

## Toll Brothers, Inc.

# See modest upside to F4Q; F2024 outlook will be investor focus

Reiterate Rating: BUY | PO: 98.00 USD | Price: 87.78 USD

## See modest upside to F4Q on deliveries

Toll Brothers is scheduled to report F4Q23 earnings (ended October) after the market close on Tuesday, December 5th and will host its conference call on Wednesday, December 6th at 8:30am EST. Like other builders this earnings season, we expect TOL to beat consensus estimates on higher deliveries (improving supply chains) and better gross margins. We model F4Q EPS of \$3.89 (vs. consensus of \$3.71).

## F4Q orders likely slowed, but how was last weekend?

We expect net orders of roughly 2,000 homes in F3Q23, which is roughly in-line with normal seasonality. Given the trajectory of mortgage rates during the quarter (higher), demand likely moderated through the quarter. With the 50bps drop in mortgage rates over the last month, we believe trends could be improving / outperforming normal seasonality in November/December. TOL management typically discusses its quarter-to-date trends (sometimes even through the prior weekend) and we/investors expect constructive near-term commentary. We model F1Q orders of roughly 1,800, slightly better than normal seasonality, partially supported by lower rates and a step-up in community count openings.

## F2024 consensus looks a little high on deliveries

We model F2024 EPS of \$11.24, 3% below consensus of \$11.64. We are positive on gross margin sustainability into next year, especially if rates come down – however, Visible Alpha consensus deliveries look a little too optimistic to us. We expect TOL's backlog to be down 18% YoY heading into F2024, which means to grow deliveries YoY supply chains would need to continue to improve (plausible) or TOL would have to increase the pace of spec building meaningfully. Also, consensus is modeling flattish JV earnings in F2024, which we expect to decline ~30% YoY given a weaker multi-family/apartment outlook (~1% drag vs. consensus).

## Valuation remains attractive; Reiterate Buy

Our key focus for the conference call will be the gross margin outlook in F2024 and capital allocation going forward (underwriting land at current valuations compared to buying back stock). Valuation is attractive at 1.4X price-to-book (current) and 1.2X 12-month, especially relative to F2024E return-on-equity outlook still in the high-teens. We reiterate Buy on TOL given its attractive valuation. We raise our PO to \$98 (from \$95) as we roll our 1.4x price-to-book valuation forward one quarter.

Estimates (Oct) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	6.92	10.90	12.15	11.24	10.60
EPS Change (YoY)	103.4%	57.5%	11.4%	-7.5%	-5.6%
Consensus EPS (Bloomberg)			11.98	11.64	12.22
DPS	0.62	0.74	0.83	0.84	0.84
Valuation (Oct)					
P/E	12.7x	8.0x	7.2x	7.8x	8.3x
Dividend Yield	0.7%	0.8%	0%	0%	1.0%
EV / EBITDA*	8.4x	6.0x	5.8x	6.4x	7.0x
Free Cash Flow Yield*	12.7%	9.4%	18.6%	19.8%	7.8%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 5.

03 December 2023

### Equity

#### Key Changes

(US\$)	Previous	Current
Price Obj.	95.00	98.00
2023E EPS	12.00	12.15
2024E EPS	10.99	11.24
2025E EPS	10.43	10.60

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### Stock Data

Price	87.78 USD
Price Objective	98.00 USD
Date Established	3-Dec-2023
Investment Opinion	B-1-7
52-Week Range	45.47 USD - 88.29 USD
Mrkt Val (mn) / Shares Out (mn)	9,763 USD / 111.2
Free Float	99.4%
Average Daily Value (mn)	112.57 USD
BofA Ticker / Exchange	TOL / NYS
Bloomberg / Reuters	TOL US / TOL.N
ROE (2023E)	20.9%
Net Dbt to Eqty (Oct-2022A)	32.9%
ESGMeter™	Medium

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Timestamp: 03 December 2023 08:13PM EST

# iQprofile<sup>SM</sup> Toll Brothers, Inc.

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	11.4%	15.5%	15.3%	12.8%	10.9%
Return on Equity	17.1%	22.8%	20.9%	16.4%	13.5%
Operating Margin	11.6%	14.7%	17.5%	16.9%	15.1%
Free Cash Flow	1,239	915	1,817	1,937	765

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.5x	0.8x	1.4x	1.7x	0.8x
Asset Replacement Ratio	0.9x	0.9x	1.1x	1.5x	1.4x
Tax Rate	23.5%	24.5%	25.4%	26.0%	26.0%
Net Debt-to-Equity Ratio	36.0%	32.9%	11.2%	-8.7%	-11.5%
Interest Cover	NM	NM	NM	NA	NA

## Income Statement Data (Oct)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	8,790	10,276	9,754	9,095	9,214
% Change	24.2%	16.9%	-5.1%	-6.8%	1.3%
Gross Profit	1,943	2,486	2,612	2,413	2,273
% Change	NA	NA	NA	NA	NA
EBITDA	1,401	1,950	2,037	1,837	1,677
% Change	67.7%	39.2%	4.5%	-9.8%	-8.7%
Net Interest & Other Income	114	195	106	70	60
<b>Net Income (Adjusted)</b>	<b>868</b>	<b>1,287</b>	<b>1,351</b>	<b>1,192</b>	<b>1,072</b>
<b>% Change</b>	<b>94.3%</b>	<b>48.2%</b>	<b>5.0%</b>	<b>-11.8%</b>	<b>-10.1%</b>

## Free Cash Flow Data (Oct)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	868	1,287	1,351	1,192	1,072
Depreciation & Amortization	76	77	79	89	90
Change in Working Capital	327	(353)	360	784	(281)
Deferred Taxation Charge	12	(97)	6	0	0
Other Adjustments, Net	23	73	111	2	12
Capital Expenditure	(67)	(72)	(91)	(131)	(128)
<b>Free Cash Flow</b>	<b>1,239</b>	<b>915</b>	<b>1,817</b>	<b>1,937</b>	<b>765</b>
<b>% Change</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>
Share / Issue Repurchase	(378)	(543)	(389)	(400)	(400)
Cost of Dividends Paid	(77)	(89)	(92)	(89)	(85)
Change in Debt	0	0	(5)	0	0

## Balance Sheet Data (Oct)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	1,638	1,347	2,051	3,499	3,779
Trade Receivables	NA	NA	NA	NA	NA
Other Current Assets	8,654	9,481	9,108	8,297	8,597
Property, Plant & Equipment	310	288	306	348	386
Other Non-Current Assets	935	1,174	1,083	1,083	1,083
<b>Total Assets</b>	<b>11,538</b>	<b>12,289</b>	<b>12,548</b>	<b>13,226</b>	<b>13,844</b>
Short-Term Debt	1,159	1,334	1,234	1,234	1,234
Other Current Liabilities	2,634	2,937	2,763	2,736	2,755
Long-Term Debt	2,404	1,995	1,596	1,596	1,596
Other Non-Current Liabilities	0	0	0	0	0
<b>Total Liabilities</b>	<b>6,197</b>	<b>6,267</b>	<b>5,592</b>	<b>5,565</b>	<b>5,585</b>
<b>Total Equity</b>	<b>5,340</b>	<b>6,022</b>	<b>6,956</b>	<b>7,661</b>	<b>8,260</b>
<b>Total Equity &amp; Liabilities</b>	<b>11,538</b>	<b>12,289</b>	<b>12,548</b>	<b>13,226</b>	<b>13,844</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

## Company Sector

Homebuilders

## Company Description

Toll Brothers is a leading US homebuilder with a focus on luxury suburban and urban markets. TOL operates in six distinct segments, focusing on highly customized homes. The company builds luxury, affordable luxury (millennial focus) and active-adult communities.

## Investment Rationale

We rate TOL share Buy. Positives include: (1) TOL has yet to see the full impact of price increases due to its longer build cycles and (2) roughly 75% of the owned land on the balance sheet was purchased pre-pandemic (roughly 3 year supply) and should provide a long runway for healthy margins.

## Stock Data

Average Daily Volume

1,282,396

## Quarterly Earnings Estimates

	2022	2023
Q1	1.24A	1.70A
Q2	1.85A	2.85A
Q3	2.35A	3.73A
Q4	5.63A	3.89E



## Price objective basis & risk

### Toll Brothers, Inc. (TOL)

Our \$98 PO on TOL shares is based on a price to forward 12-month book value multiple of roughly 1.4x, a slight discount to TOL's historical multiple (1.5x price to book value), which we view as appropriate given increasing affordability concerns and difficult comparisons.

Downside risks: (1) Luxury home demand could suffer an outsized decline during economic slowdowns, (2) Mid-Atlantic and Northeastern markets tend to grow more slowly, (3) potential earnings volatility given historically lumpy City Living sales, although this segment is now a small portion of TOL's overall business, (4) worsening affordability from rising rates, (5) supply chain issues and (6) slowing US economic growth.

Upside risks: (1) Luxury home demand could benefit by an outsized amount during economic strengthening, (2) Mid-Atlantic and Northeastern markets could grow more quickly, (3) improved lending markets could positively impact potential TOL customers needing to sell an existing home.

## Analyst Certification

I, Rafe Jadrosich, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Homebuilders and Building Products Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Armstrong World Industries, Inc.	AWI	AWI US	Rafe Jadrosich
	D.R. Horton, Inc.	DHI	DHI US	Rafe Jadrosich
	Latham Group, Inc.	SWIM	SWIM US	Shaun Calnan, CFA
	NVR, Inc.	NVR	NVR US	Rafe Jadrosich
	Owens Corning	OC	OC US	Rafe Jadrosich
	PulteGroup Inc.	PHM	PHM US	Rafe Jadrosich
	The AZEK Company Inc.	AZEK	AZEK US	Rafe Jadrosich
	Toll Brothers, Inc.	TOL	TOL US	Rafe Jadrosich
	TopBuild Corp	BLD	BLD US	Rafe Jadrosich
	Trex Company, Inc.	TREX	TREX US	Rafe Jadrosich
<b>NEUTRAL</b>				
	Builders FirstSource Inc	BLDR	BLDR US	Rafe Jadrosich
	Dream Finders Homes, Inc.	DFH	DFH US	Rafe Jadrosich
	KB Home	KBH	KBH US	Rafe Jadrosich
	Lennar Corporation	LEN	LEN US	Rafe Jadrosich
<b>UNDERPERFORM</b>				
	Fortune Brands Innovations Inc	FBIN	FBIN US	Rafe Jadrosich
	Hayward Holdings, Inc.	HAYW	HAYW US	Rafe Jadrosich
	Masco Corp	MAS	MAS US	Rafe Jadrosich
	Mohawk Industries	MHK	MHK US	Rafe Jadrosich
	Patrick Industries, Inc.	PATK	PATK US	Rafe Jadrosich
	Pool Corporation	POOL	POOL US	Shaun Calnan, CFA

## **IQmethod<sup>SM</sup> Measures Definitions**

### **Business Performance**

Return On Capital Employed

Return On Equity  
Operating Margin  
Earnings Growth  
Free Cash Flow

### **Quality of Earnings**

Cash Realization Ratio  
Asset Replacement Ratio  
Tax Rate  
Net Debt-To-Equity Ratio  
Interest Cover

### **Valuation Toolkit**

Price / Earnings Ratio  
Price / Book Value  
Dividend Yield  
Free Cash Flow Yield  
Enterprise Value / Sales

EV / EBITDA

### **Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income  
Operating Profit  
Expected 5 Year CAGR From Latest Actual  
Cash Flow From Operations – Total Capex

### **Numerator**

Cash Flow From Operations  
Capex  
Tax Charge  
Net Debt = Total Debt – Cash & Equivalents  
EBIT

### **Numerator**

Current Share Price  
Current Share Price  
Annualised Declared Cash Dividend  
Cash Flow From Operations – Total Capex  
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities  
Enterprise Value

### **Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization  
Shareholders' Equity  
Sales  
N/A  
N/A

### **Denominator**

Net Income  
Depreciation  
Pre-Tax Income  
Total Equity  
Interest Expense

### **Denominator**

Diluted Earnings Per Share (Basis As Specified)  
Shareholders' Equity / Current Basic Shares  
Current Share Price  
Market Cap = Current Share Price × Current Basic Shares  
Sales

Basic EBIT + Depreciation + Amortization

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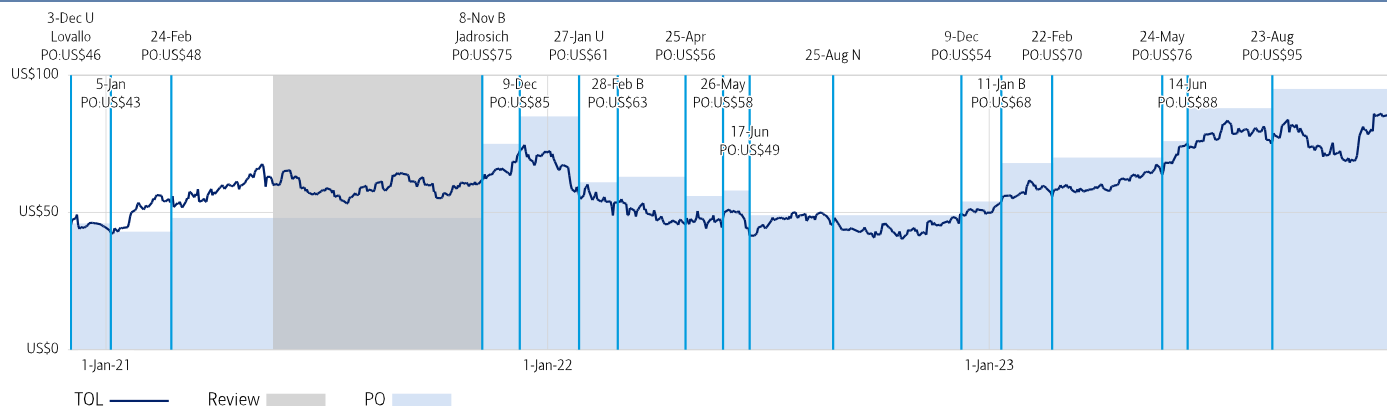
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### Toll Brothers (TOL) Price Chart



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### Equity Investment Rating Distribution: Building Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	41	47.67%	Buy	23	56.10%
Hold	14	16.28%	Hold	8	57.14%
Sell	31	36.05%	Sell	9	29.03%

### Equity Investment Rating Distribution: Global Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1869	53.48%	Buy	1046	55.97%
Hold	828	23.69%	Hold	461	55.68%
Sell	798	22.83%	Sell	370	46.37%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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