

# Toll Brothers, Inc. (NYSE: TOL) - Long Lion Cub Fund Fall 2024

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## Recommendation

Long TOL with a 2 year price target of **\$190** representing a total upside of **25%** and an IRR of **11.8%**.

## Company Overview

Toll Brothers, Inc. is the nation's leading luxury homebuilder, specializing in high-quality, customizable single-family homes, townhomes, and condominiums across affluent and high-growth markets. With over 55 years of experience, the company is known for its premium craftsmanship, strong brand reputation, and diverse portfolio that includes active adult communities and urban properties. Toll Brothers strategically targets affluent buyers, benefiting from a national footprint in desirable suburban and urban areas, a robust order backlog, and the ability to adapt to evolving consumer trends, making it a compelling choice for investors seeking exposure to the luxury real estate market.

## Investment Thesis

- I. *Toll Brothers' target customer base of Millennials and Baby Boomers implies high growth potential in the following years.*
  - uniquely positioned to capitalize on a changing demographic landscape, where Millennials, the largest generational cohort in the U.S., are driving increased demand in the housing market. Since 2020, first-time homebuyers have surged by 20%, with Millennials leading this trend.
  - Millennials are wealthier than previous generations due to higher educational attainment, dual-income households, and a shift in inheritance patterns, but they also prioritize homeownership as a key financial goal.
  - Toll Brothers, with its focus on customizable, high-quality homes, is well-suited to meet Millennial preferences for modern design, smart technology, and sustainable living in desirable suburban and urban locations.
  - The Baby Boomer generation remains a crucial demographic for Toll Brothers. As Boomers enter retirement, many are seeking luxury, low-maintenance homes in amenity-rich communities that support an active lifestyle. Toll Brothers' offerings in the luxury segment, including active adult communities with premium amenities and urban developments, cater to this affluent group looking to downsize without sacrificing quality or lifestyle.

## II. Housing market is expected to be met with deregulation

- Toll Brothers stands to gain significantly from anticipated deregulation in the housing market, particularly through policies aimed at lowering taxes and easing zoning restrictions. Deregulation is expected to reduce property and development-related taxes, directly lowering costs for homebuilders and potentially increasing profitability. These changes will enhance Toll Brothers' ability to acquire and develop land in high-demand areas at a lower cost, allowing them to maintain or expand margins while continuing to offer high-quality, luxury homes.

### Risks

- I. *Mortgage Rate Volatility* - US10YR Yield is currently trending higher even in rate cut environment due to uncertainty with the US deficit. Higher yields could keep mortgage rates higher for longer deterring first time buyers until a lower rate period in the future
- II. *Severe Recession* - A recession where real GDP is down 3-4%, unemployment at 7%+, and stagnant/falling wage growth will strongly deter demand for luxury housing and could lead to financing issues with current residents.
- III. *Tariffs on construction equipment* - Tariffs on imported materials, particularly steel, lumber, and other construction components, pose a risk to Toll Brothers' cost structure. Increased tariffs can lead to higher construction costs, squeezing margins and potentially forcing the company to pass on higher costs to consumers, which could deter demand. Uncertainty around trade policies can also affect material supply chains, potentially delaying construction timelines and increasing project costs.

			2020	2021	2022	2023	Current/LTM	2024e	2025e	2026e
<b>Capitalization</b>		<b>Revenue</b>	<b>7,078</b>	<b>8,790</b>	<b>10,276</b>	<b>9,995</b>	<b>10,533</b>	<b>10,674</b>	<b>11,003</b>	<b>11,735</b>
Share Price (11/21/24)	\$ 152.31	growth %	-2	24.2	16.9	-2.73	-1.44	6.79	3.09	6.65
FDSO	101	<b>Gross Profit</b>	<b>1,418</b>	<b>1,942.90</b>	<b>2,486.38</b>	<b>2,634.20</b>	<b>2,941.71</b>	<b>2,973.33</b>	<b>2,967.51</b>	<b>3,124.44</b>
FCF/ Share	\$ 5.60	growth %	-9.1	37.05	27.97	5.95		12.87	-0.2	5.29
Market Cap	15,338.70	margin %	20	22.1	24.2	26.36	27.93	27.86	26.97	26.62
Net Debt	1,928.80	<b>EBITDA</b>	<b>690</b>	<b>1,142.76</b>	<b>1,640.48</b>	<b>1,854.83</b>	<b>1,952.51</b>	<b>2,252.27</b>	<b>2,136.64</b>	<b>2,225.17</b>
EV	17,410.90	growth %	-13.2	65.61	43.55	13.07		21.43	-5.13	4.14
<b>Target Price</b>	<b>\$ 190.00</b>	margin %	9.7	13	15.96	18.56	18.54	21.1	19.42	18.96
<b>Multiples</b>		<b>Net Income</b>	<b>491</b>	<b>882.41</b>	<b>1,312.37</b>	<b>1,396.33</b>	<b>1,452.14</b>	<b>1,541.35</b>	<b>1,463.26</b>	<b>1,533.60</b>
EV/EBITDA	7.76x	growth %	-28.4	86.65	54.33	6.65		10.39	-5.07	4.81
P/E	11.2	margin %	6.9	10.04	12.77	13.97	13.79	14.44	13.3	13.07
		<b>EPS</b>	<b>3.4</b>	<b>6.63</b>	<b>10.9</b>	<b>12.36</b>	<b>13.67</b>	<b>14.73</b>	<b>14.59</b>	<b>15.91</b>
2 Year IRR Target	11.80%	growth %	-12.3	87.82	58.45	13.12	-3.9	19.14	-0.93	9.02

### **Valuation**

- Base case P/E Exit multiple of 12x, up marginally from 11.2x today
- Freddie Mac project 30 Year Fixed Mortgage Rates to be at least 6% end of 25'. With this in mind we calculated average yearly payment on Toll Brothers' homes to fall 5% if home prices rise forecasted 3%. If prices fall, yearly payments will be even lower.
- 10% increase in P/E is conservative estimate due to anticipated 20% increase in new home buyers and attractive falling monthly mortgage payments.