% and income from operations, essentially our homebuilding operation rose 33%. Revenue this quarter was \$1.91 billion, which positions us for the highest full year revenues in our history. We achieved 12% growth in the value of new contracts signed, which at \$2.03 billion was the



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highest for any third quarter in our history. Record third quarter contracts and a third quarter end backlog of 22% in dollars from 1 year ago indicates revenue and earnings growth for fiscal year 2019.

On a per community same-store basis, contracts per community of 8.1 were the highest for a third quarter in over a decade and up 18% compared to fiscal year 2017. The value of our contracts in the West, South and Mid-Atlantic regions and in our City Living division were all up at least double digits while the North was essentially flat. In California, our contracts were down 1% in dollars and 4% in units.

Contracts per community in California declined from 11.3 in fiscal year 2017's third quarter to 10.0 this quarter. However, contracts per community in California were still well ahead of the company-wide average of 8.1. While California is not as hot as it was a year ago, it is still one of our stronger markets. More broadly, while there has been talk about rising interest rates, the rate of a 30-year fixed-rate mortgage is about 4.75% today versus 4.625% 6 months ago. In fact, on this call 3 months ago, we cited 4.875% rate. So it is down since then. Our community count grew from 283 at second quarter end to 301 at third quarter end but still lagged fiscal year 2017's 312 at third quarter end. We expect to reach approximately 315 selling communities by fiscal year-end 2018, which should give us a strong start to fiscal year '19. And without giving specific guidance on community count for 2019, we already own or control enough communities we plan to open next fiscal year to project growth in community count by fiscal year-end 2019. And that is before potential new land acquisitions in the pipeline.

Our double-digit growth in revenues, contracts and backlog and our strong earnings results reflect the health of the new home industry in general and our unique position in the luxury market. Through our customization model, our buyers are adding on average, \$165,000 in lot premiums and structural and designer options to their homes. We're also benefiting from the quality of our brand, the diversity of our product lines and our attractively located land pipeline across our approximately 50 markets. Now let me turn it over to Marty.

Martin P. Connor - Toll Brothers, Inc. - Senior VP & CFO

Thanks, Doug. Before I address the specifics of this quarter, I do want to note that a reconciliation of the non-GAAP measures referenced during today's discussion to their comparable GAAP measures can be found in the back of today's release. We are very pleased with this third quarter's results, as we exceeded our guidance for closings, average delivered price, adjusted gross margin, SG&A leverage, other income and income from unconsolidated entities, and our effective tax rate.

Contracts per community improved significantly over last year. Our quarter-end community count was above expectation, and our third quarter backlog was the highest in a dozen years. With an average build time of over 9 months, this backlog gives goods revenue visibility into the first half of fiscal year '19. We had land write-downs of \$11 million, primarily associated with the community in the Mid-Atlantic region. We also took a \$4 million impairment of a homebuilding joint venture in the Mid-Atlantic region that lowered the income from unconsolidated entities. Gross margin this quarter benefited from approximately 60 basis points of litigation settlements, which we had expected for the fourth quarter. Last year's third quarter margin benefited a similar amount from an accrual reversal and some brownfield cleanup reimbursements. Excluding this quarter's litigation settlements, our adjusted gross margin still exceeded our guidance by 30 basis points, which we attribute to cost coming in a bit lower than expected and a slightly positive product mix of deliveries.

Our full year adjusted gross margin guidance is now set at 24%, consistent with the midpoint of our previous range.

We will give detailed margin guidance for fiscal year 2019 at our fiscal year-end 2018's earnings call. We have now at our guidance for full year deliveries while slightly increasing our average delivered price expectations. We've also updated our guidance today to reflect improved SG&A leverage, 20 basis points and a full point reduction from the midpoint of our expected tax rate range. Also, the interest in cost of sales is now projected to be 2.7% for full year 2018 compared to 3% in fiscal year 2017.

Our Apartment Living platform is performing well and should continue to show significant growth. With a total of 9 projects built totaling 4,000 units, some of which we have sold and a pipeline of over 12,000 units in construction or in planning, we are building a national business. As we have previously mentioned, we will strategically monetize certain Apartment Living assets through regular sales or recapitalizations. Such gains will exceed \$60 million in total in fiscal year 2018. During the quarter, this third quarter, we closed on the sale of Parc Westborough, a 249 unit garden-style community owned in a joint venture located in Westborough Massachusetts. This resulted in a gain to Toll Brothers of \$9 million. We



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also had a gain of approximately \$30 million in our first quarter from the sale of our Terrapin Row Student Living joint venture at the University of Maryland. In our fourth quarter, we project another gain on sale of an apartment project located in suburban Washington, D.C. This gain will be in excess of \$20 million.

All of our rental projects are developed in joint ventures where we own 50% or less. We earn performance bonuses and management fees as well as income from the properties we own long term. This is a high return on equity business, and we are excited about its progress. We remain focused on returning value to shareholders and improving our return on equity, as indicated by the year-over-year reduction in our lots owned as compared to total lots controlled, our recently increased dividend and our continued stock buybacks. Owned lots as a percentage of total were 63%, down from 68% at fiscal year '17's third quarter end. And we have repurchased another 147 million of our stock since the end of the second quarter of fiscal year '18, bringing our fiscal year '18 total to 438 million and \$10 million and 10.2 million shares today. Return on beginning equity for fiscal year 2018 is now forecast to be approximately 16%.

While affordability has been a concern in the media, our mortgage company, TBI Mortgage, has seen behavior that seems to run counter to those headlines. Our cash buyers have jumped to roughly 24% this year compared to our more typical level of 20%. We have not seen an uptick in leverage rates and in fact, our buyers' loan-to-value ratio in Q3 dropped to 67% from a more typical level of 70%.

Turning back to guidance. For the fourth quarter and fiscal year-end and subject to our normal forward-looking statements caveats, we are for the following guidance. We project full fiscal year 2018 deliveries of between 8,100 and 8,400 units with an average price between \$835,000 and \$860,000. This would result in revenues of between \$6.76 billion and \$7.22 billion, which would be the highest annual revenues in the history of the company. Fourth quarter deliveries are expected to be between 2,550 and 2,850 units with an average price of between \$840,000 and \$870,000.

For the full fiscal year 2018, we are projecting an adjusted gross margin of approximately 24% of revenues, which is consistent with the midpoint of our previous guidance and adjusted gross margin of 24.8% for the fourth quarter. We expect interest in cost to sales to be 2.7% of revenues for the full year and 2.65% for the fourth quarter. We expect full year SG&A, as a percentage of revenues to be 9.8%, which is a 28 -- I'm sorry, is a 20 basis point improvement from our previous expectations. Fourth quarter SG&A is expected to be 8.1%.

Fiscal year 2018 joint venture and other income guidance is approximately \$145 million with approximately \$55 million expected in the fourth quarter. We are also revising lower our full year effective tax rate from a midpoint of 24% to approximately 23%. Our fourth quarter effective tax rate guidance is approximately 28.5%. We reaffirm our guidance for fiscal year-end 2018 community count of 315 compared to 305 at fiscal year-end 2017. Lastly, we expect our weighted average diluted share count to be approximately 151.5 million shares in Q4 and 155 million shares for the full fiscal year. The full year share count is down 8.5% from last year's fiscal year-end share count. These share count figures do not assume any additional share repurchases in the fourth quarter. Now I'll turn it back to Doug.

Douglas C. Yearley - Toll Brothers, Inc. - CEO & Director

Thank you, Marty. Anita, we are all set for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First question today comes from John Lovallo with Bank of America Merrill Lynch.

John Lovallo - BofA Merrill Lynch, Research Division - VP

First question is, you mentioned California was strong, but perhaps not quite as strong as it was last year. Were there particular submarkets or price points where this was most evident?



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Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

John. Sure, I'll be happy to talk about California a little bit. The comp the last year is unique and was frankly fairly extraordinary in that last summer we actually saw acceleration of sales over the spring, which is something that typically doesn't occur. And I think what has happened this year is we've gone back to a normalized seasonality where the summer months are a little bit slower than the spring. It is still both in North and South in all submarkets, one of our stronger markets. As I've mentioned, we are exceeding company averages in sales per community. And so we are very happy with the operations in California. I will point out that when you look back to the third quarter of '16, we're up 32% this year. So it's really just when you focus on the summer of '17, which was pretty unique, but overall, there are no submarkets I'm worried about. And we like all of our operations, both North and South, and really love our land positions and all is good.

John Lovallo - *BofA Merrill Lynch, Research Division - VP*

Okay. That's really encouraging. Thanks, Doug. And then as a follow-up, your order growth in the South region was a lot stronger than we had expected. Just curious, how the T Select brand is doing there and how that may have contributed in the quarter?

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

When I look to the South, the 1 market that has the lower priced homes would be Jacksonville, which is a relatively small market for us and has -- but has performed well. So I would say that the -- our lower priced offerings that are more focused on the, what I'll call the leading-edge, affluent millennial, have had a pretty small impact on the strong sales we saw in the South.

Operator

The next question comes from Stephen East with Wells Fargo.

Stephen F. East - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Doug, maybe, I'll start with the capital allocation like I usually do here. But as you think about capital allocation, if you think the cycle has, say, 2 or 3 years left in it versus 5 years left in it, how would you all think differently about how you allocate toward land, debt, share repurchase? And then also on the share repurchase now as you look at it, even though you're not building any in, how are you all thinking about share repurchase currently?

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

Thanks Stephen, your 2, 3 years versus 5 is strictly a hypothetical question. I think we feel much better about the market and are not looking at it quite that way. But notwithstanding that, we've always, as you know, have been very opportunistic on land buying. We're very conservative on land buying. We underwrite deals to today's market without baking in inflation. We are very focused on what markets are performing well, what markets are not performing as well, what markets have great land opportunities, what markets may not have as good a land opportunity and that is a strategy that we employ from the day this company was born where we get in the weeds and we get very involved on a deal-by-deal basis. And we will continue to operate that way, and we will continue to buy land. We think of best locations in the best markets for the best prices. With respect to capital allocation, we've obviously exceeded through 3 quarters the \$400 million of guidance we gave, which was obviously very soft guidance as to how much stock we would buy back. And we will continue to be strategic in our buyback. So we have not exceeded some cap. And therefore, on the sidelines, we will continue to examine stock price, land opportunities, M&A opportunities and any other use of our capital. And share buyback will continue to be a growing part of our capital allocation as we move forward.



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Stephen F. East - Wells Fargo Securities, LLC, Research Division - Senior Analyst

All right. Great. That's really helpful. And then switching to gross margin. You had a little bit of a beep. You talked about some of the drivers, as you look out, I'm not asking for 2019 forecast. I'm more interested in, are you -- we've seen lumber futures drop a lot, some of the metals have come down, et cetera, what are you all seeing on the raw material front and then how long does that typically take the cycle through your business?

Douglas C. Yearley - Toll Brothers, Inc. - CEO & Director

Of course, the best news we have of late is that, lumber prices are coming down. That will not translate into lower cost for some time because of course, as you know, our houses take 9 months plus or minus to build and most of the lumber goes into the home and the front end of construction. But over the next 3, 6, 9 months, we are encouraged by the drop in lumber pricing since it's a -- obviously major component on the material side of the home. But remember that has been offset with some continued cost creep on the labor side and some continued cost creep with some other materials. So we're not going to project out '19 at this point, we'll do that on the next call. And I think I've summed it up fairly well with the pluses and minuses for both labor and material.

Operator

Next question comes from Jack Micenko with SIG.

John Gregory Micenko - Susquehanna Financial Group, LLLP, Research Division - Deputy Director of Research

Just curious, lot of mixed messages through the quarter from other builders. Curious how pace kind of migrated over your 3 months quarter?

Douglas C. Yearley - Toll Brothers, Inc. - CEO & Director

One second, I'll get that for you. So May over May was -- May over May and June over June were slightly down and July was up.

John Gregory Micenko - Susquehanna Financial Group, LLLP, Research Division - Deputy Director of Research

Okay. And then Doug, the 165, I guess the option in premium percentage. How does that look historically. I know the Toll buyers, obviously, that number has always been a larger percentage of your ASP. But in the quarter, I know you touched on the mortgage size, so I'll just dump all those questions in. Less options, are we seeing that, are we seeing any ARM loans, smaller square footage, any of those telltales despite the fact that, as you said, rates were actually down sequentially on a quarter-to-quarter basis?

Douglas C. Yearley - Toll Brothers, Inc. - CEO & Director

Right, so on the option side, we continue to run about 20% of the delivered price of the home as options, now within options is lot premiums, in many locations those are small, but in some very special locations they can be quite large. I heard of a lot premium, I think, in Southern Cal that exceeded \$1 million for the lot premium. I think Catalina Island might have been in view on a clear day. But generally, we run 20% and that number really hasn't changed. Our design studio presentation and process now is something I'm very proud of and is much more sophisticated and elegant than it's been ever been before where we have 25, 27 design studios nationwide where we send our clients to a beautiful regional center where they can pick all finishes and its performing very, very well. Marty, why don't you address the mortgage side.



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Martin P. Connor - *Toll Brothers, Inc. - Senior VP & CFO*

Sure. As I said in the prepared remarks, we've actually seen a tick down in our loan-to-value, down to 67% from a pretty long run rate of 70%. We also saw adjustable rates be only 19% of total compared to the 22% it was a year ago, which was not an abnormal number for -- so it's interesting that we don't see some of the telltale signs that you mentioned regarding affordability.

Operator

The next question comes from Ken Zener with KeyBanc.

Kenneth Robinson Zener - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

I'm sorry about that. Gentlemen, I wonder, if you could just make on the broadside, obviously, rates peaked down sequentially, your LTVs are very good. We've noticed increases in inventory -- existing inventory specifically in California given that you have very high absorption rates there. Could you just Doug give us your broad view how new sales demand for your products and the existing inventory might interact?

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

We are seeing more than ever in my 28 years a flight to new. The lifestyle of today's buyer, the architecture that we're offering with the indoor, outdoor living, the ability to customize as we talked about through our processes with not only structural changes but the design studio experience to truly create a one-of-a-kind custom home has -- we're seeing a premium for new that is larger than I -- again I've seen in my experience and it's for all those reasons that I've given. We have buyers that will only shop new. Some buyers will shop used and new, but there are more and more buyers that wanted new. They don't anyone else to have lived in the home, and they want to design it their way. And with the new architecture and the new features and this indoor, outdoor living and the ability to customize, I think we're positioned really well and have a huge advantage over the used market.

Operator

The next question comes from Michael Rehaut with JPMorgan.

Michael Jason Rehaut - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Congrats on the results. I just wanted to circle back to your comments before. I believe you said during the quarter and correct me if I'm wrong, that I heard -- misheard it that, May and June were down slightly year-over-year in terms of orders, but July was up. And that would seem to indicate that you had a pretty strong July, I presume, to result in a 7% growth for the full quarter overall. So if I heard that right, I'm just trying to get a sense of, perhaps, what drove that, if there was a certain region that kind of turned around, if there was a greater degree of timing from community count openings or little color behind that trend?

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

Sure, Mike. There is no region or division I will point to that drove it. My best guess is my comment about interest rates. They're down. They stabilize right with the fear of rising and in fact came down 0.8 point over the last 3 months.

Michael Jason Rehaut - *JP Morgan Chase & Co, Research Division - Senior Analyst*

I mean, it's surprising that such a small movement would create such a big change in order trends obviously, 0.8 point historically you don't think about that as moving the needle too much, but -- which is kind of the basis for my question. I guess, secondarily, you highlighted California and



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appreciate that obviously, a lot of focus there, kind of moving towards other parts of the country, any incremental color around, perhaps, what you're seeing in the South where you did see pretty strong order growth for the quarter as well as, I guess, kind of going back to California for a moment. The big debate there is affordability and particularly Southern Coastal California. Would you say it's more of just being in the right neighborhood because there has been a little bit of consistent feedback throughout this past earnings season around \$1-million-plus price points in Coastal Southern kind of having a little bit more of a challenge. So sorry for the long-winded question, but basically any incremental color around the South and then California?

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

Sure. I'll start with the South. Charlotte, Raleigh, Dallas, Houston and Austin drove our positive results in the South. As we continue to strategically diversify this company, I think this quarter was a good example of how that diversity has paid off. And I'm very pleased with not just the performance I mentioned in the South, but the performance we've been talking about in many markets nationwide. When I look at our top 10 performing markets this quarter on sales per community, more than half of those communities have come out of the North, the Mid-Atlantic, the South and not just the West in California, which have -- they are also -- some of those are certainly also in that top 10. But I'm very pleased with sort of the distribution of strong action now nationwide. With respect to California and affordability, as I said earlier, I'm very happy with the performance not just North and South, but also in our submarkets, which of course, in the North or the East Bay and the South Bay of San Francisco and in the South is L.A., County and Orange County with a few communities that are in wind down stage in Northern San Diego county that performed well. It is location Mike, and it's beyond location its quality and its presentation and its brand. And as I've said on many calls and as I tell all of our employees, get on a plane and go see it because it is unique, and we continue to perform very well.

Operator

The next question comes from Nishu Sood with Deutsche Bank.

Nishu Sood - *Deutsche Bank AG, Research Division - Director*

So the community is coming in a bit better than expected in the quarter. Was that just a typical volatility around just permitting or getting them open or is there something more encouraging there about the kind of general state of getting communities open?

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

There is nothing unique about it. Many of those opened very late.

Martin P. Connor - *Toll Brothers, Inc. - Senior VP & CFO*

Seven of them didn't contribute any agreements

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

Right. So many opened very late in the quarter. So if there were scheduled for August and they were able to open in the second week of July that helped the numbers, but the reality is, as Marty said, they didn't contribute significantly to the sales. But it's a story we always tell, that last permit that controls the opening date is somewhat unpredictable, notwithstanding our many years of experience. And so there is always a bit of estimating that goes into our community count and exactly when they open.



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Nishu Sood - Deutsche Bank AG, Research Division - Director

Got it. Now that's very helpful. So then a number of them didn't contribute to orders. Got it. Okay. So the second question. Marty, you mentioned in the quarter gross margins were benefited by cost coming in a bit lower than expected. Obviously, this is against a backdrop of overall input cost increasing. What specifically were the cost that came in a bit lower than expected in 3Q. Are we seeing some moderating trend, does that contribute to some moderating trend overall or was it just a 3Q event?

Martin P. Connor - Toll Brothers, Inc. - Senior VP & CFO

Well, I don't think we're seeing a moderating trend overall. I mentioned that it was a combination of both some cost coming in a bit less than we thought as well as favorable product mix. So I think it is very tough issue to pin point a couple of cost or a couple of regions. It was just a bit of a favorable quarter with respect to our estimated cost compared to actuals.

Nishu Sood - Deutsche Bank AG, Research Division - Director

Got it. So no particular observations about labor or materials or any categories. Just kind of overall unbalance over the portfolio?

Martin P. Connor - Toll Brothers, Inc. - Senior VP & CFO

Correct. Nothing, in particular, to mention.

Operator

Next question comes from Alan Ratner with Zelman and Associates.

Alan S. Ratner - Zelman & Associates LLC - Director

So on the order side, I know every July, you guys host the sales event and I know in the past you've kind of downplayed the impact to margin or anything like that. It sounds like those tend to be more things offered by your suppliers and whatnot. But just curious given the acceleration you guys saw in July, was there anything different in this event this year in terms of what those incentives were as a percentage of base price or anything that could may be partially explains that bump you saw as well?

Douglas C. Yearley - Toll Brothers, Inc. - CEO & Director

No. The events lined up the same time as prior years and there was no change.

Alan S. Ratner - Zelman & Associates LLC - Director

Got it. And then second question on the absorption rate. So I guess, if you annualize where you're running at this year, you're going to be right around 2.5 per month per community. And that's obviously up very nicely year-over-year. When you think about these new communities that are coming online and kind of understanding there is big mix impact there from region to region and whatnot. Where do you see that number normalizing out in a prior cycle, you got as high as 3.5 a month obviously, you probably don't get back close to there. But is 2.5 kind of a good run rate to think about? Or do you still think there is low-hanging fruit there to drive that rate meaningfully higher?



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Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

I think our long-term average for absorptions per community is somewhere in the 27 to 28 range when you look at kind of normalized years. We don't look at '05 and '06 as normalized years. With our mix shift to more active living and some additional lower price pointed product as well as some of the condominium products in New York, we would think that could get to 30, 32, and so we're close to that right now.

Alan S. Ratner - *Zelman & Associates LLC - Director*

Right. Okay. Got it. So pretty close to where you're at. And then if I could sneak in one more just on the margin. I know you're not giving '19 guidance, but I think a lot of people are going to look at the deceleration of California and just be a little bit concerned about the go-forward view given the significant differences in margins across your various regions, California has been a big driver, obviously, over the last year or 1.5 years there. So is there anything you can give us just about your backlog that would give us a little bit of indication that this drop off or deceleration in California is maybe offset by other regions or anything to suggest where directionally margins might go?

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

Well, we're not going to get into much specifics there. We will wait till next quarter. California, has a percentage of total deliveries for '19, because it's such a big piece of this year's backlog right now, it's actually expected to be up a bit compared to this year. So that should be a tailwind to margins and as we have mentioned, the City Living efforts this year have been to push through inventory. And hopefully, we put most of that behind us by the time we get to the end of this year and we have some buildings delivering next year that could be also a tailwind.

Alan S. Ratner - *Zelman & Associates LLC - Director*

Got it. But the mix spread between regions are pretty similar to where you've been running at, I guess, is what I'm trying to get at.

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

Yes.

Operator

The next question comes from Stephen Kim with Evercore ISI.

Stephen Kim - *Evercore ISI Institutional Equities, Research Division - Senior MD & Head of Housing Research Team*

Congratulations on strong results. My first question relates to the land. Can you give us the development spend in the quarter and then also just remind us again on what the acquisitions, so we have the total and the breakdown. And then also are you seeing any opportunity with land prices, maybe been able to get some better deals or something in light of the fact that while your results are performing extremely well, maybe some of your competitors are experiencing some little more difficulty. Was curious if you're seeing that manifesting in the ability to get some better deals on land?

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

Sure. Stephen on the land spend for the quarter, it was approximately \$195 million for improvements in stocks and around \$306 million for land spend itself.



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Stephen Kim - *Evercore ISI Institutional Equities, Research Division - Senior MD & Head of Housing Research Team*

Inclusive of the \$195 million? Or is that in addition to the \$195 million.

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

It's in addition to the \$195 million. So the total was \$501 million.

Martin P. Connor - *Toll Brothers, Inc. - Senior VP & CFO*

And Stephen on the state of the land market, it's still very competitive. We have not seen any changes of significance in the markets pretty much nationwide. They're the same players with deep pockets, with big appetite, are chasing deals. We do continue to have the advantage that much of the land we look at is in locations and at price points that are not of interest to the larger, better capitalized builders, and so we tend to be competing against smaller regional and local builders who have a difficult time financing the transaction and we can come in with our balance sheet and our ability to write a check faster or more predictably and also have the experience on the land approval, land entitlement side, and are generally well liked by towns because they like our pretty homes. And so that advantage, which has been a historic advantage continues to play out for us.

Stephen Kim - *Evercore ISI Institutional Equities, Research Division - Senior MD & Head of Housing Research Team*

Sure, great. I had a -- my next question relates to the Asian buyers. We heard, in particular, in Manhattan for example that there has been an uptick in activity at the high-end of the market, perhaps with some Chinese buyers. Perhaps maybe it's the currency or maybe it's something else. But was curious as to whether or not you're seeing that across any parts of your business, I'm thinking particularly California, for instance or City Living Manhattan whether you're seeing any indication of an increased interest there. And then just a housekeeping item, Marty you mentioned community count next year was likely to be up by the end of, I think, you said '19. Wanting to make sure that we understood, is it going to be -- is community count going to be up throughout '19 on a year-over-year basis?

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

So with respect to the community count, we're going to start the year up and we are going to end the year up and we have not refined things in the middle yet, so we're just careful in the language we chose.

Martin P. Connor - *Toll Brothers, Inc. - Senior VP & CFO*

And Stephen, with respect to the foreign and specifically Chinese buyer, we have seen no change in buying behavior over the last 3, 6, 9 months.

Operator

The next question comes from Michael Dahl with RBC Capital Markets.

Michael Glaser Dahl - *RBC Capital Markets, LLC, Research Division - Analyst*

I wanted to go back to follow up on a question that Allen asked about just regional margin trends, and just given some of the -- some of the strength that you've seen in, obviously, a lot of focus on California here, but outside of California on the demand side, I know you've mentioned there is still



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a gap in terms of the margin profiles, but directionally are you seeing opportunities to improve margins in some of your other regions like the North, the West, the South?

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

Sure. If you recall 3 months ago I mentioned that we had expected margin improvement in all regions for the third quarter and the fourth quarter. And we did deliver on that in the third quarter. And in the fourth quarter, we expect margin improvement from the third quarter in 4 of the 6 regions.

Michael Glaser Dahl - *RBC Capital Markets, LLC, Research Division - Analyst*

Got it. Okay. That's helpful. And then on the comments around what you're seeing in TBI. Interesting on the LTVs and I'm curious, if there is anything anecdotally that you've heard from the field in terms of reason for that and specifically how much if any is being driven by buyers trying to put more down to avoid the new limits on interest deductibility?

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

Don Salmon is with us, who runs TBI Mortgage, I will make 1 comment leading into Don that we've not seen any impact from SALT in those high taxed states. Don, go ahead and attend to the question on...

Donald Salmon

Yes, that's exactly what I was going to say, in answer to the question. I haven't heard of any change in behavior as a result of SALT. And just to put a little color on it, if you look at LTVs, on the conforming the average LTV as 60%, which is little more than 50% of Toll's business. So there are people putting more money down in a conforming historically. That's about in line with where it was. Actually in the second quarter last year -- this year, it was 52%. And jumbo is a little bit higher at 70%, little bit north of 70%. So -- and government, which is only 5% of the business is a little over 80%, so even our government buyers who can get 100% financing on a VA or a 3% down on a conventional were putting significant down payment down to be at 82% average LTV on a [gove] loan.

Douglas C. Yearley - *Toll Brothers, Inc. - CEO & Director*

And the mortgage interest deduction now at \$750,000 cap, we only have 18% of our mortgages in excess of that \$750,000.

Donald Salmon

Right, yes, it's just not been a factor for us.

Operator

The next question comes from Jade Rahmani with KBW.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

Inclusive of joint ventures, can you tell us what City Living did year-over-year in terms of order growth? And can you just give an overall comment on the New York City condo market, state of it. We've seen some market level reports of declines spreading beyond just the ultra-luxury segment?



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Douglas C. Yearley - Toll Brothers, Inc. - CEO & Director

Yes. So guys are looking up the specific numbers, I'll give the commentary. There has really been no change in the City Living business since the update we gave on the last call. We continue to perform very well, beyond expectations in New Jersey, which for us is 1 major new building in Hoboken, and another building in Jersey City. That market is now about \$1,000 per square foot off the water and as high as \$1,200 or \$1,400 even a square foot on the water. In Jersey City, at 10 Provost, we've had 164 contracts since July of '17, so call that 13 months. We opened a new building in Hoboken, 1425 Hudson Street, and have taken 18 contracts since June in just 3 months. And so that market is very strong. On the Manhattan side, it's the same story we have given before. At \$2,000 a foot, which is where our new buildings are generally being marketed, the market is good, 91 Leonard which is down in Tribeca, we have 67 contracts since November of '17 so call that 8 or 9 months. And the inventory we have in our older buildings that are built and occupied where in limited cases our pricing gets higher that's been slower. And we certainly recognize that and as Marty said, we are working through that inventory, we have a business plan to get through it by the end of this year or very early into '19. And even with all that commentary, our gross margin coming out of New York City Living still exceeds the company average. So I'm happy with our basis in our existing deals, and I'm happy with, as I said, the business in our new buildings, in Jersey and in Manhattan. And so now guys, it's a question about JVs.

Martin P. Connor - Toll Brothers, Inc. - Senior VP & CFO

So it's really hard to give comparisons of this year versus last year in the New York City Living projects because of how limited the inventory is. But a year ago, we sold 45 units on balance sheet, this year we sold 44 in the third quarter and a year ago, we sold 23 in JV, this year we sold 15. But I wouldn't read anything trending into that in all buildings. In our existing buildings for example, we entered the year with 65 units in open, ready to occupy existing buildings. We are down to 28. And so as you get down to the last few, it's hard to be comparative.

Operator

Question-and-answer session has concluded. Thank you for attending. This concludes our question-and-answer session. I would like to turn the conference back over to Douglas Yearley for any closing remarks.

Douglas C. Yearley - Toll Brothers, Inc. - CEO & Director

Thank you very much, Anita. Thank you, everybody for your support and interest. Have a fantastic end of the summer, and Labor Day holiday.

Operator

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

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