TOL: 'Glimmers of Hope'

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Updated from Feb. 26 with earnings results

Toll Brothers (TOL) traded lower early in the session but seemed to catch a bid on the OFHEO cap removal.

Robert Toll, who is normally open, honest and ebullient, was rather somber in his assessment of the markets. At the same time, he did offer some "glimmers of hope" from some of the markets that were first to head south.

I think that the turn in the housing market, if it is to come, will become evident in the March-June period, which is peak selling season. Until then, I think that any capital committed to the group is speculative, and tight stops should be used.

Earnings Release and Conference Call

Toll Brothers reported a first-quarter loss of 61 cents per share on revenue of $843 million. Included in these results were pre-tax writedowns of $246 million for land impairments. On an after-tax basis, these impairments were a net charge of 93 cents to earnings. Excluding the impairments, TOL would have earned 35 cents. Excluding writedowns, TOL earned 72 cents in the year-ago period.

There were 904 new-home contracts (-38% YOY) signed during the quarter, for a delivery value of $573 million (-46% YOY). TOL incurred 257 cancellations totaling $198 million of contracts vs. 436 cancellations for $319 million a year ago. ASPs for contracts signed were $634,000, vs. $646,000 a year ago with the decline attributed to product mix.

Robert Toll categorized the selling season beginning in mid-January as weak for the third consecutive year. He sees "few glimmers of hope." However, there is improvement in Naples, Fla., where through late 2007 he said you could not give a home away. In metro Washington, D.C. there was a glimmer of hope, which faded in the past but perhaps it will not this time around.

Cost of sales was 74.6% vs. 71.1% in the year-ago quarter and 73.7% in the sequential quarter. The rise in costs was attributed to product mix and incentives. Interest expense rose 30 basis points sequentially due to lower inventory turns. SG&A was 14.4% of revenue vs. 12.3% in the first quarter of 2007.

For the full year, TOL expects deliveries of 3,900 to 5,100 units with an ASP of between $630,000 and $650,000. ASPs are expected to decline sequentially over the course of the year from quarter to quarter. Cost of sales before factoring in writedowns will be higher in fiscal year 2008 vs. fiscal year 2007, and may increase as the year progresses.

TOL ended the quarter with more than $950 million in cash and over $1.2 billion in available bank lines of credit. The Q&A session offered no insight

Preview

Toll Brothers (TOL) is scheduled to report first-quarter 2008 results before the market opens on Wednesday.

The luxury homebuilder is expected to lose 44 cents a share on net revenue of $818.2 million. A year ago, TOL earned 33 cents on net revenue of $1.09 billion. Once again, we can expect the source of the loss to be traced back to land impairments, contract cancellations and sales incentives.

Shares of TOL and its peers seemed to have found a base and have begun to trade higher. Whether this is a dead cat bounce or is indicative of the beginning of an upturn for the sector is yet to be determined. Certainly, **FOMC** rate cuts have played a part in the sector's rise.

TOL has been diversifying into high-rise condos the past few years, and I will be interested to see how that segment of the homebuilding business has fared, especially as those efforts are centered in geographies which have been somewhat less impacted by the housing debacle in Florida, California, Nevada, Michigan and Ohio. As always, I will be keen to hear Robert Toll's rundown through the roll call of TOL's geographic score card and Joel Rassman's financial summary.

Overall, I maintain a wait-and-see approach to the domestic homebuilders.

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At the time of publication, Rothbort had no positions in stocks mentioned.

Scott Rothbort has over 20 years of experience in the financial services industry. In 2002, Rothbort founded LakeView Asset Management, LLC, a registered investment advisor based in Millburn, N.J., which offers customized individually managed separate accounts, including proprietary long/short strategies to its high net worth clientele.

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