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TOL - Q1 2019 Toll Brothers Inc Earnings Call

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Co. reported 1Q19 EPS of \$0.76.



FEBRUARY 27, 2019 / 4:00PM, TOL - Q1 2019 Toll Brothers Inc Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the Toll Brothers Inc. First Quarter Earnings Conference Call. (Operator Instructions) Please note, this event is being recorded. I would now like to turn the conference over to Doug Yearley, Chairman and Chief Executive Officer. Please go ahead.

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

Thank you, Nicole. Welcome, and thank you for joining us. I'm Doug Yearley, Chairman and CEO. With me today are Bob Toll, Chairman Emeritus; Rick Hartman, President and COO; Marty Connor, Chief Financial Officer; Fred Cooper, Senior VP of Finance and Investor Relations; Kira Sterling, Chief Marketing Officer; Gregg Ziegler, Senior VP and Treasurer; and Don salmon, President of TBI Mortgage Company.

Before I begin, I ask you to read the statement on forward-looking information in yesterday'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.



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Fiscal year 2019's first quarter results were strong with earnings per share of \$0.76, pretax earnings rising 15%, home sales revenue increasing 12% and home sales gross margin improving 50 basis points compared to 1 year ago. Fiscal year 2019's first quarter pretax income was the highest Q1 in over a decade.

Our first quarter contracts were down 31% in dollars and 24% in units. We attribute this decline to a difficult year-over-year comparison. Contracts were up 36% in dollars and 20% in units in fiscal 2018's first quarter and the industry-wide slowdown that began in the second half of 2018.

California's drop was the most dramatic with contracts down on 62% against a difficult comparison of up 72% in fiscal year 2018's first quarter. Some of this was due to market softening and some was attributable to mix and the life cycle of certain communities. Company-wide, on a per community basis, contracts track more closely to fiscal year 2016 and 2017's first quarter, which were still quite healthy than to the more robust fiscal year 2018 first quarter. Although, we experienced a year-over-year decline in contracts, each month of the first quarter, the decline decreased as the quarter progressed. Nonbinding reservation deposits for the first 3 weeks of February are behind last year, but we are encouraged by improving demand trends during the month, and especially by our past week's deposits, which exceeded last year's same week. This is only 1 week worth of data, but it is an important week, historically one of the biggest sales weeks of the year. Nationally, the economy remains healthy. Unemployment is low and housing supply is still tight. Many of our potential customers have benefited from a strong stock market and enjoyed increased equity in their existing homes. Mortgage rates have recently decreased to their lowest levels in a year. These factors are all generally positive for the homebuilding sector. Given our focus on the upscale market, our strategy has always been to acquire the best land in the most attractive locations. We evaluate each community weekly to carefully balance sales pace and home price. With our unique land position, we intend to continue this balanced approach. With our strong balance sheet, we continue to evaluate attractive land, new markets and builder acquisitions as we pursue our strategy of diversifying our product lines and geographic footprint. We recently announced our entry into the Metro Salt Lake City, Utah and Portland, Oregon markets with our first communities in both the markets plan to open this spring. We are excited about these markets as they represent our continued expansion in the West. Our Apartment business continues to grow. In fiscal year '19's first quarter, we announced 3 new joint ventures to develop luxury apartment communities in Westchester, New York, Atlanta and Frisco Square, a suburb of Dallas. Total cost of the 3 communities will be about \$270 million to build about 1,020 units. Because we develop our multi-family platform with partners and use project construction loans for about 65% of the cost, Toll Brothers total investment across the 3 communities is about \$24 million. We generally get fees and promotes to increase our returns and on occasion, we may recognize an upfront gain on sale of land into the joint venture. In Q1, we recognized an \$8.4 million gain from such a transaction. This is a great stand-alone business and even better serves as a complement to our for-sale homebuilding business. We currently have over 18,000 apartment units in various stages of development or lease up. We are proud of our tremendous brand. This quarter, we were once again named by Fortune magazine as the World's Most Admired Home Building Company. This is the fifth consecutive year we have been so honored. We thank the tremendous team of Toll Brothers associates who make these recognitions possible. With our well-located land, strong brand and wide variety of communities, we believe, we are well positioned. 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 yesterday's release. We exceeded our expectations for earnings this quarter.

Our pretax income rose 15% on a home sale revenue increase of 12%. Home sale gross margin came in 50 basis points better than a year ago, driven primarily by solid operations and favorable mix.

Interest expense through cost of sales was 2.6% of home sales revenues, down 30 basis points compared to a year ago. Impairments remained modest at \$7.6 million. In fiscal year 2019's first quarter, we had an SG&A margin of 12.3%, which is 110 basis point improvement over fiscal year 2018's first quarter. The improved Q1 SG&A margin reflects increased revenue and good cost control. During the quarter, we recognized an \$8.4 million net gain on the sale of land into an apartment joint venture that Doug just mentioned. And we also had a \$12 million gain on the disposition of a golf course. We remain focused on maintaining our conservative balance sheet with great liquidity, low leverage and a long dated maturity profile. We ended fiscal year 2019's first quarter with a debt-to-capital ratio of 42.7% on a gross basis and a net debt-to-capital ratio of 36%, both



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compared to 44.2% and 40.1% at fiscal year 2018's first quarter end. We had more than \$1.9 billion of untapped cash and available credit facilities at quarter end.

Our weighted average debt maturity is 5.2 years. Our weighted average interest rate is 4.65% and we have only \$250 million of maturities due in the next 36 months. Our book value per share at fiscal year 2019's first quarter end was \$33.04, our highest ever, and it's up from \$32.57 last quarter. We are well positioned to take advantage of land opportunities, to make acquisitions, to reduce our debt or to invest in our company through further share repurchases. Here is our forward-looking income statement guidance for the second quarter of 2019. We expect deliveries of between 1,650 and 1,850 units, which an -- with an average delivered price of between \$860,000 and \$890,000. We expect adjusted home sales gross margin of approximately 23.1% of home sales revenues and SG&A as a percentage of second quarter home sales revenues of approximately 11.3%. We expect other income, income from unconsolidated entities and land sales gross profit of approximately \$13 million in total. We expect the tax rate of approximately 27.5%. We are pleased that our community count has grown from 295 a year ago to 317 at the first quarter end and we expect modest community count growth through the balance of the year. Lastly, we expect interest expense to cost of sales to be approximately 2.7% and our weighted average share count for the second quarter to be approximately 148 million shares. Now let me turn it back to Doug.

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

Thank you, Marty. And Nicole, let's open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Nishu Sood of Deutsche Bank.

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

Wanted to ask first about -- you mentioned that the year-over-year pace, the decline lessened as the quarter went on month-by-month. And then also if you're looking at the nonbinding reservations in February, those improved as well. Can you just give us some numbers around those potentially just to understand where we might be currently?

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

Nishu, thanks for the question. I'm sorry, but we're not going to get into the specifics of the numbers. We mentioned a few years ago, that we would certainly give some flavor, but we're going to get off, giving week-to-week, month-to-month numbers. So I think we've explained it accurately, which is each month of the quarter, the decrease lessened. And for February, while we are behind after 3 weeks a year ago, we are encouraged by this past week, which exceeded last year.

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

Got it. Maybe thinking about it a different way then. Given that your quarter and February here as well have covered the period where there's been quite a bit of rate volatility. Can you talk about your thoughts perhaps about how the movement in rates has affected your buyer and the lessening decline that you're talking about?

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

Sure. So yes, we had a huge move down in rates in Q1. The quarter started with a 5.8% rate and the quarter ended with a 4.5% rate. I'm talking about a 30-year fixed conforming no-point mortgage. That's obviously a dramatic decrease. Coupled with that was the messaging out of the Fed, that they were going to probably slow down or eliminate rate increases throughout '19. So I think, the combination of the decrease in the rate and the commentary on what was coming was certainly encouraging. We absolutely felt an improvement in the quality of traffic and the interest of our buyers. I think sales was pretty down through the fall. And when surveyed more recently, they're excited. They feel like a solid spring season is upon them. And I think one of the primary drivers of that is that decrease in rates that I've talked about.

Nishu Sood - Deutsche Bank AG, Research Division - Director

Got it. Got it. And just in terms of incentives, can you also just talk about through this bout of volatility, obviously happen at a seasonally slow period of time and rates have come back. Your willingness to use incentives, maybe if you could just discuss how you're thinking about that and then also the competitive environment in terms of incentives, please?

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

Sure. So as we mentioned earlier on this call, as I mentioned, we're -- we've islanded Main and Main. We believe most of our land is unique. We look at every community when it comes to pricing. Pricing, of course, includes incentives to evaluate what should be done by community. And I think we do a very good job of thoughtfully balancing price with pace and with the quality of the land. Our incentive right now is 3.1% of our sales price, and went up very, very modestly as an average nationwide this quarter versus prior quarters.

Operator

Our next question comes from Stephen Kim of Evercore ISI.

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

Just wanted to ask a question regarding your brand and the flexibility of the Toll Brothers brand. Is that -- particularly as it relates to the ability to move it down market and maintain the integrity of the aspirational aspect of the brand. Can you just give a sense for how flexible, you think, you can we maybe in terms of putting it in context of price points and what gives you the confidence that you can take it down that far, while maintaining the cash share that it's always had?

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

Thanks, Steve. As you know, as we talked about, we have had and we'll continue to have a great variety in the price point of our communities from some New York City and California's that are obviously multimillion to Jacksonville and Boise and other locations that are down in the \$300,000, \$400,000, \$500,000. I am very confident that we can continue our great brand as we introduce more lower-priced communities. First of all, there won't be that many in the scheme of things, right. We have 300 to 350 communities and we're talking about something that will probably be less than 10%. But more importantly, the quality still of the architecture, the sales center, the sales managers, the design and decorating of the home, the websites, the way we treat our customer, the customer experience, I am very confident after having it -- watched it be launched in places like Phoenix, where our average price was up in the \$800,000, and we have a new offering down in the 3s that is doing terrifically well, where people are delighted to be buying the Toll Brothers home in the 3s and it's still different from what they're getting from other buyers or other builders in the 3s because it's brought to you by Toll Brothers. So it's a good question. It's a fair question. We're obviously aware of it. But I am very confident that we can continue on this business strategy without any dilution to the great Toll brand. We're building apartments under the Toll Brothers Apartment Living name. We're building student housing under the Toll Brothers Campus Living name. It's all condo quality in terms of residence clubs and pools on the roof and finishes of the units themselves. And we're actually leveraging the Toll brand into that business. And never once



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have I heard a comment out of anybody in the sales office that a buyer was concerned because they saw that we're now in luxury apartment. So I'm confident we can be wider in scope, but still focus on what got us here, which is great luxury and just expanded a bit without any issues.

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

Great. No, I appreciate that full answer. Second question I had is maybe one more for Marty. The gross margin and the SG&A both kind of surprised us in favorable directions. I was kind of curious if you could maybe just tease out, were there anything there that would explain why they performed better here in the last, when we see the results here, a few months after you last spoke?

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

Sure. So gross margin essentially remained flat with the fourth quarter. I think to address your question specifically, the ops team did very well during the quarter. And we saw our house cost come in a little bit lower than projected. We also benefited a bit from favorable mix, including more California deliveries than expected. And as it relates to SG&A, I think, we had very efficient cost control from the corporate level as well as out in the field and we had more revenue than we expected.

Operator

The next question comes from Stephen East of Wells Fargo.

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

Doug, talking about your progression, you talked about that recently. I know you don't want to put numbers around and so we'll stay away from that. But, I guess, I'm more interested when you look at some of your big markets, California, the Mid-Atlantic, Mid-Atlantic was a big positive surprise in the quarter. And I just want to understand how those progressed both in the quarter and in February?

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

Sure. So Mid-Atlantic, Stephen, was driven by -- primarily by Virginia, which is a very large and important market for Toll and it's clicking. The government shutdown didn't have any impacts on buyer sentiment. We have a terrific management team down there that has redesigned a lot of the communities, the product. And I'm just really proud of how they're operating and the market demand is very solid and that was the primary driver for the good results. Your question is more specific as to sort of month-to-month within the quarter. It -- similar to my commentary on the company, which is that it improved month-to-month throughout the quarter and the same is true through February. California, as I mentioned in my prepared comments, it's a really tough comp. California was up 72% first quarter of '18 versus '17. And last year, we had a number of communities that had just recently opened, that had huge, huge pent-up demand at the openings. I mean, we had hundreds and hundreds of people that had already been preapproved for mortgages before we even open the doors. And there's 5 communities out there, 3 in the North and 2 in the South, that combined the 259 contracts a year ago compared to 58 this quarter. And when we study those 5 communities alone, they were all new openings. They all had huge pent-up demand with all these prequalified buyers waiting for our launch. Today, they're further into the life cycle of the community. The backlogs have built, so the delivery times have gotten longer. We've obviously had price increases. There's still solid demand and that demand has improved through February, but it's very different to what it was like a year ago when they had just recently opened.

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

Fair enough. All right. That's really helpful there. And then you were talking a little bit about strategy, if I can come back to it. I guess, a two-part question. One, how important is M&A when you look at it moving forward and what are you really wanting to accomplish with it? And then you've got a lot of different initiatives and you ran through some of them, but Gibraltar, student housing, apartments, single-family for rent, hitting the



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entry-level and the active-adult. As you look at your mix of business, where do you want to invest more in, more dollars, more time, more asset -- and then where do you want to pull back a little bit, if any of those varied efforts that you have going on?

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

So the first part was M&A. And we're interested. We're -- we have an M&A team, that's all they do. And right now we -- I'd say we probably have as good or better deal flow than we had last year. We looked at 30 builders last year. We didn't buy any, but there was a handful that we were interested in. And I'd say, we're on pace for that or better and nothing certainly to announce. But we're in action and the M&A market appears to be pretty robust. We used M&A to enter new a market and we may use M&A to enter a different product line or price point. Those would be the 2 strategies behind it. As for the second part of your question, which was all the different business lines that we are now in. I'm really happy with all of it. I mentioned on my prepared comments how delighted I am with -- and we are with the Apartment business. The single-family for rent is new, but appears to be something that will be very exciting. Gibraltar, it's small right now. I mean, that company was built to buy distressed portfolios of loans from banks and be a workout restructuring firm. It's now a land bank firm. We've had better markets and that team is in place for good markets and bad, either land bank or become a workout restructuring firm. So you asked that does anyone want to shed or downsize. Absolutely not. Our primary focus to finish your questions, is still our core luxury homebuilding business. That's what gets us up every day and that's where we're going to spend most of our money and be most focused.

Operator

Our next question comes from Alan Ratner of Zelman & Associates.

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

First question, I believe this time of year in February, you guys typically do your national sales event. And in the past, I think, Doug, you've kind of downplayed the impact of that in terms of margin. But just curious when you look at your improvement in the nonbinding deposits, can you talk about how this year's sales event compared to in the last few years? And tying on to that, just wanted to confirm, the 3.1% incentive number, is that on orders or closings?

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

Orders.

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

Got it. So...

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

That's the -- yes, so the national sales event, we do 4 national sales events every year. I guess, it's our version of Lexus' December to Remember. It's something that we've worked hard at and works well and we're able to bring sort of national marketing to it. It is a combination of some, I'd say, repurposed incentives in the field and then vendor incentives that are kicked in during these events, that is not Toll dollars, but is the opportunity to upgrade flooring upgrade, kitchen cabinets upgrade, plumbing fixtures, et cetera, where the vendors participate with us because they want our backlogs to grow just as we do. And the timing of the events last year to this year are lined up. The February event is our biggest because it's sort of launches the spring selling season. In terms of a comparison to a year ago, it was slower than last year for the same reasons I gave, that overall February to date has been slower and it was more similar to what we saw in the prior year. We feel good about where we are right now and we're delighted with the last week of the sales event and how strong the deposits were.



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

Great. I appreciate that, Doug. And then second question maybe for Marty. Obviously, only given 1 quarter worth of guidance, but your backlog gives you pretty good visibility to the back half of the year as well. So any chance you can just directionally talk about when you look at the homes in backlog expected to deliver beyond 2Q. Is the margin on those homes materially different than the 23.1% you're currently guiding for in 2Q?

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

I think we just weren't comfortable going beyond the quarter at this point, Alan. We've seen a lot of changes in the marketplace over the last 3 to 6 months between demand and interest rates, et cetera. As it relates to the margin in our backlog, I think, we just delivered margin that was consistent with 3 months ago's margin. We've given guidance for 3 months from now. I wouldn't suspect that there is anything dramatically different than the guidance we've given. But we don't want to get any more specific than that.

Operator

Our next question comes from Michael Rehaut of JPMorgan Securities.

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

First question I had was kind of following in on the incentives and the gross margins. You were able to be roughly 50 bps ahead of last year in this first quarter and are looking for similar year-over-year improvement in 2Q. With the incentives you said, I guess, up only slightly on orders in the first quarter. Perhaps you could kind of describe your pace over price strategy. It seems like there is decent differentiation between yourselves and perhaps some of the other builders that got a lot more aggressive on incentives in the past several months in the face of the slowdown. So given your price point, given your positioning, did you -- it seems like you just kind of took out the recent volatility and you decided to hold margin over pace, is that a fair assessment? Or -- and maybe just kind of talk broadly to the approach.

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

Sure, Michael. So I had mentioned on the last call that we didn't feel like the months of November, December and most of January were months where you would chase sales through big increases in incentives because it's a slow time of the year, but that we would reevaluate as the spring season was beginning. And I think that is part of what you've seen and we'll see how the spring season continues to develop. And we've given plenty of commentary already on the start of that season. The one difference between Toll and many of the other builders is we're not a spec builder. We don't have finished inventory that is sitting there and needs to move because it's been built. You can sit on ground and cut the grass and pay the taxes and it's not all that painful. But when you're sitting on a finished home, you've got to make a decision every week. Bob taught me years ago, on a finish spec every week you got -- it's sitting there 1 more week guys, what are we going to do? We got to drop the price, 1 more week, we got to drop the price, it's completed.

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

It's the difference between having \$0.20 of your revenue dollar invested and \$0.80 of your revenue dollar invested.

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

So I think, that is one significant difference between our business model and some of the other builders. We talked about endlessly our land being unique, hard to be replaced and in those -- that's not everywhere, but in those locations, we will be more deliberate and more thoughtful on the balance between pace and price.



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

I appreciate it. I guess, secondly on the land market, the recent pause we've heard and generally this apply to perhaps different price points. But maybe a touch of softening here or there, maybe a little bit of retreating, maybe a little bit of easing on some terms. Have you seen any of that in your core markets? And perhaps given your approach, going a step in here, there, have you seen any more opportunities come up in the last few months?

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

Not really. The land market generally lags far behind the overall housing market until land sellers start feeling some pain, start feeling pressure. They generally stand pretty firm. In limited cases, we've had some opportunities to renegotiate some terms, but it's still a pretty robust land market out there. There's still a lot of competition. We have been careful and conservative and certainly tightened some underwriting in certain areas, but I wouldn't say there's been any significant amount of retrading or renegotiation with land sellers.

Operator

Our next question comes from John Lovallo of Bank of America Merrill Lynch.

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

The first one, Marty, the second quarter SG&A, as a percentage of sales guide of 11.3%, seems a bit high to us, just given the fact that your outlook appears to kind of call for flattish revenue on year-over-year basis and that would be a pretty good step up on a year-over-year basis in SG&A. Is there anything onetime in there that may be shifted from the first quarter into the second quarter, how should we think about that outlook?

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

No, I don't think there's anything onetime in there. I think our G&A is going to be almost within \$1 million or \$2 million in terms of absolute dollars, and then the S components up a touch.

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

Okay. And that will actually feed into the second question here in terms of -- I think, it was last quarter, you guys talked about outside realtor commissions being a little bit elevated versus history -- at least versus the fourth quarter. How did those trend in the first quarter?

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

I don't think there was any change, John, in outside realtor commissions. And remember that our outside realtor commissions are in our cost of goods sold. It's our inside sales teams that are in our S for SG&A.

Operator

Our next question comes from Susan Maklari of Crédit Suisse.



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Susan Marie Maklari - *Crédit Suisse AG, Research Division - Research Analyst*

My first question is around, you've spoken in the past about perhaps some easing on the labor side of things, which could help us as we think about as this year coming together. Can you just give us an update on what you're seeing from that front?

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

Sure. We had modest decrease in building costs in Q1. In certain markets, we are hearing of contractors agreeing to some modest price concessions because they have slowed down, which is typical of what we see when it's all demand and supply driven. So they built up their teams. And as our sales slowed a bit, they had employees that were not as busy and now we've had some modest opportunities to take the price down. I think that will continue at least for a quarter or 2. As the sales over the summer and the fall start feeding through in the construction, longer-term, we'll have to see where the markets are. But it does appear that we've at least stop the increases and we have some modest decreases.

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

And that stability in decrease that we've been able to achieve this quarter shows up in our income statement 9 months from now, not next quarter.

Susan Marie Maklari - *Crédit Suisse AG, Research Division - Research Analyst*

Yes. Okay. My next question is around, can you talk to some of the attributes of Salt Lake and Portland? What you found attractive about getting into those markets and why you decided to go greenfield there versus maybe approaching it from an M&A perspective?

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

We looked hard at M&A opportunities. We got close in one of those markets. And so as we were looking -- we first study a market and decide we want to be here, and then we look at how we're going to get there. And as we're looking to buy a builder, we're also putting the management team in place and looking to buy land. So in both locations as we are in the early stages looking at M&A opportunities, we are beginning to buy land. Since we have not yet bought a builder in either market, and I don't -- I'm not suggesting there's anything cooking, we now have a handful of land owned or controlled in both markets. Management teams in place, models -- roads going in, models being built. So there's a strategy on whether it's M&A or greenfield. I mean, if M&A doesn't work, we go with greenfield. The -- what we liked about the markets. We've looked at -- excuse me, at Portland from the perspective of the Seattle team, I guess, ever since we got into Seattle, which is now about 6 years ago, and have been studying and studying that market. And to us, it's a little -- it's a mini Seattle that is only a couple hours away. It has great job growth. It has some limitations on supply because of some pretty tough entitlements and development zones. And that's right up our alley. Because we like markets that have difficult -- are difficult to get land entitled because we have the patience and the wherewithal to stick with it. And when you get it, it's gold. A lot of the architecture can come right out of Seattle. Our management team has moved down from Seattle. And so what I'm describing, I think, is a natural progression out of our great success that we've had in Seattle. Salt Lake City is a market we looked at for more than a decade. It has changed dramatically in the last 3 to 4 years in terms of the diversity of businesses, the economy, growth. Has become a very desirable place to live, whether it be as a family moving up and working in what they now call the silicon slope because every city, of course, have to have a silicon something or whether it's a movedown location because of the lifestyle associated with Salt Lake and the mountain towns around it. So we're really excited about both opportunities, both markets. And they will start out slower because they're greenfield, but that can also be a more cautious way to go. And I'm very happy with the land we have, the teams we have. And stay tuned because we'll open in both locations this spring.

Operator

Our next question comes from Mike Dahl of RBC Capital Markets.



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

I wanted to ask about just the thoughts on where you see the business at a bit of a higher level. I know you're not giving the guidance, but clearly some market softness. But I think, Doug, overall what you're also speaking to is just a normalization particularly in a place like California, where you described kind of some supernormal trends that you're comping against. So if we're thinking about what you see as "more normal absorption" for this type of market, '15, '16, '17, as we're doing around 2 sales a month. Is that about where you think the market settling in at? Do you think there is opportunity for upside? And if so, how much of that is kind of your mix initiatives versus market recovery?

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

Mike, I can't answer you specifically because I don't have that crystal ball. I think I have properly described the difference between this first quarter and the last year. And I've also explained that '17 was a really solid year in California and that's what '19 felt more like. What I will say is, I think, we're positioned well with the communities we have and with the future land. The land that we own, that will become future communities. So we're going to have community count growth out in California because of the land that we own. And I am confident that, like I said, we are well positioned. Last year was a pretty unique year, just in terms of the number of communities we opened within a relatively short time frame that had terrific pent-up demand at the opening. That's not to say that couldn't be repeated, but it was a certainly a unique year. But overall, we're positioned well with our holdings and with our brand. And I feel good about our future out there.

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

Okay. Got it. Understood. My second question maybe for Marty. I know the JV land and other category is pretty lumpy and you described some of the contributions to the quarter. Is there any -- I think, you guys did about \$150 million in the full year of 2018. Any color you could give us on directionally or magnitude of what to expect for the balance of 2019 beyond the \$13 million in 2Q?

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

Sure. So I think if we walk backwards a little bit, last year, we did do about \$148 million. We did around \$167 million the year before that, which was significantly influenced by our Pierhouse project in Brooklyn. And the years before that, we were right around the \$100 million for 2 or 3 years in a row. So I think, we've mentioned this part of our business as being important to us and being at some sustainable level. Right now I put that sustainable level somewhere north of \$100 million for this year and south of \$150 million for this year. This next upcoming quarter is going to be a little bit lower than a pro-rata fees of that just because of the lack of any particular transactions that we currently have on the drawing board expected to close.

Operator

Our next question comes from Ken Zener of KeyBanc.

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

Doug and Marty, I -- obviously, I heard, read your comments about sequential orders and all that stuff. So we'll just let that sit. My question is more around how your backlog margin in California, which is obviously part of your 1 forward quarter guidance plays out. But how that also interacts with what we're seeing is the lower orders from that area. And I focus on California because either margin, I think, for FY '18 per your case, 23% versus 15% EBT how you guys describe it. But I'm just trying to think about how that high-margin contribution plays out within the 1 quarter forward guidance, but also how it can play out structurally, right, 2 and 3 quarters down as that order -- orders begin to kind of flow into there. I'm just -- I'm trying to think structurally how that can play out? Any help there would be appreciated.



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

Yes, Ken. It's Marty. I think we haven't given much in terms of guidance for the balance of the year. But as it relates to your specific question in California, I think, the backlog we have gives us visibility and to some level of stability in California deliveries for the balance of the year.

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

You're saying for deliveries, I'm just trying to see if it's simple as looking at the margin contribution based on kind of what the orders might suggest about forward.

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

I wouldn't expect the margin contribution to be much different quarter-over-quarter from the one we just delivered, to the ones that are in front of us during that time frame from California.

Operator

Our next question comes from Matthew Bouley of Barclays.

Matthew Adrien Bouley - *Barclays Bank PLC, Research Division - VP*

I just wanted to look at the overall order ASP \$844,000. Obviously, there's a lot of mix going on and you're still calling for \$860,000 to \$890,000 in the second quarter. But just given kind of the recent sales trends and the ASPs on these sales, how should we think about trending delivered ASPs in the second half of this year?

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

So I think it's helpful to recognize that we sell homes from \$300,000 to \$3 million. And so the movement in any particular quarter of either average delivered price or average selling price is really driven by mix predominantly, not price increases or price incentives. And so as we look across the balance of the year, I think, the best estimate you can use is the approximately \$900,000 sales price that's in our backlog.

Matthew Adrien Bouley - *Barclays Bank PLC, Research Division - VP*

Okay. I appreciate that. And then secondly, just to kind of follow up on the last question. Because it is -- it seems clear, and I think, Marty, you mentioned it earlier, that California was obviously a benefit from a mix perspective in the first quarter and that would seem to continue in the second quarter. But just given the past 2 quarters of decline on the order side, is it fair to assume that California would be a lower mix as a percentage of revenues in the second half of this year, and accordingly what would that mean for margins?

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

I think your presumption is directionally accurate, but your time frame is off. I think you got to get into next year before the California volume through the income statement is impactful to margins.

Operator

Our next question comes from Scott Schrier of Citi.



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Scott Evan Schrier - *Citigroup Inc, Research Division - Senior Associate*

I wanted to ask about the timing of closings, understanding you came in towards the higher end of your guidance for -- and the next quarter, it looks like the guide is a little lower than maybe what analysts were expecting. So I'm curious was there anything in there that happen? Understanding 1Q '18 was a big orders quarter and your cycle times, but was there anything in terms of cycle times or regional implications that we should be considering from the closings timing?

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

Scott, I'm not sure I can point to anything in particular. I do know that the nature of the buildings we are constructing, the attached product we are constructing in Northern California drives a bit longer backlog than some of the detached single-family product around the country. So I would say there is some impact of longer cycle times, not necessarily abnormally long or longer than our expectations in Northern California just because of the 24 and 36-unit buildings that need to be completed before you can deliver 1 unit.

Scott Evan Schrier - *Citigroup Inc, Research Division - Senior Associate*

Got it. And then can you just talk a little bit about what you're seeing in terms of the design studios and lot premiums and design studio option premiums and things like that?

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

Sure. So, as you know, we have almost 30 now design studios around the country in each division, where the client goes to pick all their finishes. And we encourage that process. It's a major part of what distinguishes Toll from other builders. Our upgrades, and I'm not -- this is not a number just for design studio because some of it is structural. Changes that occur at the sales center, at the community, but we are still running at about \$160,000 of upgrades, which is about 20% of the home price. And that number has not changed.

Scott Evan Schrier - *Citigroup Inc, Research Division - Senior Associate*

Got it. Okay. So no real change given market conditions or anything in buyers' appetite for the options basically in premium?

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

That's correct.

Operator

Our next question comes from Jade Rahmani of KBW.

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

Can you provide any additional information on the single-family rental investment? What's the magnitude and scope of the investment? And is it investment in another company, which has been reported in the media? Do you expect to grow it, et cetera, any color would be helpful?

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

We would love to give some color, but we must apologize that we are under confidentiality at the moment and cannot discuss it. So what you read in any builder magazines or elsewhere, it did not come from us and we can't comment on it.

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

Okay. Just separately in terms of operations, can you comment on where current cycle times are running?

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

The range and it's so community-specific is 6 or 7 to 12 months. And again, it depends on the size of the home, the extent of the backlog, the trade base, the depth of the trade base, but that is the general range.

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

I think in a perfect world, it would be 3 to 4 weeks shorter than it is right now, but labor constraints have that extended to 3 or 4 weeks, I mentioned. But I think, it's same 3 or 4 weeks we've seen for 18 to 24 months.

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

So safe to assume that the next quarter's deliveries reflect orders from the middle of last year?

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

In some markets, it could be from the middle of last year, in other markets it could be even shorter or longer than that range.

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

That's a good average.

Operator

Our next question comes from Jay McCanless of Wedbush Securities.

James C McCanless - *Wedbush Securities Inc., Research Division - SVP of Equity Research*

Just wanted to pick up on that theme, given the longer cycle times that you guys have and the visibility that should provide you. Why are you all not comfortable giving full year guidance when you, I think, have pretty decent certainty of what's in the backlog?

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

Well, I think, Jay, we've given some consideration to that. And I think we're just not comfortable at this point. We've seen a lot of changes in rate expectations. We've seen changes in demand that have been pretty significant over the last 3 and 6 months. We didn't think it was prudent to give guidance beyond the 3 months that we gave. And we gave pretty good detailed guidance in the 3 months.

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James C McCanless - *Wedbush Securities Inc., Research Division - SVP of Equity Research*

Okay. Great. The second question I had, I'm surprised to hear you guys talking about how interest rates are driving the buyers back to the Toll communities, because historically with the high amount of cash buyers you all generate relative to some of your peers. And then also with buyers, I think, typically putting down more for y'all's houses than competitors houses. It would seem that buyer -- should your average buyers should be somewhat immune to what rates are doing. I mean, has there been a large change in the composition of your buyers over the last 3 to 4 years as y'all have gone into these different product types or is there something else that you're hearing in the field besides rate and price that's making people not want to buy a home right now?

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

No, Jay -- I -- my comment, I was certainly not comparing our buyer to other buyers in the market. You are correct, our buyers are less sensitive to rate moves. No, nothing has changed with our buyer profile over the last few years. The average LTV is at 68% for our buyers that get a mortgage and 21% of our buyers are all cash. So you're right, they are less affected by a moving rate. But let's not forget the confident side of this, which is what's really going on. Let's not forget the headlines when the Fed was talking about a 4 rate moves in '19, and the other headlines that talked about the slowdown of the housing market, right. Even though they can afford the house and they're not as sensitive to the rate, they're not immune to the headlines and the fear that they were the fools that bought at the top. And so it's a confidence issue more than a specific rate move.

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

The other thing that overlays that is that they have a bit more invested in the stock market. And the fall wasn't the greatest time to have your money there. So couple different factors.

James C McCanless - *Wedbush Securities Inc., Research Division - SVP of Equity Research*

Yes, understood. And that's what I was trying to get to was the confidence thing, it sounds like it's that more than anything else. One other quick one, if I could. Active-adult, your age targeted communities, how have those been trending? And what do you all looking to do with that type of business in the '19?

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

They're trending positive. We like the business a lot. We are absolutely chasing the baby boomer as they downsize, and we are expanding the business to many different markets. It started in the Mid-Atlantic, Northeast, Midwest, and we've now expanded it into the West. We have a very large community opening next year in Greater Phoenix. Several thousand homes that will have a large component, that is active-adult. That community is called Sterling Ridge.

Kira Sterling - *Toll Brothers, Inc. - CMO*

Grove.

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

So it's Grove. Thank you, Kira, who is Sterling. If anyone should know the name, it's Kira Sterling.

So you will continue to see Toll Brothers active-adult expand.



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Operator

Our next question comes from Megan McGrath of Buckingham Research.

Bethany Megan Talbott McGrath - *The Buckingham Research Group Incorporated - Director*

Most of my questions have been answered. Just wanted to follow up on 2 core things. First on California, since the life cycle of communities was such a big impact this quarter, I want to make sure that we all understand. For the remainder of the year, is there any other compare upcoming? Any other sort of big chunk of community openings that make a difficult compare? And what is your community opening cadence look like in California for the year?

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

Community count will be relative flat. So there's nothing unique coming up in the comparison. We do have 5 new communities that we plan to open, anticipate opening in Northern Cal during the balance of the year.

Bethany Megan Talbott McGrath - *The Buckingham Research Group Incorporated - Director*

Okay. Great. And then following up on the conversation around sort of the macro factors, one thing that you haven't talked about and I'd love your opinion on now that we're further along is the tax reform. Do you think that impacted anything in California and other high tax markets?

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

It -- we don't hear about it from sales, right. Common sense would suggest that it has to play a part in some buyer's decisions, particularly as they're now beginning to prepare tax returns and understand the impact. But the frontline sales teams are not hearing about that impact. So California has always been a very expensive place to live long before SALT. And thankfully, with that sun shining and the beautiful environment and great jobs, people that have the money are willing to live there even though it cost a lot. Those that are not there, that's why we have Boise, and that's why we have Reno, and that's why we have Las Vegas. And even we're hearing of some buyers that make their way to Dallas, Austin and Houston. But our core business in the coastal areas where the very affluent live, we are not hearing much about it. Also, remember that in certain submarkets of California, we have a significant proportion of foreign buyers and they are not paying U.S. taxes and are not impacted by the tax reform.

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

Additionally, small business owners saw some relief from tax reform. But, I guess, a lot of this will play out as people file their taxes and see what their situation is over the course of the next month or 2.

Operator

Our next question comes from Buck Horne of Raymond James.

Buck Horne - *Raymond James & Associates, Inc., Research Division - SVP of Equity Research*

Wanted to see if you've given some consideration to your land spending plans for the year. I know last year, your total land budget was up pretty significantly. If your -- given your views on the market right now, have you kind of tightened up your underwriting? And how do you plan on budgeting land acquisition going forward?



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

Yes, Buck, we don't budget. We don't allocate capital to divisions. We stay opportunistic. When good deals come in, in markets we like, we go. Yes, the underwriting has certainly tightened up through the fall in certain locations, either because we have a lot of land or we're concerned about some market dynamics. But it's really market-by-market, deal-by-deal. If you look at prior years, as a guide, we have recently spent just north of \$1 billion a year on land. And I'd say at this point, fairly early on into '19, we're -- I think that's a fair estimate.

Buck Horne - *Raymond James & Associates, Inc., Research Division - SVP of Equity Research*

Okay. Helpful. And we haven't talked too much about City Living, so I just wanted to back to circle back on the City Living side and get your thoughts on how the markets reacting to market conditions in New York, and I think how the recent building openings have progressed, your thoughts on timing of any new buildings coming up.

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

Sure. So the decline in contracts this quarter to last year in City Living was driven by 10 Provost, which is our high-rise in Jersey City, and the sellout of the Sutton, which was -- is one of our buildings in Manhattan. The City Living market continues pretty much the same as we've described in other quarters, which is that it's okay. It's not strong, it's okay. We have thankfully bought land and positioned ourselves in locations that are about \$2,000 per square foot selling price and that market is okay. The margins are high. They're still above company average. The Jersey side, which is for us Hoboken and Jersey City, has slowed down a bit, which is what I mentioned with the 10 Provost in Jersey City having more sales last year than it did this year. With respect to future opportunities and new buildings, we continue to look. We see deals fairly regularly. Most land sellers are not realistic in today's value of their land based on today's market conditions. But I'm still hopeful based on the deal flow, that we'll pick off 1 or 2, here or there that makes sense. But we're not going to chase a deal in New York, building in inflation. It's just not what we do and it's too risky of a business with the price of land, with building these big buildings all at once. And so we're going to be very disciplined. It has certainly our investment in New York and in City Living has strong significantly over the last few years since we haven't bought new land.

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

It's the lowest it's been since 2012.

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

Yes, so...

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

And it gets to your point earlier about have land sellers changed their expectation. Now we see that in New York, they have not yet despite a number of years of the market not being as strong as it had been.

Operator

Our next question comes from Carl Reichardt of BTIG.



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Carl Edwin Reichardt - BTIG, LLC, Research Division - MD

I want to ask about the cancellation rate and it's always low for you, and so we're not talking about a lot of units. But the change was reasonably significant from last year. Doug, would you attribute that to this idea of the fear factor that you talked about? Or is that a function of contingencies, inability of folks to sell houses or something else in terms of that increase?

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

So Carl, the increase is spread out. We study. We're giving reports on the reason people cancel. There's not a lot we can read into it. It doesn't appear that it was driven by fear or the inability to sell a home or I'm worried about job security or I'm worried about the market. Remember, we -- our average deposit is \$75,000. So we take in most locations a lot of money before we start your semi-custom home. Because your home is unique and we deserve that deposit to proceed and build the house that you have specifically designed. Cancellation as a percentage of beginning backlog is at 2.4%, we're just pretty consistent with where it's been in the past.

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

I think we have a bit of a math issue. We had a little less sales in the quarter, so cancellations as a percentage of sales are up. And we have a bigger backlog from where those cancellations can come from. So the best way to look at it in a market like this is as a percentage of beginning backlog and it hasn't moved that much.

Carl Edwin Reichardt - BTIG, LLC, Research Division - MD

All right. Fair enough, Marty. And then you talked about sunny California, but the weather actually has been pretty atrocious as in the Pacific Northwest in February. I mean, I'm assuming the larger houses are already at dry end. But Marty, are you assuming any kind of a delay impact on closings from this important state for you in the second quarter just based on what we've seen so far this month?

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

We are not.

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

I don't think we are, that would be up to the individual teams in terms of what they've submitted to us, in terms of what they expect to close the line.

Operator

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

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

Thank you, Nicole. Thanks, everybody, for all of your support. Have a great week.

Operator

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



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