Management's Prepared Remarks
Fourth Quarter and Year-End Conference Call
February 26, 2019

Tabitha Zane
Vice President, Investor Relations

On the call today are Jerry Volas, Chief Executive Officer, Robert Buck, President and Chief Operating Officer, and John Peterson, Chief Financial Officer. Please note, we have posted senior management's formal remarks on the Investor Relations section of our website at topbuild.com.

Many of our remarks will include forward-looking statements concerning the company's operations and financial condition. These forward-looking statements include known and unknown risks, including those set forth in this morning's press release as well as in the Company's filings with the SEC. The Company assumes no obligation to update or supplement forward looking statements that become untrue because of subsequent events.

In addition, we will also discuss non-GAAP financial measures which can be reconciled to the most comparable GAAP measures in a table included in today's press release.

Jerry Volas
Chief Executive Officer

We finished 2018 with a strong fourth quarter, completing another outstanding year for TopBuild. Our strategy, diversified business model and execution again delivered on our objective of achieving profitable growth.

Before discussing our financial results, I'd like to provide an update of our current view of the U.S. housing industry. On our November call, I talked about consumer affordability issues potentially causing a short term pause within the context of an otherwise strong environment for new home construction.

Since then, the Fed has moderated their view on future interest rate increases, mortgage rates have come down from fourth quarter highs and the stock market has rebounded from an overall negative sentiment that significantly impacted valuations. In addition, our builder customers, as they always do, are adjusting their strategies to provide homes that consumers want and can afford. All of these developments are positive for new residential home construction. As an additional overall positive, the general economy remains strong with solid wage and job growth.

While we still believe there could be a short term pause in the near term, all of the factors I just mentioned appear to preclude an escalation of consumer affordability issues.

Looking ahead, we continue to believe that supply and demand fundamentals will eventually drive housing starts towards the historical average of 1.4 to 1.5 million per year. Inventory is low, household formations are increasing and we believe pent-up demand is growing. The next quarter or two will certainly inform the magnitude of any potential 2019 pause. Whatever shape that takes, our diversified business model that includes installation and distribution in both the residential and commercial markets, and a core competency around acquisition selection and integration, offers multiple avenues for growth and gives us the ability to perform well in any environment.

Although John will get into further detail regarding our fourth quarter and full year 2018 financial results, let me discuss a few of the overall trends.

Within the context of 90 day lagged housing starts which were up 5.3% for the year, our total 2018 revenue increased 25.1%, with same branch up 8.5% and acquisitions contributing 16.6%. We view this as outstanding top line performance, driving share in our existing branches, and expanding our footprint aggressively through acquisitions.

At the gross profit line, fourth quarter 2018 improved 40 basis points over fourth quarter 2017 and total year 2018 was flat at 24.2%. By far, the single most significant factor was our ability to successfully offset unprecedented material cost increases with higher sales pricing. Given our expansive geographic footprint and customer base, achieving this delicate balance between price and volume has been a monumental effort by our operators across the country, and they have done an outstanding job. It also reflects positively on the quality of our partnerships with both our suppliers and customers.

Adjusted operating income and adjusted EBITDA margins expanded both for the fourth quarter and the full year. The incremental EBITDA margin, a key metric for us, was strong in the fourth quarter and finished the total year at 17.9%, 25.1% same branch and 14.3% for acquisitions. Our consistent culture of operational improvement and the leveraging of fixed costs across the Company are the key drivers of this excellent result. Beyond that, our core competency around integrating acquisitions has produced excellent returns on the capital we are spending on our number one capital allocation priority.

Looking back on 2018, other significant accomplishments include:

- Closing and integrating three acquisitions, including USI, that are expected to generate over $410 million in annual revenue, with significant synergies driving margin results

- Completing a $400 million bond offering at 5.625%

- Returning $65 million of capital to our shareholders through a share repurchase program, and

- Winning the 2018 ENERGY STAR Partner of the Year for our continued leadership in protecting the environment through superior energy efficiency achievements. TopBuild Home Services has been an ENERGY STAR partner for 16 years by working closely with home builders and consumers to create homes that are more comfortable and energy efficient.

As we look to 2019, we are optimistic that it will be another year of profitable growth for TopBuild. The housing market, even if there is a short-term pause, will eventually regain momentum due to strong supply and demand fundamentals. Our enhanced size and scale facilitate strong supplier partnerships and contribute to the outstanding value proposition we provide our customers. We will continue to drive operational efficiencies, improve sales and labor productivity and leverage our cost base with higher revenue to further improve margins.

Capital allocation remains an important component of our shareholder value creation strategy, with acquisitions being our number one priority. Our pipeline is robust with a primary focus on profitable companies within our two core businesses. As a reminder, we seek well managed companies with solid customer bases that expand our market share in high growth regions.

Cash, beyond what is required to fund internal growth and acquisitions, will be returned to our shareholders through our newly authorized $200 million share repurchase program.

John Peterson
Chief Financial Officer

We finished with a strong 4th quarter which closed out a solid 2018 for TopBuild. I'll start by discussing our fourth quarter results, then provide an overview of full year 2018.

In the fourth quarter, consolidated revenue increased 27.6% to $639.5 million, driven by $105.7 million of revenue from companies acquired since January 2018, as well as improved selling prices. On a same branch basis, revenue increased 6.5% compared to fourth quarter 2017.

Gross margin expanded 40 basis points to 24.7%, compared to the same period a year ago, demonstrating, once again, our ability to recover material cost increases through selling price increases and operational efficiencies. Adjusted operating profit grew 32.1% to $67.2 million, with a corresponding margin improvement of 40 basis points. Both gross margin and operating margin improvements were driven by higher selling prices, improved labor and sales productivity, and USI synergies; partially offset by higher material costs, higher amortization expenses and higher share-based compensation costs. Fourth quarter 2018 adjustments totaled approximately $2 million, primarily tied to the integration of USI.

Fourth quarter adjusted EBITDA was $82.5 million, compared to $57.9 million in 2017, and our EBITDA margin was 12.9%, a 130-basis point improvement from fourth quarter 2017.

Our drop-down to adjusted EBITDA margin was 17.8% in the fourth quarter. On a same branch basis, adjusted EBITDA was $65.3 million and our drop-down to adjusted EBITDA was 22.5%, driven by improved selling prices, USI synergies, strong cost control and continued leveraging of our platform; partially offset by higher material costs. Incremental EBITDA related to our three acquisitions was 16.3%.

Looking at our full-year results, total sales increased 25.1% to $2,384 million, principally driven by the three acquisitions we completed in 2018 along with volume growth and increased selling prices. On a same branch basis, revenue increased 8.5% to $2,068 million. USI, which we acquired last May, contributed $266.3 million to our top line. In addition, EBITDA margin from acquisitions was 14.3%, of which USI was the largest contributor.

Adjusted gross margin was flat at 24.2% as there was a delay in recovering 1st half 2018 material cost increases. The second half of 2018 saw gross margin expansion offsetting the margin compression we saw in 1st half. As Jerry pointed out, our operations teams did a great job of successfully navigating three material cost increases during the year.

Our adjusted operating margin expanded 80 basis points to 9.8%. Adjusted EBITDA for 2018 grew 43.4% to $283.4 million, and our EBITDA margin improved 150 basis points to 11.9%. Our drop-down to adjusted EBITDA margin for 2018 was 17.9% and 25.1% on a same branch basis.

Adjusted net income for the fourth quarter of 2018 was $42.2 million, or $1.20 per diluted share compared to $30.1 million, or $0.84 per diluted share in the fourth quarter of 2017. Adjusted net income for full year 2018 was $149.3 million, or $4.19 per diluted share, compared to $101.8 million, or $2.78 per diluted share for full year 2017.

Interest expense in 2018 increased from $20.7 million to $28.7 million, primarily related to the funding of the USI acquisition which included the issuance of $400 million Senior Notes and our borrowing of the $100 million delayed draw term loan.

CAPEX for full year 2018 was $52.5 million, approximately 2.2% of revenue. During the year we issued $26.6 million of equipment notes to fund our fleet acquisitions.

Working capital as a percent of proforma trailing twelve-month sales was 10.4%, 130 basis points higher than prior year. The biggest driver behind the increase is that USI had a higher mix of installation versus distribution business, and the installation business comes with higher working capital requirements. We've updated our long-term outlook range for year-end working capital from the previous guidance of 10% to the revised guidance of 10% to 11% of revenue.

In 2018, our effective tax rate finished at 25.5%, primarily due to a one-time beneficial adjustment in 2017 of our deferred tax assets and liabilities to reflect the change in the federal tax rate.

Operating cash flow was $167.2 million for the year. We ended 2018 with net leverage of 2.19X using pro-forma EBITDA, well within our comfort zone of 2 to 2.5 times. Total liquidity at year end was $291.6 million, inclusive of the available balance on the revolver of $190.7 million and cash of $100.9 million.

Moving to 2019 annual guidance, we are projecting total revenue to be between $2,570 million and $2,635 million and adjusted EBITDA to be between $310 million and $330 million. This guidance assumes a range of residential new housing starts of between 1.26 million and 1.3 million. It does not include any acquisitions we may make this year. We have changed three of our long-term modeling assumptions, including working capital, which I already mentioned. The other two are a change to our normalized tax rate which we now project in a range of 26% to 27% instead of a flat rate of 27%, and our estimate of residential revenue TopBuild will generate for every 50,000 increase in Residential starts, which has increased from $75 million to $80 million.

Robert Buck
President and Chief Operating Officer
Before discussing TruTeam and Service Partners' financial results, I want to thank our employees for their hard work, dedication and ongoing push for operational excellence throughout 2018…what a great year and I could not be prouder of our entire TopBuild Team.

While continuing to work safely and provide outstanding service to our customers, we successfully managed the acquisition, financing and integration of three companies, including USI which had 38 branches and over 1,000 installers. In addition, our local teams achieved selling price increases which more than offset an unprecedented three material cost increases over the 12-month period. 2018's strong financial performance clearly demonstrates the effectiveness of our energized, very engaged and diverse team of 10,000 plus individuals.

Looking at TruTeam's results, fourth quarter sales increased 36.1%, with USI contributing over 74% of that growth. This acquisition continues to perform exceptionally well. On a same branch basis, TruTeam sales were up 8.9% in the quarter, driven by a 5.9% increase in selling prices and 3% volume growth. For the full year, TruTeam's same branch sales were up 10.1%, with volume driving 5.9% of that growth, outpacing lagged housing starts of 5.3%.

Shifting to TruTeam's adjusted operating margin, we saw a 20-basis point decline in the fourth quarter to 12.5%. Primary drivers were the absorption of acquisition fixed costs, mainly from USI, higher amortization expenses and timing adjustments on insurance accruals versus 2017. On a full year basis, TruTeam's adjusted operating margin expanded 80 basis points driven by volume leverage, higher selling prices and operational efficiencies; partially offset by higher material costs and USI fixed costs as well as higher amortization expenses. Overall, great operational execution by TruTeam's leadership and everyone in the field.

Our TruTeam branches also continue to grow their spray foam business which is benefitting from increased fiberglass costs, new building codes and consumer education. For the full year, spray foam sales increased almost 39%, 16.5% on a same branch basis.

Turning to Service Partners, in the fourth quarter total sales grew 10.7%, led by selling price increases of 7.9% and acquisitions, notably USI and ADO Products; partially offset by a volume decrease of 5.3%. The volume decline was driven by deliberate price volume decisions and the decision to exit some low margin business.

As a result of these decisions, Service Partner's fourth quarter adjusted operating margin expanded 80 basis points to a robust 10.1% driven by improved selling prices and strong cost controls, partially offset by higher material costs and the absorption of acquisition fixed costs and deal amortization expenses.

For the full year, Service Partners sales were up 14.0% driven by higher selling prices and acquisitions, while volume was flat. Adjusted operating margin was 9.6%, flat versus a year ago primarily due to the timing of material cost increases and the delayed recovery of selling prices throughout the year. Distribution revenue from spray foam increased 32% in 2018, and 21% on a same branch basis.

I do want to briefly discuss material. Fiberglass remains tight with manufacturers keeping a firm rein on supply. It is still too early to tell the traction of the January price increase, but we do believe if there are additional material cost increases this year, they will be highly dependent on industry demand and housing starts.

Turning to USI, with the exception of our branch optimization effort, which we expect to finalize by late June, the integration is essentially complete and, as you can see from our results, USI's performance has been outstanding. Our integration team did a great job and we are highly confident we will exceed $15 million of cost-savings synergies within two years of close. USI has been a great addition to our company.

Our total commercial business grew 28.1% for full year 2018, and 11.8% on a same branch basis, exceeding our long-term target of 10% annual growth. We continue to drive improvements in this business and it remains an important avenue for growth. Our commercial backlog is strong and our bundled services approach is giving us a competitive advantage.

In summary, 2018 was a year of solid execution. Our disciplined cadence for how we run the business and our focus on improving or shutting down under-performing branches has proven to be a successful strategy. We have built competencies in new products and services, as well as acquisition selection and integration. We have also been focused on continuing to build our talented team and developing our bench strength.

This year, an important strategic initiative we are undertaking is a deep dive review of adjacent product offerings that will provide value to our existing customers and enhance our relationships with certain supplier partners. One potential area of expansion, which we've mentioned in the past, is glass and windows, a product line we expanded into through the USI acquisition. There are other adjacent businesses we are evaluating as well. However, be assured we will be very deliberate in our approach, putting scale, talent and synergies at the top of our criteria list.

As I mentioned last quarter, I am constantly in the field working directly with our customers and suppliers. Builders seem increasingly optimistic that 2019 will be a good year. We are encouraged by our start to 2019 and are pleased to see our customers moving to build more entry level homes that families want and can afford.

Even if there is a short pause in housing starts, TopBuild's model supports profitable growth from a number of vantage points with a continued focus on:

Driving operational improvements through best in class execution;
Growing our heavy and light commercial businesses;
Expanding into adjacent product areas; and
Increasing market share organically and through acquisitions.

Our track record over the past few years of expanding adjusted operating and EBITDA margins speaks to our success and our ability to identify and integrate strategic acquisitions is a distinct competitive advantage. We believe 2019 will be another solid year for TopBuild and we look forward to once again delivering strong bottom line results for our shareholders.

Jerry Volas
Chief Executive Officer
Before opening it up to questions, I want to again emphasize that we look forward to 2019 as another year of profitable growth. The external environment is positive, our strong and diversified business model has produced excellent results, and our team executes well.