

Toll Brothers Inc.(TOL)

\$37.35 (As of 07/28/20)

Price Target (6-12 Months): **\$32.00**

Long Term: 6-12 Months | **Zacks Recommendation:** **Underperform**
(Since: 07/28/20)
Prior Recommendation: Neutral

Short Term: 1-3 Months | **Zacks Rank:** (1-5) **5-Strong Sell**
Zacks Style Scores: VGM:A
Value: A | Growth: B | Momentum: B

Summary

Shares of Toll Brothers have underperformed its industry year to date. Challenging sales conditions in the luxury home markets and rising building materials and labor costs have been impacting the company's performance over the past few quarters. Although the recent movement observed by Toll Brothers suggest more resilient housing market than anticipated earlier, delayed deliveries and unfavorable mix are pressing concerns. Estimates for the current quarter and fiscal 2020 have also witnessed downward revision depicting analysts' concern over the stock's growth potential. Although the company is well positioned to gain from geographic expansions in the long term, we wait for better visibility.

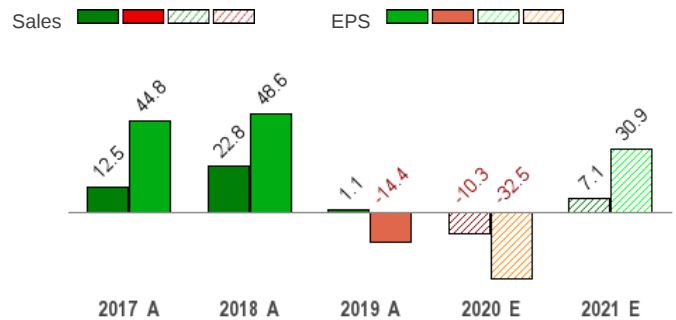
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$49.31 - \$13.28
20 Day Average Volume (sh)	1,954,892
Market Cap	\$4.7 B
YTD Price Change	-5.5%
Beta	1.69
Dividend / Div Yld	\$0.44 / 1.2%
Industry	Building Products - Home Builders
Zacks Industry Rank	Top 6% (16 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	22.9%
Last Sales Surprise	-0.8%
EPS F1 Est- 4 week change	0.6%
Expected Report Date	08/18/2020
Earnings ESP	-9.6%
P/E TTM	11.0
P/E F1	13.7
PEG F1	1.6
P/S TTM	0.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,360 E	1,638 E	1,797 E	2,296 E	6,945 E
2020	1,331 A	1,549 A	1,570 E	2,036 E	6,482 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	\$0.43 E	\$0.77 E	\$0.92 E	\$1.55 E	\$3.56 E
2020	\$0.41 A	\$0.59 A	\$0.66 E	\$1.07 E	\$2.72 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 07/28/2020. The reports text is as of 07/29/2020.

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.

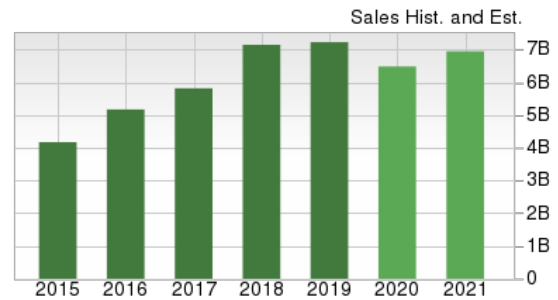
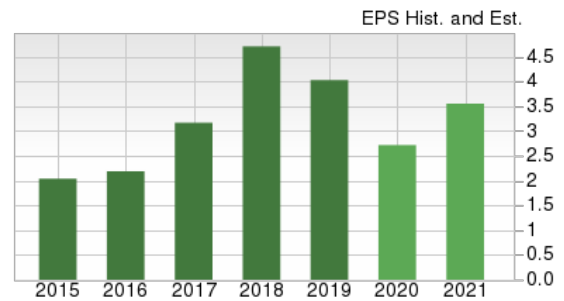
The company operates in Arizona, California, Florida, Delaware, Maryland, Pennsylvania, and South Carolina. Toll Brothers offers homes under two segments, namely Traditional Home Building Product and City Living.

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.

At fiscal second quarter-end, Toll Brothers had \$2 billion of total liquidity, comprising \$741 million in cash and \$1.3 billion in unused revolver capacity. The company had \$5.49-billion backlog at fiscal second quarter-end, which is expected to provide cash over the next 9-12 months, as cancellations have remained low according to Toll Brothers.



Reasons To Sell:

- ▼ **Coronavirus-Related Woes & Softness in the High-End Housing Market:** Owing to disruptions caused by the coronavirus outbreak, Toll Brothers' net signed contracts declined 64% year over year from Mar 16 through Apr 30. Notably, 40% of the company's selling communities and 50% of the dollar value of backlog were concentrated in highly-impacted markets.

Coronavirus-related woes, softness in the high-end housing market and gross margin pressure are raising concerns

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.

- ▼ **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.

Also, modest pricing to combat affordability woes of homebuyers will continue to weigh on its margins.

- ▼ **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.
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Risks

- **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.

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. These communities are expected to be more capital efficient.

Given favorable housing market fundamentals in the early part of 2020, Toll Brothers witnessed a rise in consumer demand, which in turn resulted in growth in orders. The company's net signed contracts were up 43% year over year through the six weeks ended Mar 15, 2020.

- **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. To preserve liquidity in order to combat COVID-19, the company has plans to significantly reduce spending on new land acquisitions and development. Nonetheless, it will choose to selectively invest in new land acquisitions based on local market conditions.

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 second-quarter fiscal 2020. In mid-April 2020, it closed a Toll Brothers Apartment Living joint venture to develop a 289-unit rental community in Boston's Woburn suburb.

- **Enough Liquidity to Tide Over the Pandemic:** At fiscal second quarter-end, Toll Brothers had \$2 billion of total liquidity, comprising \$741 million in cash and \$1.3 billion in unused revolver capacity. Revolving bank credit facility will not mature until November 2024. Notably, the weighted average maturity of its debt is more than five years and it has no significant debt maturities until 2022. The company had \$5.49-billion backlog at fiscal second quarter-end, which is expected to provide cash over the next 9-12 months, as cancellations have remained low according to Toll Brothers.

Last Earnings Report

Toll Brothers Q2 Earnings Top, Recent Orders Improve

Toll Brothers, Inc.'s second-quarter fiscal 2020 earnings topped the Zacks Consensus Estimate but revenues missed the same. Although COVID-19 impacted its order trends from Mar 16 to Apr 30, the recent trends observed by Toll Brothers suggest that "the housing market may be more resilient than anticipated just two months ago."

Douglas C. Yearley, Jr., chairman and chief executive officer, said, "Our deposits, which typically precede a binding sales contract by about three weeks and represent a leading indicator of current market demand, were up 13% over the past three weeks versus the same three-week period last year. Importantly, our recent deposit-to-contract conversion ratio has remained consistent with pre-Covid-19 levels. Web traffic has also steadily improved from the lows we experienced in mid-March and has returned to the same strong activity we enjoyed pre-Covid-19 in February."

Quarter Ending **04/2020**

Report Date	May 27, 2020
Sales Surprise	-0.80%
EPS Surprise	22.92%
Quarterly EPS	0.59
Annual EPS (TTM)	3.41

Earnings & Revenue Discussion

The country's leading luxury homebuilder reported earnings of 59 cents per share in the quarter under review, beating the consensus mark of 48 cents by 22.9%. However, the said figure dropped 32.2% from the year-ago level of 87 cents as a result of lower revenues, higher SG&A expenses, as well as reduced margins.

Consolidated revenues of \$1.55 billion lagged the consensus mark of \$1.56 billion by 0.8%. The reported figure also decreased 9.7% 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 declined 9% year over year to \$1.48 billion and that of City Living decreased 56.2% to \$36.8 million during the quarter.

Inside the Headline Numbers

Homebuilding deliveries during the quarter were up 1% year over year to 1,923 units. Deliveries increased in all the regions served by the company, except North and Pacific. Deliveries in Citi Living declined to 29 units from 72 units a year ago.

The average price of homes delivered was \$788,500 in the quarter, down 12% from the year-ago level of \$895,900.

The number of net signed contracts or orders during the reported quarter was 1,886 units, down 22% year over year. The value of net signed contracts was \$1.55 billion, reflecting a 22% decrease from the year-ago quarter. Notably, 40% of the company's selling communities and 50% of the dollar value of backlog were concentrated in highly-impacted markets. From Mar 16 through Apr 30, Toll Brothers' net signed contracts declined 64% year over year.

At fiscal second quarter-end, it had a backlog of 6,428 homes, representing a 1% year-over-year decrease. Potential revenues from backlog also declined 3% year over year to \$5.49 billion.

Cancellation rate during the reported quarter was 9.7%, reflecting an increase from 5.3% in the prior-year period.

Margins

The company's adjusted home sales gross margin was 21%, which contracted 250 bps in the quarter.

SG&A expenses — as a percentage of home sales revenues — were 11.8%, up 140 bps from the year-ago quarter. Operating margin of 6% was down 340 bps in the quarter.

Financials

Toll Brothers had \$741.2 million cash and cash equivalents as of Apr 30, 2020 compared with \$1.29 billion at fiscal 2019-end and \$519.8 million at fiscal first quarter-end. During the first half of the fiscal second quarter, the company repurchased 4.3 million shares for a total purchase price of \$157.5 million.

At fiscal second quarter-end, it had \$2 billion of liquidity that included \$741.2 million of cash and marketable securities, as well as \$1.3 billion available under the \$1.9-billion revolving credit facility. Notably, this facility will mature in November 2024. The company has no significant debt maturities until February 2022. Owing to business disruptions and unprecedented impact of the COVID-19 pandemic on the U.S. economy, the company revoked its fiscal 2020 guidance.

Recent News

Toll Brothers Partners With JD Capital For a New Project, Ferro – Jul 22, 2020

Toll Brothers recently joined hands with JD Capital USA for the development of a 379-unit luxury apartment community – Ferro. Notably, the joint venture has secured a \$46 million construction loan facility from Santander Bank, N.A. and the projects development will be looked after by Toll Brothers Apartment Living.

Valuation

Toll Brothers shares are down 5.5% in the year-to-date period but up 3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Construction sector are up 14.2% and 0.8% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 29.3% and 12.1%, respectively.

The S&P 500 index is up 0.1% in the year-to-date period and 7.3% in the past year.

The stock is currently trading at 11.18X forward 12-month earnings, which compares to 11.73X for the Zacks sub-industry, 19.24X for the Zacks sector and 22.46X 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 9.76X. Our Underperform recommendation indicates that the stock will worse than the market. Our \$32 price target reflects 9.58X 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	11.18	11.73	19.24	22.46
	5-Year High	17.99	14.36	19.24	22.46
	5-Year Low	3.52	6.34	10.74	15.25
	5-Year Median	9.76	10.72	15.86	17.52
P/B TTM	Current	1.03	1.48	4.16	4.4
	5-Year High	1.89	2.29	6.74	4.56
	5-Year Low	0.38	0.66	1.71	2.83
	5-Year Median	1.18	1.49	3.29	3.71
P/S F12M	Current	0.69	1.1	2.06	3.54
	5-Year High	1.53	1.21	2.12	3.54
	5-Year Low	0.23	0.57	1.17	2.53
	5-Year Median	0.84	0.92	1.63	3.02

As of 07/28/2020

Industry Analysis Zacks Industry Rank: Top 6% (16 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
D.R. Horton, Inc. (DHI)	Outperform	1
Meritage Homes Corporation (MTH)	Outperform	1
NVR, Inc. (NVR)	Outperform	1
Beazer Homes USA, Inc. (BZH)	Neutral	3
KB Home (KBH)	Neutral	3
Lennar Corporation (LEN)	Neutral	3
PulteGroup, Inc. (PHM)	Neutral	1
Taylor Morrison Home Corporation (TMHC)	Neutral	1

Industry Comparison Industry: Building Products - Home Builders				Industry Peers		
	TOL	X Industry	S&P 500	DHI	LEN	NVR
Zacks Recommendation (Long Term)	Underperform	-	-	Outperform	Neutral	Outperform
Zacks Rank (Short Term)	5	-	-	1	3	1
VGM Score	A	-	-	D	A	D
Market Cap	4.69 B	3.03 B	22.47 B	23.48 B	21.98 B	13.94 B
# of Analysts	6	4	14	17	3	2
Dividend Yield	1.18%	0.00%	1.84%	1.08%	0.71%	0.00%
Value Score	A	-	-	B	A	D
Cash/Price	0.16	0.17	0.07	0.13	0.06	0.17
EV/EBITDA	9.63	9.03	13.04	11.26	11.22	12.00
PEG Ratio	1.62	2.13	2.97	1.39	2.13	3.57
Price/Book (P/B)	1.03	1.19	3.11	2.19	1.32	5.34
Price/Cash Flow (P/CF)	7.92	9.34	12.07	14.04	11.61	15.49
P/E (F1)	14.04	13.21	21.52	13.16	11.12	17.30
Price/Sales (P/S)	0.67	0.70	2.35	1.24	0.97	2.00
Earnings Yield	7.28%	7.57%	4.34%	7.60%	8.99%	5.78%
Debt/Equity	0.94	0.46	0.76	0.40	0.45	0.49
Cash Flow (\$/share)	4.72	3.90	7.01	4.60	6.06	244.50
Growth Score	B	-	-	F	A	D
Hist. EPS Growth (3-5 yrs)	21.87%	21.77%	10.85%	23.17%	15.69%	25.78%
Proj. EPS Growth (F1/F0)	-32.55%	-14.12%	-7.56%	14.34%	10.28%	-0.96%
Curr. Cash Flow Growth	-11.99%	-2.58%	5.47%	3.66%	-6.27%	10.03%
Hist. Cash Flow Growth (3-5 yrs)	13.21%	18.38%	8.55%	23.21%	22.34%	24.62%
Current Ratio	6.84	3.18	1.31	7.25	14.21	5.80
Debt/Capital	48.38%	32.45%	44.41%	28.63%	31.07%	32.78%
Net Margin	6.85%	7.19%	10.44%	10.82%	9.30%	11.77%
Return on Equity	9.91%	13.03%	15.10%	18.90%	13.08%	33.66%
Sales/Assets	0.66	0.98	0.54	1.16	0.77	1.71
Proj. Sales Growth (F1/F0)	-10.26%	0.00%	-1.97%	5.11%	-5.73%	2.24%
Momentum Score	B	-	-	D	D	B
Daily Price Chg	-3.31%	-2.32%	-0.80%	-2.99%	-3.63%	-3.17%
1 Week Price Chg	5.03%	0.32%	0.37%	0.43%	0.27%	13.99%
4 Week Price Chg	14.61%	14.26%	3.64%	16.47%	14.22%	16.24%
12 Week Price Chg	49.58%	43.64%	11.56%	36.19%	37.70%	22.19%
52 Week Price Chg	3.01%	16.19%	-3.92%	38.82%	45.26%	15.20%
20 Day Average Volume	1,954,892	302,341	1,867,919	3,591,200	3,163,062	21,229
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	14.27%
(F1) EPS Est 4 week change	0.60%	0.29%	0.21%	0.44%	-0.16%	14.27%
(F1) EPS Est 12 week change	-22.62%	6.22%	-1.29%	7.59%	4.85%	40.53%
(Q1) EPS Est Mthly Chg	-1.87%	0.25%	0.09%	0.25%	-1.03%	32.48%

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.

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	A
Growth Score	B
Momentum Score	B
VGM Score	A

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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