Management's Prepared Remarks
Fourth Quarter and Full Year 2019 Conference Call
February 25, 2020

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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. 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.

Please note that, other than as otherwise specifically stated, the financial measures to be discussed on this call will be on a non-GAAP basis. The non-GAAP measures are not intended to be considered in isolation or as a substitute for results prepared in accordance with GAAP. We have provided a reconciliation of these financial measures to the most comparable GAAP measures in a table included in today's press release and in the presentation accompanying this call.

Jerry Volas
Chief Executive Officer
Good morning everyone, and thanks for joining us today. We were pleased to end the year with a strong fourth quarter, with solid top line growth and operating margin expansion at both business segments. For full-year 2019, we again demonstrated the strength of our diversified business model and our seasoned management team as we delivered on our objective of achieving profitable growth.

In 2019, the U.S. housing industry grew stronger as the year progressed, culminating in a 19.6% increase in starts in the fourth quarter. Our expectation that new residential construction will continue to strengthen in 2020 is based on several factors:

Consumer affordability keeps improving as:

- Mortgage rates remain low
- Wage growth is offsetting home price appreciation and
- Builders have pivoted towards supplying more entry level homes

In addition, household formations continue to be strong. Many people who delayed home ownership are beginning to engage, fueling pent-up demand. We are also seeing limited inventory, reflecting the slow ramp from the housing bust.

All in all, an excellent operating environment for TopBuild and our 2020 annual guidance reflects our optimism.

While John will discuss our financial results in detail, I want to start with a discussion of a few of the overall trends.

Within the context of 90-day lagged housing starts, which were down 2.3% for the year, our 2019 net sales increased 10.1%, with same branch sales increasing 4.6%. Our commercial business again performed extremely well, with same branch revenue in the fourth quarter and full year growing 11.4% and 18.6%, respectively.

Our operating and EBITDA margin expansion are the result of our consistent focus on:

- Identifying and implementing operational efficiencies,
- Realizing synergies from the USI acquisition,
- Balancing selling price and input costs and
- Leveraging our national footprint and fixed costs across the Company.

All play a role in driving our bottom line, leading to adjusted EPS increasing 31% to $5.49.

While Robert will talk about our commercial business plans and outlook in more detail, it is clear from our results over the past few years that our bundled solutions approach for general contractors continues to gain traction. This business now represents approximately 23% of our sales, up from 16% in 2015, and we now have an 11% market share compared to just 6% a few years ago. In addition, our commercial business is an important aspect of our uniquely diversified business model, as it helps to mitigate any cyclicality of the residential new construction market. This was clearly demonstrated in the first half of 2019 when lagged starts were down almost 7% and our commercial business grew over 23%.

Turning to capital allocation, after pausing acquisitions to focus on the integration of USI, we completed one acquisition in 2019, Viking Insulation, based in Burbank, California. More recently, in the just the last week, we have closed two acquisitions, Hunter Insulation and Cooper Glass. Furthermore, based on our strong prospect pipeline we expect to close on additional acquisitions this year. And, having developed a core competency integrating acquisitions onto our systems and supply chain, we expect to drive meaningful synergies quickly from these deals.

As a reminder, our primary focus remains on core insulation companies, though we continue to evaluate a number of glass companies that would fit well with our existing $160 million business in this product adjacency. As noted on our last call, we believe this product category offers many attractive characteristics similar to insulation. While expansion in this area will be independent of our branch insulation network, we will be able to leverage our management expertise, customer relationships and supply chain model.

Also, on the capital allocation front, in 2019 we purchased 1.3 million shares of our common stock for approximately $111 million. This includes the $50 million accelerated share repurchase announced on our last call that should be completed no later than the end of this quarter. Our share repurchase program reflects the confidence of both management and our board in the long-term potential of TopBuild, our strong future cash flow position and our firm commitment to optimizing the efficiency of our capital structure.

John Peterson
Chief Financial Officer

As Jerry noted, we finished with a strong fourth quarter which closed out a solid 2019 for TopBuild.

I'll start by discussing our fourth quarter results, with comparisons to fourth quarter 2018, then provide an overview of full year 2019.

In the fourth quarter, net sales increased 3.6% to $662 million, primarily driven by improved selling prices and volume increases in both Residential and Commercial; partially offset by a higher mix of multi-family work and an increase in entry level homes which generate lower revenue per unit.

Gross margin expanded 120 basis points to 25.9%, and adjusted operating profit grew 14.1% to $76.6 million, with a corresponding margin improvement of 110 basis points. Both gross margin and operating margin improvements were driven by higher selling prices, improved labor and sales productivity and synergies from USI; partially offset by higher material costs. Fourth quarter 2019 adjustments were nominal at just under $200,000, primarily tied to acquisition related expenses.

Fourth quarter adjusted EBITDA was $92.5 million, compared to $82.5 million, and our adjusted EBITDA margin was 14.0%, a 110-basis point improvement.

Our drop-down to adjusted EBITDA margin was 44.0% in the fourth quarter, driven by improved selling prices, higher volume, strong cost controls, synergies from USI and continued leveraging of our platform; partially offset by higher material costs.

Adjusted net income for the fourth quarter of 2019 was $50.0 million, or $1.48 per diluted share, compared to $42.2 million, or $1.20 per diluted share, in the fourth quarter of 2018.

Looking at our full-year results, total sales increased 10.1% to $2,624 million, principally driven by our USI acquisition, completed in May 2018, increased selling prices and higher volume.

Gross margin expanded 180 basis points to 26.0%, primarily due to increased selling prices, synergies from the USI acquisition, higher sales growth in our installation segment and operational efficiencies, partially offset by higher material costs. Adjusted operating profit improved 25.8% to $292.7 million with a corresponding margin improvement of 140 basis points to 11.2%. Full-year 2019 adjustments totaled $3.2 million including rationalization charges and acquisition related expenses, the majority tied to the USI acquisition

Adjusted EBITDA grew 26.7% to $359.1 million, and our adjusted EBITDA margin improved 180 basis points to 13.7%. Our drop-down to adjusted EBITDA margin for 2019 was 31.6%, 46.1% on a same branch basis.

Adjusted net income for full year 2019 was $188.9 million, or $5.49 per diluted share, compared to $149.3 million, or $4.19 per diluted share for full year 2018.

Interest expense in 2019 increased from $28.7 million to $37.8 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 2019 was $45.5 million, approximately 1.7% of revenue. During the year we issued $15.0 million of equipment notes to help fund our fleet acquisitions.

Working capital as a percent of trailing twelve-month sales was 10.3%, 10 basis points lower than prior year. A reduction in inventory was partially offset by an increase in accounts receivable days-sales-outstanding driven by the continued growth in our Commercial business.

Our effective tax rate decreased from 25.5% in 2018 to 24.7% in 2019, primarily due to an increased benefit from share-based compensation, partially offset by an increase in state and local taxes. For 2020, we expect our normalized tax rate to be 26%, which is higher than our 2019 effective tax rate, since the 2020 normalized rate assumes no benefit from share-based compensation.

Operating cash flow was $271.8 million for the year. Total liquidity at year end was $373.4 million, inclusive of the available balance on the revolver of $188.6 million and cash of $184.8 million. Net leverage at year end was 1.54X.

Moving to 2020 annual guidance, we are projecting total sales to be between $2,765 million and $2,835 million and adjusted EBITDA to be between $387 million and $412 million. This assumes a range of residential new housing starts of between 1.30 million and 1.34 million. It also includes the two acquisitions, Hunter Insulation and Cooper Glass, which we acquired this month, but no additional acquisitions we may make this year.

We've also provided our long-range modeling targets for a number of metrics, most of which are unchanged from when we last provided them to you a year ago. The range for working capital remains at 10% to 11% of trailing twelve-month sales. The range for same branch incremental EBITDA is 22% to 27% and 11% to 16% for acquisitions, also unchanged. We still project $80 million of revenue for every 50,000 increase in residential housing starts and our commercial sales growth to average 10% annually. We have lowered our normalized tax rate to 26% from the previous target of 26.5%. Finally, we now project CapEx at 2% of sales, compared to the previous guidance of 2% to 2.5%.

Building on these metrics, here is what TopBuild could hypothetically look like at 1.4 million starts. Starting at 1.32 million starts, the midpoint of our 2020 guidance, and increasing starts by 40,000 each year through 2022, we project just over $3 billion in annual revenue and EBITDA around $460 million, delivering a 15% EBITDA margin. Acquisitions would bolster these numbers and we expect considerable activity in this area over the next three years.

Robert Buck
President and Chief Operating Officer
Before discussing TruTeam and Service Partners' financial results, I want to thank our entire TopBuild Team for their hard work, dedication and ongoing push for operational excellence throughout 2019. Everyone's efforts delivered another great year for our Company.

Looking at TruTeam's results, fourth quarter sales grew 4.0%, beating lagged housing starts. Contributing to this increase were selling price, volume growth in both residential and commercial and contributions from acquisitions. Our solid results were offset, to some extent, on the residential side as a result of a higher mix of multi-family work and the move by production builders to more entry level homes which have a smaller footprint resulting in a lower take per unit. For the full year, TruTeam's sales were up 13.4%, 6.3% on a same branch basis, again beating lagged housing starts which declined 2.3% for full year 2019.

Shifting to TruTeam's adjusted operating margin, we saw a 90-basis point increase in the fourth quarter to 13.4% and a 150-basis point increase for the full year to 13.3%. Primary drivers were increased selling price, increased sales volume, operational efficiencies and synergies from the USI acquisition, partially offset by higher material costs. Since 2015, our first year as a public company, TruTeam's full-year adjusted operating margin has expanded 820 basis points, a testament to great operational execution by TruTeam's leadership and our team in the field.

Turning to Service Partners, in the fourth quarter total sales grew 4.3%, led by selling price increases of 2.3% and volume growth of 2.0%. For the full year, Service Partners sales were up 5.1%, driven by higher selling prices and a small contribution from acquisitions, offset by a slight 0.8% volume decline.

You may recall that in the fourth quarter of 2018 we walked away from some low margin business which our team has been working hard to replace. Sales volume did increase in the fourth quarter and we expect volumes to continue to grow in 2020.

Partially as a result of the exiting of that low margin business in 2018, Service Partner's adjusted operating margin expanded, up 120 basis points in the fourth quarter to 11.3% and up 90 basis points for the full year to 10.5%. Adjusted operating margin also benefitted from strong cost control, increased selling prices and operational efficiencies, partially offset by increased material costs.

I know one top of mind issue for many is material pricing and industry capacity. The manufacturers announced a cost increase effective late January, and while it is still early in the year, based on recent housing starts and the optimism we are hearing in the field from our builder customers, the increase will likely have some traction. Capacity could also tighten, assuming housing starts continue to improve. However, we don't expect a situation akin to 2018 where we saw loose-fill material on allocation. Additional batt capacity has come on line since 2018 and additional loose fill capacity is expected to be on line by the end of this year and the first quarter of 2021. We are confident in our supply chain and our ability to successfully pass through material cost increases, as we've previously demonstrated. Just a reminder, labor will remain at a premium in this rising housing environment.

One of our strongest growth areas is our commercial business. Sales grew 24.0% for the full year, 18.6% on a same branch basis. On the heavy commercial side, we plan to greenfield more locations this year, which will bring our heavy commercial presence to more than 22 locations. Recent projects we've been awarded include 2 Penn Plaza in New York City and the George Lucas Museum in LA. We also continue to seek heavy commercial acquisitions which will expand our market presence and the types of insulation services we can offer to our general contractors. This bundled services approach has given us a distinct competitive advantage, growing our market share of this $5.5 billion industry from 6% just a few years ago to 11% today.

Looking ahead, we are extremely excited about our prospects for our commercial business. We have a robust pipeline of potential activity and are already bidding jobs well into 2022. I will remind everyone that commercial revenue can fluctuate quarterly, especially for heavy commercial projects, as was evident in 2018 when sales started out slow in the first half of the year but increased in the back half of the year.

As Jerry mentioned, we completed two acquisitions this month, Hunter Insulation and Cooper Glass. Hunter is a residential insulation company that has been serving the Long Island market for over 80 years and we are pleased to have the talented team at Hunter join our TruTeam business. Hunter installs both fiberglass and spray foam and generates approximately $10 million in revenue. This is a great addition for TruTeam, increasing our market share in this high growth region and providing strong synergies as the company moves to our supply chain.

Cooper Glass, which specializes in commercial storefront glass, is our first dedicated acquisition in this adjacent product category, where we already generate approximately $150 million of annual revenue. Cooper, which will contribute approximately $9 million in annual revenue, has been servicing the Memphis market for 28 years and we are happy to have the Cooper team join our company. We are excited about the prospects of the glass business and expect to grow our footprint and market share through strategic acquisitions.

Before turning the call back to Jerry, I want to talk about one area of our operations that gets little attention publicly but is at the heart of our Company. Safety. Putting the safety of our people first is a core value and it guides everything we do at TopBuild. We believe safety is a lifestyle both at work and at home, not just a program or initiative. We strive for a Zero-Accident Safety environment at all of our nearly 300 branches as well as at our Daytona Branch Support Center. Safety training at each branch is conducted monthly and we ask our employees to sign a Safety Pledge, where they promise to never sacrifice or compromise safety to perform a job and to report immediately any unsafe conditions to their supervisors. Our employees visit over 15,000 job sites every day and we want them to return home safely to their families every night. In fact, a percentage of management's annual bonus is tied to our safety metrics.

As we look out to 2020, we will begin to benefit from the substantial ramp-up in starts as the year progresses. We are further encouraged by our extensive conversations with builders who are reporting solid demand. We are growing our market share organically and through acquisitions and expect to see continued margin expansion at both TruTeam and Service Partners. Our team is energized and we look forward to once again delivering strong bottom line results for our shareholders. All in all, it should be another great year for TopBuild.

Jerry Volas
Chief Executive Officer
Before opening up the call for questions, I want to briefly mention the announcement we made in January regarding my retirement at the end of the year. Launching TopBuild as a public company in mid-2015 and driving outstanding financial results and shareholder value over the subsequent four years has certainly been a highlight of my business career. But it's important to understand that this track record of performance comes from the efforts of a broad team beginning with Robert and John, extending to those here in Daytona at the Branch Support Center and, most importantly, in the field with our locally empowered branch management.

The Board's selection of Robert as my successor was a thoughtful decision at the end of an organized process over the last couple of years. Robert and I have worked closely developing the Company's strategy and, as COO, Robert has executed this strategy throughout our national footprint. He has more than ten years of experience with our business model and you can expect the same focus on profitable growth to continue under his leadership.

In closing, 2020 should be another year of profitable growth for TopBuild. With a macro environment of strong residential housing starts and commercial activity, we will continue to focus on growing market share organically and through acquisitions. Our culture of cost control and operational improvement will translate that top line growth into further margin improvement.