TOLL BROTHERS INC
Form 10-Q
September 05, 2018

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 31, 2018
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 001-09186
TOLL BROTHERS, INC.
(Exact name of registrant as specified in its charter)

Delaware	23-2416878
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
250 Gibraltar Road, Horsham, Pennsylvania	19044
(Address of principal executive offices)	(Zip Code)

(215) 938-8000
(Registrant's telephone number, including area code)
Not applicable
(Former name, former address and former fiscal year, if changed since last report)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:
At September 4, 2018, there were approximately 147,364,000 shares of Common Stock, $0.01 par value, outstanding.

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STATEMENT ON FORWARD-LOOKING INFORMATION

Certain information included in this report or in other materials we have filed or will file with the Securities and Exchange Commission (“SEC”) (as well as information included in oral statements or other written statements made or to be made by us) contains or may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. One can identify these statements by the fact that they do not relate to matters of a strictly historical or factual nature and generally discuss or relate to future events. These statements contain words such as “anticipate,” “estimate,” “expect,” “project,” “intend,” “plan,” “believe,” “may,” “can,” “could,” “might,” “should,” and other words or phrases of similar meanin statements may include, but are not limited to, information related to: anticipated operating results; home deliveries; financial resources and condition; changes in revenues; changes in profitability; changes in margins; changes in accounting treatment; cost of revenues; selling, general, and administrative expenses; interest expense; inventory write-downs; home warranty and construction defect claims; unrecognized tax benefits; anticipated tax refunds; sales paces and prices; effects of home buyer cancellations; growth and expansion; joint ventures in which we are involved; anticipated results from our investments in unconsolidated entities; the ability to acquire land and pursue real estate opportunities; the ability to gain approvals and open new communities; the ability to sell homes and properties; the ability to deliver homes from backlog; the ability to secure materials and subcontractors; the ability to produce the liquidity and capital necessary to expand and take advantage of opportunities; and legal proceedings, government investigations, and claims.

From time to time, forward-looking statements also are included in other reports on Forms 10-K, 10-Q, and 8-K; in press releases; in presentations; on our website; and in other materials released to the public. Any or all of the forward-looking statements included in this report and in any other reports or public statements made by us are not guarantees of future performance and may turn out to be inaccurate. This can occur as a result of incorrect assumptions or as a consequence of known or unknown risks and uncertainties. Many factors mentioned in this report or in other reports or public statements made by us, such as market conditions, government regulation, and the competitive environment, will be important in determining our future performance. Consequently, actual results may differ materially from those that might be anticipated from our forward-looking statements.

Forward-looking statements speak only as of the date they are made. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events, or otherwise.

For a more detailed discussion of these factors, see the information under the captions “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our most recent Annual Report on Form 10-K filed with the SEC and in this report.

When this report uses the words “we,” “us,” “our,” and the “Company,” they refer to Toll Brothers, Inc. and its subsidiaries, unless the context otherwise requires. References herein to fiscal year refer to our fiscal years ended or ending October 31.

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
TOLL BROTHERS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Amounts in thousands)

	July 31, 2018 (unaudited)	October 31, 2017
ASSETS		
Cash and cash equivalents	$522,181	$712,829
Restricted cash	686	2,482
Inventory	7,957,616	7,281,453
Property, construction, and office equipment, net	195,728	189,547
Receivables, prepaid expenses, and other assets	622,402	542,217
Mortgage loans held for sale	94,291	132,922
Customer deposits held in escrow	136,322	102,017
Investments in unconsolidated entities	419,994	481,758
	$9,949,220	$9,445,225
LIABILITIES AND EQUITY		
Liabilities		
Loans payable	$694,409	$637,416
Senior notes	2,860,771	2,462,463
Mortgage company loan facility	82,274	120,145
Customer deposits	470,231	396,026
Accounts payable	327,872	275,223
Accrued expenses	936,084	959,353
Income taxes payable	40,199	57,509
Total liabilities	5,411,840	4,908,135
Equity		
Stockholders’ equity		
Preferred stock, none issued	—	—
Common stock, 177,937 shares issued at July 31, 2018 and October 31, 2017	1,779	1,779
Additional paid-in capital	722,461	720,115
Retained earnings	4,866,980	4,474,064
Treasury stock, at cost — 29,707 and 20,732 shares at July 31, 2018 and October 31, 2017, respectively	(1,060,746)	(662,854)
Accumulated other comprehensive loss	(1,810)	(1,910)
Total stockholders’ equity	4,528,664	4,531,194
Noncontrolling interest	8,716	5,896
Total equity	4,537,380	4,537,090
	$9,949,220	$9,445,225

See accompanying notes.

TOLL BROTHERS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(Amounts in thousands, except per share data)
(Unaudited)

	Nine months ended July 31,		Three months ended July 31,	
	2018	2017	2018	2017
Revenues	$4,688,020	$3,787,151	$1,913,353	$1,502,909
Cost of revenues	3,742,256	2,986,471	1,509,619	1,176,028
Selling, general and administrative	497,990	438,497	174,071	154,650
	4,240,246	3,424,968	1,683,690	1,330,678
Income from operations	447,774	362,183	229,663	172,231
Other:				
Income from unconsolidated entities	53,913	112,274	12,469	19,925
Other income – net	35,756	38,107	10,965	11,418
Income before income taxes	537,443	512,564	253,097	203,574
Income tax provision	100,268	168,947	59,839	55,011
Net income	$437,175	$343,617	$193,258	$148,563
Other comprehensive income, net of tax	512	504	170	167
Total comprehensive income	$437,687	$344,121	$193,428	$148,730
Per share:				
Basic earnings	$2.85	$2.11	$1.28	$0.91
Diluted earnings	$2.81	$2.01	$1.26	$0.87
Cash dividends declared	$0.30	$0.16	$0.11	$0.08
Weighted-average number of shares:				
Basic	153,290	163,186	151,257	163,478
Diluted	155,733	171,127	153,173	171,562

See accompanying notes.

TOLL BROTHERS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)
(Unaudited)

	Nine months ended July 31, 2018	2017
Cash flow (used in) provided by operating activities:		
Net income	$437,175	$343,617
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	18,724	18,423
Stock-based compensation	21,879	22,088
Income from unconsolidated entities	(53,913)	(112,274)
Distributions of earnings from unconsolidated entities	53,166	125,138
Income from foreclosed real estate and distressed loans	(1,269)	(4,287)
Deferred tax (benefit) provision	(19,747)	59,266
Change in deferred tax valuation allowances		(32,154)
Inventory impairments and write-offs	28,746	11,314
Other	208	2,299
Changes in operating assets and liabilities		
Increase in inventory	(541,889)	(228,887)
Origination of mortgage loans	(941,336)	(821,265)
Sale of mortgage loans	979,715	979,625
Decrease in restricted cash	1,796	12,461
(Increase) decrease in receivables, prepaid expenses, and other assets	(123,521)	46,941
Increase in customer deposits	39,900	64,252
Increase (decrease) in accounts payable and accrued expenses	24,428	(133,845)
Increase in income taxes payable	3,698	55,273
Net cash (used in) provided by operating activities	(72,240)	407,985
Cash flow provided by (used in) investing activities:		
Purchase of property and equipment — net	(21,701)	(22,401)
Sale and redemption of marketable securities and restricted investments — net		18,049
Investments in unconsolidated entities	(15,189)	(119,714)
Return of investments in unconsolidated entities	93,669	139,346
Investment in foreclosed real estate and distressed loans	(519)	(688)
Return of investments in foreclosed real estate and distressed loans	3,934	12,429
Acquisition of a business		(85,183)
Net cash provided by (used in) investing activities	60,194	(58,162)
Cash flow provided by (used in) financing activities:		
Proceeds from issuance of senior notes	400,000	455,483
Debt issuance costs for senior notes	(3,531)	(4,446)
Proceeds from loans payable	1,908,085	1,083,472
Principal payments of loans payable	(2,020,495)	(1,513,078)
Proceeds from stock-based benefit plans	9,731	57,958
Purchase of treasury stock	(426,895)	(90,716)
Dividends paid	(45,519)	(26,016)
Receipts related to noncontrolling interest, net	22	
Net cash used in financing activities	(178,602)	(37,343)
Net (decrease) increase in cash and cash equivalents	(190,648)	312,480

Cash and cash equivalents, beginning of period	712,829	633,715
Cash and cash equivalents, end of period	$522,181	$946,195

See accompanying notes.

TOLL BROTHERS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
1. Significant Accounting Policies
Basis of Presentation
The accompanying condensed consolidated financial statements include the accounts of Toll Brothers, Inc. (the "Company," "we," "us," or "our"), a Delaware corporation, and its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. Investments in 50% or less owned partnerships and affiliates are accounted for using the equity method unless it is determined that we have effective control of the entity, in which case we would consolidate the entity.
The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial information. The October 31, 2017 balance sheet amounts and disclosures included herein have been derived from our October 31, 2017 audited financial statements. Since the accompanying condensed consolidated financial statements do not include all the information and footnotes required by U.S. generally accepted accounting principles ("GAAP") for complete financial statements, we suggest that they be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended October 31, 2017 ("2017 Form 10-K"). In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all adjustments, which are of a normal recurring nature, necessary to present fairly our financial position as of July 31, 2018; the results of our operations for the nine-month and three-month periods ended July 31, 2018 and 2017; and our cash flows for the nine-month periods ended July 31, 2018 and 2017. The results of operations for such interim periods are not necessarily indicative of the results to be expected for the full year.
Recent Accounting Pronouncements
In February 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" ("ASU 2018-02"). ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act enacted on December 22, 2017 and also requires entities to disclose their accounting policy for releasing income tax effects from accumulated other comprehensive income. We elected to adopt ASU 2018-02 in the first quarter of fiscal 2018, and the adoption did not have a material effect on our consolidated financial statements and disclosures.
In March 2017, the FASB issued ASU No. 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost" ("ASU 2017-07"). ASU 2017-07 requires an employer to report the service cost component of pension and other post-retirement benefit costs in the same line item as other compensation costs arising from services rendered by the pertinent employees while the other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. We adopted ASU 2017-07 on November 1, 2017, and the adoption did not have a material effect on our consolidated financial statements and disclosures.
In March 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). ASU 2016-09 simplifies several aspects related to the accounting for share-based payment transactions, including the accounting for income taxes and forfeitures, statutory tax withholding requirements and classification on the statement of cash flows. We adopted ASU 2016-09 on November 1, 2017. Excess tax benefits or deficiencies for stock-based compensation are now reflected in our Condensed Consolidated Statements of Operations and Comprehensive Income as a component of income tax expense, whereas previously they were recognized in equity. We have also elected to account for forfeitures as they occur, rather than estimate expected forfeitures. As a result of adopting ASU 2016-09, the impact of recognizing excess tax benefits and deficiencies in our Condensed Consolidated Statements of Operations and Comprehensive Income resulted in a $4.0 million reduction in our income tax expense in the nine-month period ended July 31, 2018. The remaining aspects of adopting ASU 2016-09 did not have a material impact on our financial statements and

disclosures.

In February 2017, the FASB issued ASU No. 2017-05, “Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets” (“ASU 2017-05”). ASU 2017-05 is meant to clarify the scope of the original guidance within Subtopic 610-20 that was issued in connection with ASU 2014-09, as defined below, which provides guidance for recognizing gains and losses from the transfer of nonfinancial assets in contracts with noncustomers. ASU 2017-05 also added guidance for partial sales of nonfinancial assets. ASU 2017-05 is effective for our fiscal year beginning November 1, 2018 and we are required to adopt ASU 2017-05 concurrent with the adoption of ASU 2014-09. We are currently evaluating the impact that the adoption of ASU 2017-05 may have on our consolidated financial statements and disclosures.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”), which provides guidance for revenue recognition. ASU 2014-09 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets. ASU 2014-09 supersedes the revenue recognition requirements in Accounting Standards Codification (“ASC”) Topic 605, “Revenue Recognition,” and most industry-specific guidance. ASU 2014-09 also supersedes some cost guidance included in ASC Subtopic 605-35, “Revenue Recognition—Construction-Type and Production-Type Contracts.” The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under the current guidance. These judgments and estimates include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price, and allocating the transaction price to each separate performance obligation. In August 2015, the FASB issued ASU 2015-14 “Revenue from Contracts with Customers” (“ASU 2015-14”), which delays the effective date of ASU 2014-09 by one year. ASU 2014-09, as amended by ASU 2015-14, is effective for our fiscal year beginning November 1, 2018, and, at that time, we expect to adopt the new standard under the modified retrospective approach. We do not believe the adoption of ASU 2014-09 will have a material impact on the amount or timing of our home building revenues. However, we currently expect that the adoption of ASU 2014-09 will result in the following changes:

- Retained customer deposits are currently classified in “Other income-net” on our Condensed Consolidated Statements of Operations and Comprehensive Income. As of November 1, 2018, we expect these retained customer deposits will be reclassified to “Revenue” on our Condensed Consolidated Statements of Operations and Comprehensive Income. Prior period balances for retained customer deposits will not be reclassified and are not material to our condensed consolidated financial statements.
- We currently capitalize certain costs related to our marketing efforts, including sales offices and model home upgrades and furnishings within “Inventory” on our Condensed Consolidated Balance Sheets and amortize such costs through “Selling, general, and administrative” on our Condensed Consolidated Statements of Operations and Comprehensive Income. As of November 1, 2018, we expect to reclassify approximately $105.0 million to “Property, construction, and office equipment, net” on our Condensed Consolidated Balance Sheets, primarily related to sales offices and model home improvement costs, that we plan to continue depreciating through “Selling, general, and administrative” on our Condensed Consolidated Statements of Operations and Comprehensive Income. Additionally, we expect to record a cumulative effect adjustment to retained earnings of approximately $25.0 million for certain other marketing costs that will no longer qualify for capitalization under the new guidance, and such costs will be expensed as incurred in the future.

We additionally expect our accounting for incomplete deliverables at the time a home closes may be impacted upon adoption of the new guidance, and we expect a change to the timing of recognition of revenues and profits on land sale transactions and certain management fees that we earn from our unconsolidated entities. We are currently quantifying the impact of these changes. We continue to evaluate the impact the adoption of ASU 2014-09 may have on other aspects of our business and on our consolidated financial statements and disclosures.

In February 2016, the FASB issued ASU No. 2016-02, “Leases” (“ASU 2016-02”), which requires an entity to recognize assets and liabilities on the balance sheet for the rights and obligations created by leased assets and provide additional disclosures. In July 2018, the FASB issued ASU No. 2018-11, “Leases: Targeted Improvements” (“ASU 2018-11”), which provides an entity with the option to apply the transition provisions of the new standard at its adoption date instead of at its earliest comparative period presented. ASU 2016-02 also provides an entity with a practical expedient that permits lessors to not separate nonlease components from the associated lease component if certain conditions are met. ASU 2016-02, as amended by ASU 2018-11, is effective for our fiscal year beginning November 1, 2019, and, at that time, we will adopt the new standard using a modified retrospective approach. We are currently evaluating the impact that the adoption of ASU 2016-02, as amended by ASU 2018-11, may have on our consolidated financial statements and disclosures.

Reclassification

The Condensed Consolidated Statement of Cash Flows for the nine months ended July 31, 2017 was restated to reflect a reclassification of approximately $18.0 million of cash flow from “Net cash (used in) provided by operating activities” to “Net cash provided by (used in) investing activities” related to restricted investment activity. In addition, certain other prior period amounts have been reclassified to conform to the fiscal 2018 presentation.

2. Inventory

Inventory at July 31, 2018 and October 31, 2017 consisted of the following (amounts in thousands):

	July 31, 2018	October 31, 2017
Land controlled for future communities	$126,288	$87,158
Land owned for future communities	1,224,504	1,142,870
Operating communities	6,606,824	6,051,425
	$7,957,616	$7,281,453

Operating communities include communities offering homes for sale; communities that have sold all available home sites but have not completed delivery of the homes; communities that were previously offering homes for sale but are temporarily closed due to business conditions or non-availability of improved home sites and that are expected to reopen within 12 months of the end of the fiscal period being reported on; and communities preparing to open for sale. The carrying value attributable to operating communities includes the cost of homes under construction, land and land development costs, the carrying cost of home sites in current and future phases of these communities, and the carrying cost of model homes.

Communities that were previously offering homes for sale but are temporarily closed due to business conditions, do not have any remaining backlog, and are not expected to reopen within 12 months of the end of the fiscal period being reported on have been classified as land owned for future communities.

Information regarding the classification, number, and carrying value of these temporarily closed communities, as of the dates indicated, is provided in the table below:

	July 31, 2018	October 31, 2017
Land owned for future communities:		
Number of communities	16	14
Carrying value (in thousands)	$125,766	$ 110,732
Operating communities:		
Number of communities	1	