

## Toll Brothers Inc.(TOL)

**\$25.02** (As of 05/06/20)

Price Target (6-12 Months): **\$26.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 12/04/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**3-Hold**

Zacks Style Scores:

VGM:D

Value: B

Growth: F

Momentum: C

### Summary

Shares of Toll Brothers have underperformed the industry in past six months. Of late, the company's shares have declined sharply due to the coronavirus pandemic. The coronavirus-induced global crisis is likely to disrupt material chain supply, which in turn will hurt construction sites and development pipelines. Delayed deliveries, unfavorable mix and closeout costs related to certain older communities are also pressing concerns. However, it is well positioned to gain from geographic expansions in the near term. Its focus on low-priced luxury homes is encouraging. However, in the past 60 days, estimates for current quarter and year have witnessed sharp downward revisions.

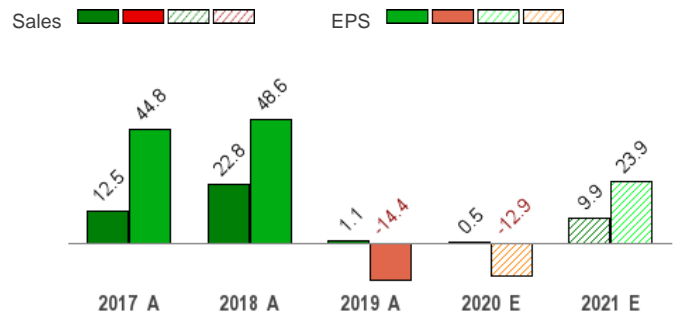
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$49.31 - \$13.28
20 Day Average Volume (sh)	2,440,077
Market Cap	\$3.2 B
YTD Price Change	-36.7%
Beta	1.56
Dividend / Div Yld	\$0.44 / 1.8%
Industry	<a href="#">Building Products - Home Builders</a>
Zacks Industry Rank	Bottom 9% (229 out of 253)

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-8.9%
Last Sales Surprise	-6.6%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	05/19/2020
Earnings ESP	0.0%
P/E TTM	6.8
P/E F1	7.1
PEG F1	0.8
P/S TTM	0.4

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,505 E	1,795 E	2,047 E	2,591 E	7,976 E
2020	1,331 A	1,597 E	1,898 E	2,445 E	7,260 E
2019	1,363 A	1,716 A	1,766 A	2,379 A	7,224 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.58 E	\$0.86 E	\$1.23 E	\$1.94 E	\$4.35 E
2020	\$0.41 A	\$0.50 E	\$1.00 E	\$1.69 E	\$3.51 E
2019	\$0.76 A	\$0.87 A	\$1.00 A	\$1.41 A	\$4.03 A

\*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 05/06/2020. The reports text is as of 05/07/2020.

## Overview

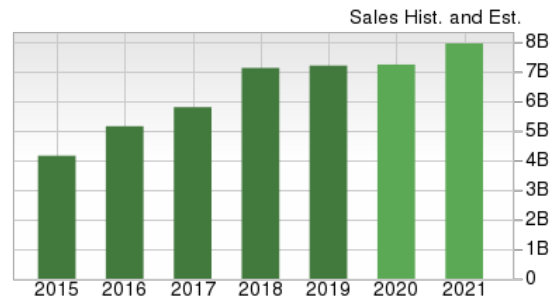
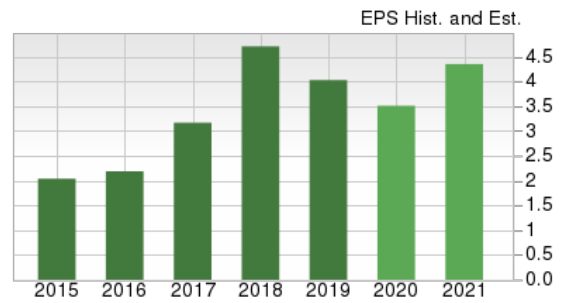
Based in Horsham, PA, Toll Brothers Inc. builds single-family detached and attached home communities; master planned luxury residential resort-style golf communities; and urban low, mid, and high-rise communities, principally on the land it develops and improves.

The company operates in Arizona, California, Florida, Delaware, Maryland, Pennsylvania, and South Carolina. Toll Brothers offers homes under two segments, namely Traditional Home Building Product and City Living.

Traditional Home Building (accounting for 94.5% of fiscal first-quarter 2020 revenues) include detached and attached homes for move-up, empty-nester, active-adult, age-qualified, as well as second-home buyers. Within Traditional Home Building Products, Toll Brothers operates in four geographical segments, North, Mid Atlantic, South and West. City Living (2.9%) includes homes built and sold in urban infill markets.

Since November 2018, the company started reporting land sale activities under the Land sales category (2.6%).

Toll Brothers is also building homes for rental apartment projects. Toll Brothers Apartment Living, Toll Brothers Realty Trust and Toll Brothers Campus Living are brands offered under this rental apartment projects. These rental projects operate in lucrative markets like metro-Boston to metro-Washington, D.C. corridor and Atlanta.



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## Reasons To Buy:

▲ **Limited Competition in the Luxury Housing Market:** Toll Brothers mostly offers luxury homes and its communities are located in prosperous suburban areas with easy access to major cities. Luxury homes generally face limited competition. The company mostly caters to luxury move up buyers, who already possess a residence and are looking for a shift to larger and better homes. These homebuyers are less sensitive to price changes. Toll Brothers enjoys greater pricing power than other homebuilding companies.

Lack of competition in the luxury new home market and buyout synergies are expected to drive growth

The company continues to look for opportunities to expand its luxury brand to new product lines and price points, in a bid to maintain leadership in the luxury segment. At the same time, the company has been strategically adding more affordable luxury communities in view of the current demographic trends, and expanding footprint and customer base. Notably, nearly 40% of Toll Brothers' current communities (as of the fiscal first quarter) offer a home with a base price of \$500,000 or less. These communities are expected to be more capital efficient.

Given the favorable housing market fundamentals in the earlier part of 2020, Toll Brothers has witnessed a rise in consumer demand thereby resulting in growth in new orders. In the first quarter of fiscal 2020, Toll Brothers registered 31% growth in orders.

▲ **Significant Land Positions, Boosting Presence:** Given the significant pent up housing demand, Toll Brothers has secured some of the most sought-after urban locations in the country, where land is scarce and approvals are not easy to obtain. Toll Brothers is using its strong liquidity position to secure the most sought-after urban locations in the country like New York City Market, Northern New Jersey, Washington D.C. and Philadelphia. The company's solid land position places it well to meet growing demand in these regions, thus giving it a competitive edge over its peers who are presently facing land availability constraints.

The company has been expanding geographically via selective acquisitions. Toll Brothers has completed three acquisitions in the past nine months in the Southeastern United States (as of the end of first-quarter fiscal 2020). These acquisitions have helped the company to enter into five dynamic new markets: Atlanta, Nashville, Charleston, Greensboro, and Myrtle Beach. It added three more markets with expansion into Portland, Oregon, Tampa, and Salt Lake City within the past 18 months.

In 2019, the company expanded its footprint to four new states and seven new markets. It also opened first communities in Salt Lake City, Utah and Portland, Oregon markets. Toll Brothers is expanding northward in Florida's west coast into Tampa. Meanwhile, the company has been serving urban and suburban renters. In a bid to expand its reach in Atlanta, Georgia, Charleston, Greenville, Myrtle Beach and South Carolina markets, the company acquired Sharp Residential LLC ("Sharp") and Sabal Homes LLC ("Sabal") in fiscal 2019. Through Toll Brothers Apartment Living, it had a pipeline of 20,000 units in various stages of approval and development across the country, as of first-quarter fiscal 2020. With improving demographics, low interest rates, record low unemployment, continued wage growth, and limited new and resale inventory in many markets, the company remains optimistic about the opportunities that lie ahead.

▲ **Active Management of Cash Flows:** Toll Brothers has been actively managing cash flows, returning much of its free cash to investors through share repurchases and dividends. During the first quarter of fiscal 2020, Toll Brothers has accelerated stock repurchases to \$476 million buying back 8% of shares outstanding at an average price of \$40.73. In the quarter, it also paid dividend worth \$15 million.

During fiscal 2019, the company repurchased 6.6 million shares, at an average price of \$35.28 per share, for a total purchase price of \$233.5 million. In fiscal 2019, the company paid out cash dividends of 44 cents per share.

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## Reasons To Sell:

### ▼ Coronavirus-Related Woes, Softness in the High-End Housing Market & Weak Q1:

During fiscal first-quarter earnings call, Toll Brothers highlighted that the coronavirus outbreak in China has led to shortages of lighting fixtures and small appliances, prompting it to delay the sale of 11 homes in California, which is one of the company's biggest markets.

Softness in the high-end housing market and gross margin pressure are raising concerns

Now, the extent of the impact is subject to the capability of any U.S. builders to substitute products from China with supplies from domestic or other international vendors. As the outbreak has taken the shape of a global crisis, material supply chain disruptions could also impact construction sites and development pipelines.

Meanwhile, demand in the high-end housing market has been declining in recent times. The main reason behind the same was reduced activity of wealthy overseas purchasers, many of whom seek out amenity-rich, full-service communities with on-site property management. This is mostly affecting California, which typically accounts for more than one third of purchases by Chinese buyers, and the products that are sold at a high price point in New York. Again, reduced SALT deductions — particularly in high-tax states like California, New York, New Jersey and Connecticut — have been impacting higher-end real estate markets.

Toll Brothers reported disappointing fiscal first-quarter results primarily due to lower-than-expected deliveries, mainly in high-value Northern California communities, wherein it missed 60 closings, valued at \$67 million. Overall, a combination of delayed deliveries, unfavorable mix, and additional closeout costs related to certain older communities resulted in lower-than-expected revenues and gross margin in first-quarter fiscal 2020. These factors are expected to impact fiscal second-quarter results as well.

### ▼ Margin-Related Woes: Rising building materials and labor costs are growing concerns for the company's margin. Land prices are inflating due to limited availability. This could eat into homebuilders' margins in the forthcoming quarters. Moreover, tariff-related woes are also pressing concern. In order to mitigate top-line related woes, the company has been making investments that comprise implementation of IT system upgrades. This is causing increased SG&A, as a percentage of revenues, in fiscal 2020.

The guidance for fiscal 2020 is disappointing. Management's guidance for adjusted gross margin is projected at 20.5% for the fiscal second quarter, indicating 300 basis points (bps) year-over-year decline. Notably, adjusted gross margin for the quarter is expected to be impacted by the challenging sales environment that lasted from late 2018 till July 2019. During this period, the company had to opt for modest pricing to combat affordability woes of homebuyers, owing to high interest rate environment. In its newly-formed Pacific region, which includes California, Portland, and Seattle, contracts and dollars did not turn positive until first-quarter fiscal 2020. This eventually resulted in an adverse impact on the income statement.

Although Toll Brothers is working to lower margin-related woes and targeting sequential margin expansion of 100 bps in second-half fiscal 2020, full-year gross margin is still expected to decrease 180 bps to 21.3%. The company's guidance implies continued pressure on SG&A expense for the remainder of fiscal 2020. It expects SG&A expense ratio to be 12.4% for the fiscal second quarter (indicating 200 bps year-over-year growth) and 11.4% for the full year (suggesting 100 bps year-over-year increase).

Notably, during fiscal 2019, the company's adjusted home sales gross margin also declined by 70 basis points (bps) as compared with the year-ago period. Also, operating margin declined by 160 basis points in fiscal 2019 as compared with the year-ago period.

### ▼ Federal Government Actions: The housing industry is cyclical and is affected by consumer confidence levels, prevailing economic conditions and interest rates. The federal government's actions related to economic stimulus, taxation and borrowing limits could affect consumer confidence and spending levels, which in turn, could hurt both the economy and the housing market.

Although strong economy along with labor market strength provide the basis for strong demand, its influence on the homebuilding industry is undeniable and uncertain. Indeed, rising interest and mortgage rates as well as land and labor shortages raise concerns, as do rising material prices. High mortgage rates dilute the demand for new homes as mortgage loans become expensive. This lower purchasing power of the buyers and hurts volumes, revenues and profits of homebuilders.

Additionally, the rise in mortgage rates may impact affordability at a time when millennials are taking baby steps into the housing market. Higher interest rates will only flare up the issues and further delay home purchases by millennials.

## Last Earnings Report

### Toll Brothers (TOL) Q1 Earnings Lag, Margin Woes to Stay

Toll Brothers, Inc.'s first-quarter fiscal 2020 earnings and revenues lagged the respective Zacks Consensus Estimate, as lower average selling prices weighed on margins. It expects a challenging sales environment to further affect adjusted gross margin in the first half of fiscal 2020.

#### Earnings & Revenue Discussion

The country's leading luxury homebuilder reported earnings of 41 cents per share in the quarter under review, missing the consensus mark of 45 cents by 8.9%. Moreover, the said figure dropped 46.1% from the year-ago figure of 76 cents as a result of lower revenues and margins.

Consolidated revenues of \$1.33 billion lagged the consensus mark of \$1.42 billion by 6.6%. The reported figure also decreased 2.3% year over year due to lower average selling prices.

#### Segment Detail

Toll Brothers operates under two reportable segments, namely Traditional Home Building and Urban Infill ("City Living").

Revenues from Traditional Home Building totaled \$1.26 billion, down 0.4% year over year, and that of City Living decreased 42% to \$39.8 million during the quarter.

#### Inside the Headline Numbers

Homebuilding deliveries during the quarter grew 5.3% year over year to 1,611 units. Deliveries decreased in all the regions served by the company, except Pacific. Deliveries in Citi Living declined to 36 units from 64 units a year ago.

The average price of homes delivered was \$805,300 in the quarter, down 6.6% from the year-ago level of \$862,300.

Nonetheless, the number of net signed contracts or orders during the reported quarter was 1,806 units, up 31% year over year. The value of net signed contracts was \$1.49 billion, reflecting a 28% increase from the year-ago quarter.

At the end of fiscal first quarter, Toll Brothers had a backlog of 6,461 homes, representing a 8.5% year-over-year increase. Potential revenues from backlog improved 1.6% year over year to \$5.45 billion owing to a 8.5% rise in the number of homes in backlog.

Cancellation rate during the reported quarter was 9.4%, reflecting a decline from 9.6% in the prior-year period.

#### Margins

The company's adjusted home sales gross margin was 20.9%, contracting 330 bps in the quarter.

SG&A expenses — as a percentage of home sales revenues — were 14.8%, up 250 bps from the year-ago quarter. Operating margin of 3.6% was down 550 bps in the quarter.

#### Financials

Toll Brothers had \$519.8 million cash and cash equivalents as of Jan 31, 2019 compared with \$1.29 billion at fiscal 2019-end.

During the fiscal first quarter, the company repurchased 11.7 million shares for a total purchase price of \$476 million.

#### Second-Quarter Fiscal 2020 Guidance

For the quarter, home deliveries are anticipated in the range of 1,850-2,050 units at an average price of \$800,000-\$820,000 (suggesting a decrease from the year-ago figure of \$895,900). Home deliveries in the year-ago period were 1,911 units.

Toll Brothers expects adjusted home sales gross margin of 20.5%, implying a decline from 23.5% recorded in the year-ago period. SG&A expenses, as a percentage of home sales revenues, are projected at 12.4% (indicating an increase from 10.4% in the year-ago period).

Quarter Ending **01/2020**

Report Date	Feb 25, 2020
Sales Surprise	-6.55%
EPS Surprise	-8.89%
Quarterly EPS	0.41
Annual EPS (TTM)	3.69

## Recent News

### Toll Brothers Partners With Carlyle to Develop Emblem 120 – Apr 20, 2020

Toll Brothers' subsidiary, Toll Brothers Apartment Living teams up with an affiliate of global investment firm — The Carlyle Group — to develop Emblem 120. Toll Brothers Apartment Living will manage the development, marketing, leasing and property management of its fourth project in the Boston suburbs.

## Valuation

Toll Brothers shares are down 36.7% in the year-to-date period and 33.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Construction sector are down 18.7% and 23.6% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 6% and 11.5%, respectively.

The S&P 500 index is down 10.9% in the year-to-date period and 0.6% in the past year.

The stock is currently trading at 6.34X forward 12-month earnings, which compares to 9.55X for the Zacks sub-industry, 15.93X for the Zacks sector and 20.52X for the S&P 500 index.

Over the past five years, the stock has traded as high as 17.99X and as low as 3.52X, with a 5-year median of 9.84X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$26 price target reflects 6.59X forward 12-month earnings.

The table below shows summary valuation data for TOL

Valuation Multiples - TOL					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	6.34	9.55	15.93	20.52
	5-Year High	17.99	14.36	17.94	20.52
	5-Year Low	3.52	6.27	10.76	15.19
	5-Year Median	9.84	10.71	15.88	17.44
P/B TTM	Current	0.67	0.92	2.33	3.78
	5-Year High	1.89	2.29	6.73	4.55
	5-Year Low	0.38	0.63	1.7	2.84
	5-Year Median	1.21	1.53	3.27	3.64
P/S F12M	Current	0.42	0.78	1.57	3.21
	5-Year High	1.53	1.21	2.12	3.44
	5-Year Low	0.23	0.57	1.17	2.54
	5-Year Median	0.86	0.92	1.59	3.01

As of 05/06/2020

## Industry Analysis Zacks Industry Rank: Bottom 9% (229 out of 253)



## Top Peers

Company (Ticker)	Rec	Rank
Taylor Morrison Home Corporation (TMHC)	Outperform	4
DR Horton Inc (DHI)	Neutral	3
KB Home (KBH)	Neutral	3
Lennar Corporation (LEN)	Neutral	3
Meritage Homes Corporation (MTH)	Neutral	3
NVR Inc (NVR)	Neutral	4
PulteGroup Inc (PHM)	Neutral	4
Beazer Homes USA Inc (BZH)	Underperform	5

Industry Comparison Industry: Building Products - Home Builders				Industry Peers		
	TOL	X Industry	S&P 500	DHI	LEN	NVR
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	4
VGM Score	D	-	-	D	B	C
Market Cap	3.17 B	2.02 B	19.11 B	17.18 B	15.95 B	11.30 B
# of Analysts	7	5	14	16	7	2
Dividend Yield	1.76%	0.00%	2.2%	1.48%	0.98%	0.00%
Value Score	B	-	-	B	B	D
Cash/Price	0.17	0.20	0.06	0.17	0.05	0.14
EV/EBITDA	7.78	6.66	11.69	8.41	9.30	9.74
PEG Ratio	0.82	1.03	2.48	1.03	1.03	2.95
Price/Book (P/B)	0.70	0.83	2.58	1.60	0.98	4.68
Price/Cash Flow (P/CF)	5.31	6.33	10.40	10.27	8.42	12.54
P/E (F1)	7.13	9.04	18.81	10.31	8.86	19.83
Price/Sales (P/S)	0.44	0.51	1.97	0.93	0.70	1.58
Earnings Yield	14.03%	11.06%	4.99%	9.69%	11.28%	5.04%
Debt/Equity	0.86	0.50	0.75	0.40	0.50	0.28
Cash Flow (\$/share)	4.72	3.90	7.01	4.60	6.06	244.50
Growth Score	F	-	-	D	C	A
Hist. EPS Growth (3-5 yrs)	23.82%	21.16%	10.87%	23.17%	15.42%	27.65%
Proj. EPS Growth (F1/F0)	-12.83%	-11.53%	-9.86%	6.83%	0.42%	-30.09%
Curr. Cash Flow Growth	-11.99%	-3.09%	5.88%	3.66%	-6.27%	10.03%
Hist. Cash Flow Growth (3-5 yrs)	13.21%	21.78%	8.55%	23.21%	22.34%	24.62%
Current Ratio	6.82	4.63	1.25	7.25	12.65	4.82
Debt/Capital	46.17%	33.26%	44.23%	28.63%	33.38%	22.01%
Net Margin	7.44%	7.23%	10.87%	10.26%	8.77%	12.14%
Return on Equity	10.81%	12.76%	16.36%	17.70%	12.76%	37.44%
Sales/Assets	0.68	0.98	0.55	1.15	0.78	1.88
Proj. Sales Growth (F1/F0)	0.50%	0.00%	-2.18%	3.38%	1.61%	-25.22%
Momentum Score	C	-	-	D	B	F
Daily Price Chg	0.20%	-0.29%	-1.27%	-0.34%	-0.08%	-1.13%
1 Week Price Chg	8.02%	12.18%	0.53%	13.68%	15.35%	6.66%
4 Week Price Chg	8.92%	9.32%	0.68%	19.19%	17.78%	4.44%
12 Week Price Chg	-48.37%	-37.54%	-22.30%	-23.28%	-27.42%	-22.93%
52 Week Price Chg	-33.51%	-19.22%	-11.55%	9.32%	-0.12%	-5.05%
20 Day Average Volume	2,440,077	444,100	2,470,143	4,733,452	3,259,093	31,903
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.30%	0.00%	-0.80%
(F1) EPS Est 4 week change	0.00%	-10.96%	-6.52%	-4.63%	0.00%	-23.39%
(F1) EPS Est 12 week change	-10.42%	-21.46%	-14.84%	-13.00%	-7.35%	-32.31%
(Q1) EPS Est Mthly Chg	0.00%	-7.32%	-12.48%	-10.01%	0.00%	-26.01%

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## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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### Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	<b>B</b>
Growth Score	<b>F</b>
Momentum Score	<b>C</b>
VGM Score	<b>D</b>

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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