Management's Prepared Remarks
Third Quarter 2020 Conference Call
November 3, 2020

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. 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 are pleased to report another strong quarter as the TopBuild team continues to perform very well in this environment.

Despite the ongoing negative impact of COVID-19 on the overall economy, the housing industry remains a positive story. Our builder customers are reporting very strong traffic and record order growth. In his October Homebuilder Analysis and Forecast Report, John Burns cited the environment as the "Strongest Current Housing Market Conditions Ever," and one of our builder customers on their third quarter conference call a few weeks ago stated that "demand is through the roof."

We recognize that part of this trend is driven by COVID-19 impacts such as:

- Buyers looking to escape dense urban environments
- Work from home policies driving demand for more space, and
- Active adults seeking to avoid senior residential facilities.

And while all of this is currently having a positive impact on our industry, the long-term fundamentals of the housing industry also continue to remain strong. Most notably:

- Historically low interest rates
- Increasing household formations, and
- Very low inventory

These short and long-term factors are translating into strong housing starts and our expectation is that this will continue, and we will benefit from this growth. We acknowledge that labor and material will likely be gating factors, elongating the build cycle which we did see in the third quarter, but our team has demonstrated its expertise in navigating these waters as Robert will discuss in a few minutes.

Our third quarter results again reflect the strength of our diversified model and the ability of the TopBuild team to perform well at all points in any cycle. Net sales increased 2.2% to $697.2 million, despite delays in some of our commercial projects due to social distancing protocols. We are particularly pleased with the expansion of our adjusted operating and EBITDA margins by 280 basis points and 270 basis points, respectively, which drove adjusted net income to $2.10 per diluted share, an increase of 37.3% over the same quarter last year.

Regarding capital allocation, our acquisition team is back to executing on our top priority as we closed Garland Insulating on October 1st. Garland was one of the largest locally owned and operated insulation companies in Texas having built a strong reputation through 70 years of outstanding customer service. We are very pleased to have this company and their excellent management team as part of the TopBuild organization.

Looking ahead, our pipeline is filled with outstanding potential partners, several of which we expect to join us over the next few quarters. In addition to acquisitions, we returned capital to our shareholders through the repurchase of almost 58,000 shares at an average price of $155.63 per share.

Before turning the call over to Robert, I want to remind you that this will be my last analyst conference call as I will be retiring as CEO and member of the Board effective December 31. I am very proud of what TopBuild has accomplished since becoming a public company on July 1, 2015, the result of a well-timed spin off from Masco, our previous parent company. We have significantly increased our national scale with 14 acquisitions and have demonstrated the strength of our diversified business model with both installation and distribution serving the residential and commercial markets. A culture built around safety, operational improvement and customer service have become fully ingrained in everything we do every day. As a result, we have performed well in many different economic environments and have increased our market cap from approximately $1 billion to over $5 billion today. In fact, on Friday we were pleased to learn that TopBuild placed 47th on *Fortune* Magazine's list of the 100 fastest growing companies in the world.

Most exceptional is the team that will be taking TopBuild forward. Robert Buck will be assuming the role of CEO and Director. Since the spin, Robert has been the COO and primary architect of the numerous operational improvements that have driven our outstanding financial results. Having worked closely with Robert for many years at different stops throughout our careers, I am fully confident that Robert will be an outstanding CEO and drive further value. Surrounding Robert will be not only John and Tabitha, who you know well from their investor related activities, but also many other excellent professionals in all areas of the Company. TopBuild is in very good hands.

Robert Buck
President and Chief Operating Officer
To echo Jerry's remarks, TopBuild is performing very well. Our quarterly and nine-month results demonstrate our team's success in continuing to drive solid financial performance and focus on operational excellence.

Starting with TruTeam's third quarter financial results, sales fell 1.2%, primarily driven by a decline in the volume of our commercial business, partially offset by increased selling prices of 1.2% and acquisitions which contributed 1%. Despite this drop in commercial revenue, TruTeam's adjusted operating margin expanded a robust 300 basis points to 17% in the third quarter and improved 170 basis points to 15% for the first nine months of the year. This is a direct result of our continued focus on improving labor and sales productivity and implementing operational efficiencies throughout the business. Residential housing starts continue to climb, which I will discuss further in a few minutes. We are very excited about the overall environment for our TruTeam business.

Service Partners' third quarter sales were up a strong 10.5%, driven by a 12.2% increase in volume partially offset by a 1.7% decline in selling prices as a result of cost reductions in two commodity products: gutter coil and spray foam.

As you know, we made some important decisions and changes at Service Partners over the past two years, including stepping away from some low margin business and focusing on our mix of customers and products offered. We also made some key leadership changes and now have a very entrepreneurial and forward-focused team. We are seeing the benefits of these moves as evidenced by our strong volume growth and our adjusted operating margin, which was 13.4% in the third quarter, a 280 basis point improvement, and 12.5% for the first nine months, a 200 basis point improvement. We are excited about the prospects for continued growth of the Service Partners business.

As we look ahead, our builder customers and contractors remain extremely optimistic as they report historically high order rates and continued strong traffic. The acceleration of housing starts we've seen over the past few months is positive for both of our business segments and our company is well positioned to capitalize on this growth.

However, given several constraints in the home building supply chain, we expect these housing starts to be slow coming out of the ground, lagging into the first quarter and perhaps even the first half of 2021. This slower ramp will elongate the cycle and provide a solid pipeline of activity for TopBuild. You can be assured we are ready to service these new housing starts, and we will continue to leverage our operating platform to help drive solid financial results.

Our commercial business, specifically on the heavy commercial side, continues to be negatively impacted by project delays due to safety protocols related to COVID-19. On a same branch basis, commercial revenue for all of TopBuild fell 6.8% in the third quarter and is down 6.9% year-to-date. While we have seen a few projects cancelled, the vast majority of projects we've been awarded continue to be delayed due to social distancing rules which limit the number of trades on a job site.

Our long-term outlook for our commercial business is still bullish. Our backlog remains robust and we are bidding on projects well into 2022. As a reminder, this is a $5 billion plus industry, bigger than residential new construction, and we have an 11% market share. So, while we will likely see a slower recovery on the heavy commercial side, we see plenty of room to grow and our bundled solutions approach continues to appeal to general contractors.

As Jerry noted a few minutes ago, we were pleased to acquire Garland Insulating last month. The integration is going well, and our footprint has been significantly enhanced in the high growth state of Texas. Our M&A group continues to seek out well-managed, profitable companies with strong management teams that will enhance our footprint in similar high growth regions. As we've said on many calls, good acquisitions are a high priority for our Company, and we are excited about the prospects in our pipeline.

I also want to touch on a few other areas that are top of mind for our customers concerning the home building supply chain.

First is labor, which will likely continue to tighten across our industry as we move through this robust housing environment. Our team has always risen to the labor challenge and is approaching this environment creatively, giving us an advantage in attracting and retaining labor.

For example, we recently introduced a recruiting program to our 10,000 co-workers asking them to invite their friends and family to join our TopBuild team. The high level of engagement having our employees involved to bring their friends and family to our company is a win for everyone and we are providing an attractive referral bonus to support this program. This program has been very well received throughout our organization and is already beginning to yield results.

Once we get a candidate installer onboard, we offer a comprehensive benefits package which helps make us an "employer of choice." This includes health benefits, a matching 401k plan, tuition reimbursement and a career path which can eventually lead to a branch management position. Our installer training program is also comprehensive and covers not only all facets of working safely but also how to become a more efficient and productive installer. This is important because the majority of our installers work on piece rate which means as they get more productive it creates better earnings power for them and for our company. An average installer earns $45,000 to $50,000 per year plus benefits and our top producing installers are making six figures.

Just a reminder, we have a unique advantage and differentiator with our ability to share labor among our divisions as they are all on the same ERP system. For example, there have been a couple of regions where our competitors have struggled to meet deadlines because of labor shortages. We were hired and brought in crews from two or three neighboring divisions to insulate 90 to 100 homes in a very short time period and meet the customer's deadline.

The second issue that is top of mind is building materials supply, including fiberglass capacity. As starts have accelerated, capacity has tightened for all building materials. Part of this tightness is due to some slowdown in production lines earlier in the year when the pandemic first hit. We do expect to see additional capacity come online next year. Last week, Owens Corning announced that they are restarting their Kansas City Batts and Rolls lines and they should be up and running by the second quarter. This will add about two to three percent to the industry capacity. In addition, Johns Manville has informed us they are moving full steam ahead with their new line and it should be producing material in early fourth quarter. We also understand that Knauf is moving forward with their plans to bring on additional capacity in the second half of 2021. In addition, the manufacturers are also improving their operational efficiencies, increasing capacity with existing lines.

From TopBuild's perspective, as the largest purchaser of fiberglass in the United States by nearly two times our nearest competitor, we are comfortable with our supply chain. We buy from a wide variety of building material suppliers and while we have no long-term contracts, we do provide them with monthly forecasts and are confident in our ability to meet the growing demand from our builder customers.

As far as material pricing, we saw an increase in September and Owens Corning and Knauf announced last week an 8% increase for January and it is likely the other manufacturers will follow suit. We feel very confident in our ability to manage these cost increases as we demonstrated in 2018. This is a testament to our strong local division managers and the quality of our partnerships with our suppliers and customers.

Before I hand it over to John, I would like to make a quick comment on Jerry's retirement at the end of this year. On behalf of our Board of Directors, management team and over 10,000 co-workers, thank you Jerry for everything you've done for TopBuild. Speaking for myself, it has been a pleasure working with you for over 20 years, first at Masco and then at TopBuild. You've been a mentor and a friend, and I look forward to seeing you enjoy the years ahead.

John Peterson
Chief Financial Officer
To echo Robert, Jerry, you will be missed, and we thank you for all that you've done for everyone at TopBuild.

Moving to our financials, we are pleased with our results, particularly our strong margin expansion, again demonstrating the strength of our diversified business model.

Starting with the third quarter, net sales increased 2.2% to $697.2 million, primarily driven by increased same branch sales volume, revenue from acquisitions and increased selling prices. Revenue for the first nine months of 2020 rose 1.8% to $1,996.6 million.

Adjusted gross profit margin increased 220 basis points in the third quarter to 28.5%, and for the first nine months of 2020 expanded 160 basis points to 27.6%. Gross margin improvements were driven by volume gains, increased selling prices, lower gutter and spray foam material costs, lower insurance costs and continued gains in operational efficiencies.

Adjusted operating profit in the third quarter grew 26.2% to $101.7 million, with a corresponding margin improvement of 280 basis points to 14.6%. For the first nine months, adjusted operating profit increased 18.2% to $255.5 million with a corresponding margin improvement of 180 basis points to 12.8%.

Adjusted EBITDA for the third quarter was $119.2 million, compared to $98.0 million in 2019, a 21.6% increase, and our adjusted EBITDA margin improved 270 basis points to 17.1%. Both operating and EBITDA margin gains were driven by the previously mentioned factors impacting gross margin improvement as well as cost reduction initiatives implemented in the second quarter and lower travel and entertainment and legal expenses.

For the first nine months of 2020, adjusted EBITDA grew 18.3% to $315.3 million, and adjusted EBITDA margin was 15.8%, a 220-basis point improvement over the first nine months of 2019.

Third quarter SG&A as a percent of revenue was 13.9% compared to 14.5% in the third quarter of 2019. The year-over-year decrease was primarily the result of lower travel and entertainment expenses and savings from cost reduction initiatives.

Adjusted income for the third quarter was $69.6 million, or $2.10 per diluted share compared to $52.7 million, or $1.53 per diluted share, in 2019. Third quarter 2020 adjustments were approximately $160,000, primarily related to acquisition costs and COVID-19 pay. Our effective tax rate was 25.5% for the third quarter.

For the first nine months of 2020, adjusted income was $171.2 million, or $5.14 per diluted share, compared to $138.8 million, or $4.02 per diluted share. Adjustments for the first nine months were $3.7 million and were primarily related to rationalization charges, COVID-19 pay and acquisition related costs.

Interest expense in the third quarter 2020 was $7.7 million and for the first nine months was $24.9 million. This compares to $9.5 million for the third quarter of 2019 and $28.7 million for the first nine months of last year. The decrease in interest expense was primarily driven by lower LIBOR rates and a lower balance due on our term loan.

CAPEX for the first nine months of the year was $27.2 million, 1.4% of sales, lower than our targeted long-term range of 2%. As we have noted on previous calls, at the start of the pandemic, we pared back our planned 2020 CAPEX spend, however we do expect that to return closer to the 2% range in the fourth quarter.

Working capital as a percent of sales for the trailing twelve months was 10.1% versus 11.6% a year ago. This decrease is primarily due to improvements in our accounts receivable aging, a decline in heavy commercial sales which have longer receivable terms and carry higher working capital requirements and a richer segment mix of our Service Partners business which carries lower working capital requirements.

We ended the third quarter with net leverage of just under one times trailing 12 months adjusted EBITDA. Total liquidity at September 30, 2020 was $704.9 million, including cash of $315.3 million and accessible revolver of $389.6 million. Operating cash flow was $255.7 million for the nine months ended September 30, 2020.

We remain extremely bullish about the current and future health of the residential and commercial businesses we serve. Housing starts are strong, and our commercial backlog and bidding activity remain very healthy. However, there is still some uncertainty over the pace of this growth which is why we have not given guidance at this time. We hope to have more clarity over the next few months and are optimistic we will be able to provide annual revenue and EBITDA guidance for 2021 at the end of February on our fourth quarter call.

Jerry Volas
Chief Executive Officer
In closing, I want to emphasize that our national scale gives us a significant competitive advantage, both from a material and a labor standpoint. Just as important, our diversified business model with both installation and distribution into both the residential and commercial markets give us the ability to perform well in any environment. Our year-to-date results clearly demonstrate the value of this business model.

Finally, I would like to conclude our formal remarks by thanking our 10,000+ employees for their hard work and commitment to our company. Because of you, my five and a half years at TopBuild have been one of the most enjoyable and rewarding times in my 40-year business career. Although somewhat difficult to step away, it’s a bit easier knowing that the Company is in such good hands.