TOLL BROTHERS INC
Form 10-Q
March 10, 2014

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 January 31, 2014
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 or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting 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

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 March 3, 2014, there were approximately 177,693,000 shares of Common Stock, $.01 par value, outstanding.

TOLL BROTHERS, INC.
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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 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. You can identify these statements by the fact that they do not relate to matters of strictly historical or factual nature and generally discuss or relate to estimates or other expectations regarding future events. They contain words such as “anticipate,” “estimate,” “expect,” “project,” “intend,” “plan,” “believe,” “may,” “can,” “could,” “might,” “should” and other words or phrases of similar meaning in connection with any discussion of future operating or financial performance. Such 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; 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; legal proceedings and claims; the anticipated benefits to be realized from the consummation of the Shapell acquisition; and post-closing asset sales.

From time to time, forward-looking statements also are included in other periodic reports on Forms 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 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 Securities and Exchange Commission 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 2013,” “fiscal 2012,” “fiscal 2011,” “fiscal 2010,” “fiscal 2009,” and “fiscal 2008” refer to our fiscal years ending October 31, 2013, October 31, 2012, October 31, 2011, October 31, 2010, October 31, 2009, and October 31, 2008, respectively. References herein to "fiscal 2014" refer to our fiscal year ending October 31, 2014.

PART I — FINANCIAL INFORMATION

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

	January 31, 2014 (unaudited)	October 31, 2013
ASSETS		
Cash and cash equivalents	$1,190,489	$772,972
Marketable securities	13,017	52,508
Restricted cash	32,175	32,036
Inventory	5,235,647	4,650,412
Property, construction and office equipment, net	131,190	131,320
Receivables, prepaid expenses and other assets	240,034	229,295
Mortgage loans held for sale	58,131	113,517
Customer deposits held in escrow	45,834	46,888
Investments in and advances to unconsolidated entities	430,615	403,133
Investments in distressed loans	19,253	36,374
Investments in foreclosed real estate	79,267	72,972
Deferred tax assets, net of valuation allowances	284,603	286,032
	$7,760,255	$6,827,459
LIABILITIES AND EQUITY		
Liabilities		
Loans payable	$158,606	$107,222
Senior notes	2,921,851	2,321,442
Mortgage company warehouse loan	51,470	75,000
Customer deposits	218,747	212,669
Accounts payable	166,286	167,787
Accrued expenses	516,097	522,987
Income taxes payable	99,825	81,188
Total liabilities	4,132,882	3,488,295
Equity		
Stockholders’ equity		
Preferred stock, none issued		
Common stock, 177,553 and 169,353 shares issued at January 31, 2014 and October 31, 2013, respectively	1,776	1,694
Additional paid-in capital	683,965	441,677
Retained earnings	2,937,583	2,892,003
Treasury stock, at cost — 2 and 0 shares at January 31, 2014 and October 31, 2013, respectively	(81)	—
Accumulated other comprehensive loss	(2,124)	(2,387)
Total stockholders’ equity	3,621,119	3,332,987
Noncontrolling interest	6,254	6,177
Total equity	3,627,373	3,339,164
	$7,760,255	$6,827,459

See accompanying notes

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

	Three months ended January 31,	
	2014	2013
Revenues	$643,681	$424,601
Cost of revenues	514,032	345,937
Selling, general and administrative	97,870	78,047
	611,902	423,984
Income from operations	31,779	617
Other:		
Income from unconsolidated entities	22,915	3,083
Other income - net	16,541	4,626
Income before income taxes	71,235	8,326
Income tax provision	25,655	3,894
Net income	$45,580	$4,432
Income per share:		
Basic	$0.26	$0.03
Diluted	$0.25	$0.03
Weighted-average number of shares:		
Basic	176,474	169,064
Diluted	184,888	171,903

See accompanying notes

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Amounts in thousands)
(Unaudited)

	Three months ended January 31,	
	2014	2013
Net income	$45,580	$4,432
Other comprehensive income (loss), net of tax:		
Change in pension liability	53	(173)
Change in fair value of available-for-sale securities	(31)	96
Unrealized income on derivative held by equity investee	241	93
Other comprehensive income	263	16
Total comprehensive income	$45,843	$4,448

See accompanying notes

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

	Three months ended January 31, 2014	2013
Cash flow used in operating activities:		
Net income	$45,580	$4,432
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	5,289	6,525
Stock-based compensation	7,669	5,684
Excess tax benefits from stock-based compensation	(789)	
Income from unconsolidated entities	(22,915)	(3,083)
Distributions of earnings from unconsolidated entities	22,143	2,413
Income from distressed loans and foreclosed real estate	(6,619)	(3,011)
Deferred tax provision	1,711	2,306
Deferred tax valuation allowances	(448)	(216)
Inventory impairments and write-offs	1,982	709
Change in fair value of mortgage loans receivable and derivative instruments	605	554
Gain on marketable securities	(21)	
Changes in operating assets and liabilities		
Increase in inventory	(363,914)	(378,715)
Origination of mortgage loans	(146,354)	(141,148)
Sale of mortgage loans	200,830	176,830
(Increase) decrease in restricted cash	(139)	13,519
Increase in receivables, prepaid expenses and other assets	(7,274)	(8,256)
Increase in customer deposits	7,132	12,059
(Decrease) increase in accounts payable and accrued expenses	(14,282)	1,302
Increase in income taxes payable	19,426	2,274
Net cash used in operating activities	(250,388)	(305,822)
Cash flow (used in) provided by investing activities:		
Purchase of property and equipment — net	(2,853)	(5,391)
Purchase of marketable securities		(26,019)
Sale and redemption of marketable securities	39,243	38,775
Investments in and advances to unconsolidated entities	(60,408)	(7,614)
Return of investments in unconsolidated entities	32,429	17,311
Investments in distressed loans and foreclosed real estate	(191)	(16,252)
Return of investments in distressed loans and foreclosed real estate	17,574	3,015
Deposit - acquisition of a business	(161,000)	
Net cash (used in) provided by investing activities	(135,206)	3,825
Cash flow provided by (used in) financing activities:		
Proceeds from issuance of senior notes	600,000	
Debt issuance costs for senior notes	(4,700)	
Proceeds from loans payable	275,334	244,830
Principal payments of loans payable	(307,195)	(299,862)
Redemption of senior subordinated notes		(59,068)
Net proceeds from issuance of common stock	220,357	
Proceeds from stock-based benefit plans	18,529	6,108

Excess tax benefits from stock-based compensation	789	
Receipts related to noncontrolling interest	81	
Purchase of treasury stock	(84)	(79)
Net cash provided by (used in) financing activities	803,111	(108,071)
Net increase (decrease) in cash and cash equivalents	417,517	(410,068)
Cash and cash equivalents, beginning of period	772,972	778,824
Cash and cash equivalents, end of period	$1,190,489	$368,756

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”), a Delaware corporation, and those majority-owned subsidiaries it controls. 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 the Company has effective control of the entity, in which case the entity would be consolidated.
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, 2013 balance sheet amounts and disclosures included herein have been derived from the Company’s October 31, 2013 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, the Company suggests that they be read in conjunction with the consolidated financial statements and notes thereto included in its Annual Report on Form 10-K for the fiscal year ended October 31, 2013. 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 the Company’s financial position as of January 31, 2014, the results of its operations for the three-month periods ended January 31, 2014 and 2013, and its cash flows for the three-month periods ended January 31, 2014 and 2013. The results of operations for such interim periods are not necessarily indicative of the results to be expected for the full year.
Subsequent Events
Acquisition of Shapell Industries, Inc.
On February 4, 2014, the Company completed its previously announced acquisition of Shapell Industries, Inc. (“Shapell”) pursuant to the Purchase and Sale Agreement (the “Purchase Agreement”), dated November 6, 2013, with Shapell Investment Properties, Inc. (“SIPI”). Pursuant to the Purchase Agreement, the Company acquired, for cash, all of the equity interests in Shapell from SIPI for an aggregate purchase price of approximately $1.60 billion (the “Acquisition”). The Company acquired the single-family residential real property development business of Shapell, including a portfolio of approximately 4,950 home sites in California, some of which the Company expects to sell to other builders. As of the acquisition date, Shapell’s home building operation had 11 active selling communities in Northern California and Southern California, within which it is focused on a select number of premium markets. In addition, the Company acquired approximately $120.0 million of cash. As part of the acquisition, the Company assumed contracts to deliver approximately 126 homes with an aggregate value of approximately $105.3 million. At January 31, 2014, the Company had deposited with an escrow agent $161.0 million of the purchase price. This deposit is included in "Inventory" on the Company's Condensed Consolidated Balance Sheet at January 31, 2014.
The purchase price is subject to post-closing adjustment in accordance with the terms of the Purchase Agreement. The Company financed the Acquisition with a combination of $370 million of borrowings under its $1.035 billion unsecured revolving credit facility, $485 million from the term loan facility described below, as well as with $830 million in proceeds from debt and equity financings completed in November 2013.
Senior Unsecured Term Loan
On February 3, 2014, the Company entered into a 5-year senior, $485 million, unsecured term loan facility (the "Term Loan Facility") with ten banks. The full amount of the Term Loan Facility was borrowed by the Company on February 3, 2014. The Company may select interest rates for the Term Loan Facility equal to (i) the London interbank offered rate ("LIBOR") plus an applicable margin, (ii) the base rate (which is defined as the greatest of (a) SunTrust Bank’s prime rate, (b) the federal funds effective rate plus 0.5% and (c) one-month LIBOR plus 1%) plus an applicable margin or (iii) the federal funds / Euro rate (which is defined as the greater of (a) the sum of the federal funds effective rate plus an applicable margin plus 0.25% and (b) one-month LIBOR), with the applicable margin, in each case, based on the Company's leverage ratio. The initial interest rate on the Term Loan will be 1.72% per annum.

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The Company and substantially all of its 100% owned home building subsidiaries are guarantors under the Term Loan Facility. The Term Loan Facility contains substantially the same financial covenants as the Company's five-year, unsecured revolving credit facility ("Credit Facility"). The Term Loan Facility will mature, and amounts owing under it will become due and payable, on February 3, 2019.

364-Day Senior Unsecured Revolving Credit Facility

On February 4, 2014, the Company entered into a 364-day senior unsecured revolving credit facility (the "364-Day Facility") with five banks. The 364-Day Facility provides for an unsecured revolving credit facility to be made available to the Company, from time to time after February 4, 2014 and prior to February 3, 2015, in the amount of $500 million. The Company intends for this facility to remain undrawn and its existence is to provide the Company additional liquidity should unforeseen circumstances arise. The Company may select interest rates for the 364-Day Facility equal to (i) LIBOR plus an applicable margin, (ii) the base rate (which is defined as the greatest of (a) Citibank's prime rate, (b) the federal funds effective rate plus 0.5% and (c) one-month LIBOR plus 1%) plus an applicable margin or (iii) the federal funds / Euro rate (which is defined as the greater of (a) the sum of the federal funds effective rate plus an applicable margin plus 0.25% and (b) one-month LIBOR), with the applicable margin, in each case, based on the Company's leverage ratio. The Company is obligated to pay an undrawn commitment fee.

The Company and substantially all of its 100% owned home building subsidiaries are guarantors under the 364-Day Facility. The 364-Day Facility contains substantially the same financial covenants as the Company's Credit Facility. The 364-Day Facility will terminate, and amounts owing under the 364-Day Facility will become due and payable, on February 3, 2015.

2. Inventory

Inventory at January 31, 2014 and October 31, 2013 consisted of the following (amounts in thousands):

	January 31, 2014	October 31, 2013
Land controlled for future communities	$254,549	$99,802
Land owned for future communities	1,491,205	1,287,630
Operating communities	3,489,893	3,262,980
	$5,235,647	$4,650,412

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 twelve 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 that do not have any remaining backlog and are not expected to reopen within twelve months of the end of the fiscal period being reported on have been classified as land owned for future communities. Backlog consists of homes under contract but not yet delivered to the Company's home buyers ("backlog").

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

	January 31, 2014	October 31, 2013
Land owned for future communities:		
Number of communities	22	25
Carrying value (in thousands)	$141,356	$153,498
Operating communities:		
Number of communities	15	15
Carrying value (in thousands)	$91,984	$88,534

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The amounts the Company provided for inventory impairment charges and the expensing of costs that it believed not to be recoverable, for the periods indicated, are shown in the table below (amounts in thousands).

	Three months ended January 31,	
	2014	2013
Land controlled for future communities	$682	$9
Operating communities	1,300	700
	$1,982	$709

See Note 13, "Fair Value Disclosures," for information regarding the number of operating communities that the Company tested for potential impairment, the number of operating communities in which it recognized impairment charges, the amount of impairment charges recognized, and the fair values of those communities, net of impairment charges.

See Note 15, "Commitments and Contingencies," for information regarding land purchase commitments.

At January 31, 2014, the Company evaluated its land purchase contracts to determine if any of the selling entities were variable interest entities ("VIEs") and, if they were, whether the Company was the primary beneficiary of any of them. Under these land purchase contracts, the Company does not possess legal title to the land and its risk is generally limited to deposits paid to the sellers and the creditors of the sellers generally have no recourse against the Company. At January 31, 2014, the Company determined that 86 land purchase contracts, with an aggregate purchase price of $865.2 million, on which it had made aggregate deposits totaling $47.6 million, were VIEs, and that it was not the primary beneficiary of any VIE related to its land purchase contracts.

Interest incurred, capitalized and expensed, for the periods indicated, was as follows (amounts in thousands):

	Three months ended January 31,	
	2014	2013
Interest capitalized, beginning of period	$343,077	$330,581
Interest incurred	39,944	31,748
Interest expensed to cost of revenues	(25,440)	(19,974)
Write-off against other income	(317)	(88)
Interest capitalized on investments in unconsolidated entities		