Management's Prepared Remarks
Fourth Quarter 2021 Conference Call
February 22, 2022

Tabitha Zane
Vice President, Investor Relations
On the call today are Robert Buck, President and Chief Executive Officer, John Peterson, Chief Financial Officer, and Rob Kuhns, Vice President and Controller.

We have posted senior management's formal remarks and a PowerPoint presentation that summarizes our comments on our website at topbuild.com. Many of our remarks will include forward-looking statements which are subject to known and unknown risks and uncertainties, 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, some of 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 our fourth quarter presentation which can also be found on our website.

Robert Buck
President and Chief Executive Officer
We were pleased to end the year with a strong fourth quarter, reporting solid top line growth and a 17.1% adjusted EBITDA margin. For full-year 2021, we again demonstrated the strength of our diversified business model and our seasoned management team and delivered on our objective of achieving profitable growth. Revenue increased 28.3% and adjusted operating and EBITDA margins expanded 160 and 130 basis points, respectively.

Full year 2021 was also very productive. Highlights include:

- Reporting our best year ever with regards to our safety and personal injury rate
- Managing both material and labor constraints while moving resources across our network to meet the needs of our customers
- Successfully managing material cost increases with appropriate selling price adjustments,
- Putting over $1 billion of capital to work through the acquisition of 11 companies, including Distribution International, or DI, establishing TopBuild as the leading distributor of mechanical insulation
- Entering the industrial insulation end-market and broadening our insulation capabilities and services
- More than doubling our specialty distribution network, including expansion into Canada, and,
- Maintaining our focus on driving operational efficiencies throughout the organization.

We've also evolved as a company compared to where we were when we went public in 2015. To give you some context, six years ago, approximately 84% of our revenue was derived from residential housing. Today, on a pro forma basis, it's about 63%, with commercial now representing 29% and industrial 8%. We've also expanded our Specialty Distribution business, which, again on a pro forma basis, accounts for 42% of our revenue versus 35% in 2015. Perhaps most important, we've successfully demonstrated our ability to outperform in any environment as evidenced by our exceptionally strong adjusted operating and EBITDA margin expansion every single year.

While we've seen important changes as a company, what has remained constant over these same six years is our unwavering focus on our core business, insulation. We've doubled our revenue over this time frame and increased the percentage of sales from insulation and insulation related accessories by 400 basis points to 80%. We are the market leader in all three insulation end-markets we serve, giving us unparalleled size, scale, and leverage.

Turning to operations, I'll start with Specialty Distribution and specifically DI which had a very strong fourth quarter beating the high end of the sales and adjusted EBITDA guidance we gave on our third quarter call. DI's adjusted EBITDA margin for the fourth quarter was close to 11%, a substantial improvement from DI's full year 2020 pro forma adjusted EBITDA margin of 8.2%.

DI has been an outstanding acquisition for TopBuild, providing us with a leadership position in the $5 billion mechanical insulation market.

With the DI acquisition, we have:

- Expanded our core business
- Joined forces with a very talented, experienced, and knowledgeable team
- Welcomed over 13,000 new insulation customers
- Gained a recurring revenue stream driven by an MRO business and industry leading fabrication capabilities
- Entered the Canadian market with a strong leadership team in place in that country
- Further enhanced our partnership with the manufacturers of fiberglass insulation and,
- Expanded our M&A prospect pipeline to now include industrial, commercial, and of course residential.

Looking ahead, we expect solid performance this year for mechanical insulation in both the commercial and industrial end-markets, including new projects and maintenance and repair work.

As far as the integration, while still in the early stages, it is going really well. In fact, in some areas we are even ahead of schedule. Making this success possible are the strengths of our talented operating teams, working closely together, forged by a similar culture focused on safety, integrity and operational efficiency. We are highly confident we will achieve the $35 million to $40 million of run-rate synergies in the first 24 months of ownership as we outlined when we announced this transaction last September.

Service Partners also had an outstanding year with strong margin expansion as our team successfully balanced material cost increases and other inflation factors with customer pricing. Volume growth in the quarter was challenged by material constraints in both fiberglass and spray foam. Spray Foam, which represents about 18% of our legacy insulation sales, continues to face supply chain challenges and prices have significantly increased over the last 12 to 18 months. We are hopeful this situation will ease in the back half of the year.

Speaking of material, we did see additional loose fill capacity come online late last year from Knauf and anticipate additional capacity coming online from Johns Manville by the end of next month. While in total this will add only about 3% to capacity, our outstanding partnerships with these two suppliers ensures we will secure our fair share of these new lines. That being said, fiberglass supply remains tight.

Switching to the TruTeam installation business, we saw healthy demand throughout 2021 for residential new construction as well as a very strong pricing environment. We are also pleased that TruTeam's commercial business saw positive same branch revenue growth for the full year, despite continued project delays due to COVID job site safety protocols and industry wide material constraints.

I do want to take a minute to talk about TopBuild's safety performance. As I mentioned earlier, we reported our best year ever with regards to our safety injury rate. Our incident rate has steadily declined since 2017 and we believe this downward trend is an important indicator of the adoption of our safety culture and the effectiveness of our safety programs. With over 16,000 job sites visited each day, safety is not just a choice, it's engrained in our culture and our code of ethics. Our over 410 locations strive to maintain a zero-incident safety culture and a portion of management's compensation is tied to this metric. I am really proud of our team for their passionate and personal leadership of a safety lifestyle and integrating safety within the hearts and minds of everyone at TopBuild.

On the capital allocation front, we completed 11 acquisitions in 2021, including four in the fourth quarter: DI, Tonks Insulation, Shepherds Insulation, and Insulating Products. Earlier this month we added Billings Insulation, a residential insulation installer serving the Montana and Northern Wyoming markets. We remain focused on acquiring high quality residential and commercial installation and specialty distribution companies. All three of our end-markets are highly fragmented and present great opportunities to put the strong free cash flow that our business generates to work. However, while we expect to remain active on the M&A front in all three end-markets, the successful integration of DI is our number one priority.

In 2021, we also purchased just over 183,000 shares of our common stock for approximately $35.6 million. We have a $200 million share repurchase program in place, reflecting the confidence of both management and our board in the long-term potential of TopBuild, our strong future free cash flow position and our firm commitment to optimizing the efficiency of our capital structure.

Next, I would like to briefly discuss our ESG initiatives and where we are in our ESG journey.

First and foremost, our business is inherently ESG friendly. The insulation products we install and distribute provide energy efficiency and improved environmental conditions to thousands of residential, commercial, and industrial locations every single day.

Last year, we established a formal ESG sustainability program directly overseen by our Board of Directors. The program is managed by an ESG committee comprised of the Company's executive officers, including me, and a newly appointed ESG leader who reports to our General Counsel.

In this year's 10K we have expanded our disclosures regarding our workforce demographics, our diversity and inclusion initiatives and our OSHA recordable incident and lost time rates. Our plan is to publish our 2022 Sustainability Report in the second quarter. We are committed to the quality of our reporting, inclusive of our acquisitions, and will be keeping our stakeholders informed and providing additional information on an ongoing basis.

As we look at 2022, we are optimistic that it will be another good year for TopBuild. The acquisition of DI has further enhanced our growth opportunities within our core business, insulation.

We believe residential new construction will remain strong despite the likelihood of interest rate hikes. Our builder customers continue to be optimistic and are still restricting sales due to outsized demand. Housing inventory is extremely tight, and labor and material constraints continue to elongate the build cycle. Our backlog is very strong and is growing as the delta between starts and completions continues to widen.

Turning to our outlook for our commercial business, as the threat of COVID wanes, which statistics indicate is occurring, commercial construction should get back on track. We have a solid backlog in this end-market and bidding activity remains strong. And, as I mentioned earlier, we expect solid demand for mechanical insulation in both the commercial and industrial end-markets, including new projects and maintenance and repair work.

Operationally, we remain focused on continuing to implement initiatives that drive operational efficiency and improve labor and sales productivity. Strategic acquisitions will remain our number one capital allocation priority and will continue to be an important aspect of our projected growth. And finally, we believe energy codes will continue to strengthen, providing growth opportunities for all areas of TopBuild's business.

Before turning the call over to John, I want to note that this is his last earnings call as CFO of TopBuild as he is retiring at the end of March. John has played a key role in our growth and success and has built an outstanding track record of creating strategic value for our stakeholders. I consider him a colleague and a friend and really appreciate his partnership over the years.

John Peterson
Chief Financial Officer
Thanks Robert and thank you to the entire TopBuild team for making these past almost seven years successful, memorable and fun. I will miss all of you. Robert, special thanks to you for your leadership, partnership, and friendship over the past 12 years. I've enjoyed every moment of it.

As most of you know, Rob Kuhns, who has served as our Vice President and Controller for almost four years, will be assuming the CFO role at the end of next month. Rob has made significant contributions to our strategy, growth and success and has built a very strong team. His in-depth experience, understanding of our operations and leadership skills make for this to be a very smooth passing of the baton. I look forward to watching all the success he and the rest of the TopBuild team will have in the future.

I also want to thank all of you on the call, most of whom I have met. Your support of TopBuild over these years has been greatly appreciated.

Rob Kuhns
Vice President and Controller
As Robert noted, we finished 2021 with a strong fourth quarter and entered 2022 well-positioned to capitalize on the anticipated growth in the three end-markets we serve. We'll begin with a review of our 2021 results, then provide our outlook for 2022. First a couple of housekeeping items. As Robert mentioned, DI's results are being reported, along with Service Partners, as part of our Specialty Distribution segment. In addition, due to the significant amortization from the purchase accounting associated with DI, we are now providing adjusted EBITDA results for both of our reporting segments.

Starting with our fourth quarter results, net sales increased 47.4% to $1.1 billion. The 11 acquisitions we completed in 2021 increased sales by 34.9% with DI contributing $188.3 million, ahead of our expectations. On a same branch basis, sales increased 12.5%, driven by higher selling prices partially offset by slightly lower volume due to the continued industry wide supply chain shortages and labor constraints along with a more difficult year-over-year comp for Service Partners.

Sales for full-year 2021 increased 28.3% to $3.5 billion. On a same branch basis, sales increased 12.7%, driven by higher selling prices and higher sales volume.

Adjusted gross margin improved 60 basis points in the fourth quarter to 28.1% and improved 90 basis points for the full year to 28.4%. On a same branch basis, adjusted gross margin improved 190 basis points and 150 basis points for the fourth quarter and full year, respectively. Adjusted gross margin improvement for both the fourth quarter and the full year was driven primarily by higher selling prices, strong cost controls, and productivity initiatives, partially offset by material inflation.

Adjusted operating profit in the quarter grew 45.0% to $150.7 million, while adjusted operating margin declined 20 basis points to 14.2%. As we have previously discussed, DI is currently operating at lower margins than our legacy TopBuild business. In addition, due to the purchase accounting from the DI transaction, we incurred an additional $8 million of amortization expense in the quarter. On a same branch basis, removing the impact of DI and all other M&A, our adjusted operating margin improved 230 basis points in the fourth quarter. On a full year basis, adjusted operating profit improved 43.4% to $515.2 million, while adjusted operating margin improved 160 basis points to 14.8%. On a same branch basis, our operating margin improved 260 basis points.

Fourth quarter adjusted EBITDA was $182.1 million, compared to $121.5 million last year, a 49.9% increase. Our fourth quarter adjusted EBITDA margin was 17.1%, a 30-basis point improvement. On a same branch basis, EBITDA margin was 19.0%, a 220-basis point improvement.

Our fourth quarter incremental adjusted EBITDA margin was 17.7%, which consisted of incremental same branch EBITDA margin of 36.0% and EBITDA from M&A of 11.1%. DI's fourth quarter EBITDA was $20.4 million, or 10.8% percent of sales, ahead of our expectations.

For full-year 2021, adjusted EBITDA grew 38.7% to $605.9 million, and adjusted EBITDA margin improved 130 basis points to 17.4%. On a same branch basis, adjusted EBITDA margin improved 200 basis points. Our full year incremental adjusted EBITDA margin was 22.0%, which consisted of incremental same branch EBITDA margin of 34.1% and EBITDA from M&A of 12.2%.

Both adjusted operating profit and adjusted EBITDA improvements were driven by the previously mentioned factors impacting gross margin, as well as lower legal fees and lower share-based compensation expense.

Interest expense in 2021 was $29.1 million, versus $32.5 million in 2020. The decrease was primarily due to lower LIBOR rates on our term loan and the first quarter refinancing of our $400 million 5.625% Senior Notes due in 2026 that were replaced with $400 million 3.625% Senior Notes due in 2029. This lower interest expense was partially offset by additional interest expense from our private offering in October of $500 million 4.125% Senior Notes due in 2032.
Our effective tax rate for the full year increased from 23.5% to 25.2% driven by a decrease in the tax benefit related to share-based compensation and an increase in non-deductible items.

Adjusted net income for the fourth quarter was $103.3 million, or $3.12 per diluted share, an increase of 45.1% compared to prior year. Fourth quarter 2021 non-GAAP adjustments totaled $32.3 million and were primarily tied to the DI acquisition. This included $16 million from the one-time impact of purchase accounting inventory step-up, $12 million from transaction costs, and $4 million from integration related costs.

Adjusted net income for full year 2021 was $359.7 million, or $10.85 per diluted share, an increase of 49.0% compared to prior year. Full-year 2021 non-GAAP adjustments totaled $52.7 million, primarily related to acquisition related expenses, the purchase accounting inventory step-up, refinancing costs and the related extinguishment of debt associated with the redemption of our 5.625% Senior Notes.

CAPEX for full year 2021 was $55.5 million, approximately 1.6% of revenue. Working capital as a percent of trailing twelve-month sales was 13.3%, 400 basis points higher than prior year, primarily as a result of the DI acquisition. We are evaluating working capital improvements at DI and expect to see working capital as a percentage of revenue settle in at a range of 11% to 13%.

We ended the year with net leverage of 2.02 times trailing twelve months pro forma adjusted EBITDA. Our net leverage is already down significantly from the proforma 2.5 times we announced at the time of the DI acquisition. Total liquidity at year end was $569.8 million, inclusive of the $430.1 million available on our $500 million revolver and cash of $139.8 million. Operating cash flow was $403.0 million for 2021.

Now let’s turn to our segment results.

Starting with Installation, sales increased 23.3% in the fourth quarter to $627.1 million. Same branch sales increased 12.2% driven by an 11.0% increase in price and a 1.2% increase in volume. Residential and commercial markets continued to see strong demand, but volume growth was hampered by ongoing material shortages and labor constraints. For the full year, Installation same branch revenue grew 11.0% driven by higher selling prices of 6.5% and volume growth of 4.5%.

For Installation, fourth quarter adjusted EBITDA grew 29.0% to $121.8 million and adjusted EBITDA margin was 19.4%, an 80-basis point improvement compared to a year ago. For the full year, adjusted EBITDA was $444.9 million and adjusted EBITDA margin also improved 80 basis points to 18.7%. Both the fourth quarter and full year EBITDA growth were driven by higher sales volume, higher selling prices, fixed cost controls, and productivity initiatives partially offset by material cost increases.

Moving to Specialty Distribution, fourth quarter sales were up 93.1% to $485.8 million. Same branch revenue was up 15.6% driven by higher selling prices of 22.4%, partially offset by a 6.8% decline in volume. As a reminder, on a same branch basis the fourth quarter was a tough comp for our Service Partners business as our 2020 fourth quarter volume growth was 13.3%. For the full year, Specialty Distribution same branch revenue grew 17.0% driven by pricing increases of 13.7% and volume growth of 3.3%.

Fourth quarter adjusted EBITDA for Specialty Distribution more than doubled from fourth quarter 2020 to $73.1 million and adjusted EBITDA margin improved 70 basis points to 15.0%. For the full year, adjusted EBITDA increased 62% to $205.6 million and adjusted EBITDA margin expanded 230 basis points to 16.0%. Both the fourth quarter and full year EBITDA growth were driven by higher selling prices, fixed cost controls, productivity initiatives, and the acquisition of DI, partially offset by material cost increases.

Moving to our 2022 annual guidance, there are a number a tailwinds impacting the industries we serve. They include strong wage growth, strong consumer demand, healthy backlogs in our three end-markets, and historically low housing inventory. We also are cognizant that rising interest rates and inflation could lead to affordability issues that might dampen demand, but we have not seen any impact to date. In addition, our guidance does not anticipate that the current material and labor supply constraints will be resolved quickly, and we are estimating only a slight improvement starting in the back half of 2022.

We are projecting total sales to be between $4.5 billion and $4.65 billion and adjusted EBITDA to be between $770 million and $820 million. This includes revenue from announced acquisitions but does not include any additional acquisitions we may make this year.

We've also provided our long-range modeling assumptions for a number of metrics. We are now projecting $107 million of revenue for every 50,000 new homes insulated and non-residential sales growth to average between 5.0% and 7.5% annually.

The range for same branch incremental EBITDA is 22% to 27% and 11% to 16% for acquisitions. The range for our normalized tax rate is 25% to 27%.

The range for working capital is now 11.0% to 13.0% of trailing twelve-month sales, slightly higher than previous guidance primarily as a result of the acquisition of DI. And finally, we project CapEx at 1.5% to 2.0% of sales.

Before turning the call back over to Robert, I too would like to thank John for his many contributions to TopBuild and for his guidance and leadership over these past three plus years as part of the Company's ongoing succession planning. I look forward to working with all of you and appreciate your continuing support of TopBuild.

Robert Buck
President and Chief Executive Officer
Before opening the call up for questions I wanted to note that we have moved our Investor Day from March 15 to May 26, with the same New York City location. Most of you should have received a new "Save the Date" email a few weeks ago. This change was due solely to the wide spread of Omicron and our concern for the health and safety of our team and our Investor Day attendees.

2022 should be another year of profitable growth for TopBuild. Our backlog is strong and demand is healthy. Our entire team is focused on the successful execution of our plan:

- Providing energy efficient solutions for our customers
- Driving operational efficiencies throughout our company
- Integrating DI on our operating platform
- Successfully managing input costs and pricing and
- Identifying accretive acquisitions that support our core business, insulation

In closing, I want to thank our entire TopBuild team (TruTeam, SP, DI, Branch Support and Field Support Center Teams) for their dedication and hard work. We had a great year in 2021, and our success is due to your outstanding efforts and constant drive to improve.