TOPBUILD Q4 2021 WEBCAST

Operator (00:00):

Greetings, and welcome to TopBuild Earnings Conference Call. At this time all participants are in a listen only mode. A question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star zero on your telephone key pad. As a reminder, this conference is being recorded. I would now like to turn the conference over to your host Ms. Tabitha Zane, Vice President, Investor Relations.

Tabitha Zane (00:36):

Thank you, and good morning. 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 in 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 FCC. 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 release and in our fourth quarter presentation, which can also be found on our website. I will now turn the call over to Robert Buck.

Robert Buck (01:48):

Good morning, everyone, and thanks for joining us today. We're 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 to achieve 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.

Robert Buck (03:18):

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 proforma 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 proforma basis, accounts for 42% of our revenue versus 35% in 2015. Perhaps most important we successfully demonstrated our ability to outperform in any environment, as evidence 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 timeframe 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.

Robert Buck (04:32):

Moving 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 proforma 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 include industrial, commercial, and of course residential.

Robert Buck (05:45):

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's going really well. In fact, in some areas we're 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 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 the situation will ease in the back half of the year.

Robert Buck (07:05):

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. Although in total this will add only about 3% to capacity, our outstanding partnerships with these two suppliers ensure 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're 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. Rob will cover more details for each segment in his prepared remarks.

Robert Buck (07:59):

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 ingrained 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.

Robert Buck (08:45):

On the capital allocation front, we completed 11 acquisitions in 2021, including four in the fourth quarter; DI, [inaudible 00:08:56] 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 insulation 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 repurchased 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.

Robert Buck (09:57):

Next I'd 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 improve environmental conditions to thousands of residential, commercial and industrial locations, every single day. Last year we established a formal ESG sustainability program, correctly overseen by a 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 10-K we have expanded our disclosure 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. We'll be keeping our stakeholders informed and providing additional information on an ongoing basis.

Robert Buck (11:06):

As we look at 2022, we are optimistic there'll 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 and strong despite the likelihood of interest rate hikes, our builder customers continue to be optimistic and are still restricting sales due to outsized demand. Our 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. According 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.

Robert Buck (12:00):

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 in all areas of TopBuild's business.

Robert Buck (12:35):

Before I turn 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 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. Thank you, John.

John Peterson (12:57):

Thanks, Robert. And thank you to the entire TopBuild team for making these past almost seven years successful, memorable and fun. I'll 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've met, your support of TopBuild over these years has been greatly appreciated. Rob will now discuss the company fourth quarter results.

Rob Kuhns (13:57):

Thank you, John. And good morning, everyone. 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.

Rob Kuhns (14:11):

We'll begin with a review of our 2021 results, then provide our outlook for 2022. First, a of couple 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.

Rob Kuhns (14:36):

Starting with our fourth quarter, 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 the 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.

Rob Kuhns (15:25):

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.

Rob Kuhns (15:58):

Adjusted operating profit in the quarter grew 45% 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.

Rob Kuhns (16:52):

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 was 19%, 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% and EBITDA from M&A of 11.1%. DI's fourth quarter EBITDA was $20.4 million or 10.8% of sales, ahead of our expectations. The 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%, 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.

Rob Kuhns (18:17):

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 five and five eighths senior notes due in 2026, that were replaced with $400 million three and five eighths 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 four and one eighths 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.

Rob Kuhns (19:06):

Adjusted net income for the fourth quarter was $103.3 million for $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.

Rob Kuhns (19:36):

Adjusted net income for the full year 2021 was $359.7 million or $10.85 per diluted share, an increase of 49% 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 and the related extinguishment of debt associated with the redemption of our five and five eighths senior notes.

Rob Kuhns (20:08):

CapEx for the full year 2021 was $55.5 million, approximately 1.6% of revenue. Working capital as a percentage trailing 12 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 revenues settle in at a range of 11% to 13%. We ended the year with net leverage of 2.02 times, trailing 12 months proforma 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 was $403 million for 2021.

Rob Kuhns (21:07):

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% increase in price and a 1.2% increase in volume. Residential and commercial markets continue 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%, driven by higher selling prices of 6.5% and volume growth of 4.5%. For installation fourth quarter adjusted EBITDA grew 29% to $120.8 million and adjusted EBITDA margin was 19.4%, an 80 basis point improvement compared to a year ago.

Rob Kuhns (21:57):

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.

Rob Kuhns (22:19):

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%, 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%. For the full year adjusted EBITDA increased 62% to $205.6 million and adjusted EBITDA margin expanded 230 basis points to 16%. 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.

Rob Kuhns (23:34):

Moving to our 2022 annual guidance, there are a number of 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 are also 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 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.

Rob Kuhns (24:27):

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% 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% to 13% of trailing 12 months 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% of sales.

Rob Kuhns (25:11):

Before turning the call back over to Robert, I would like to thank John for his many contributions to TopBuild and for his guidance and leadership over the 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?

Robert Buck (25:28):

Thank you, Rob. Before opening up the call for questions, I wanted to note that we have moved our investor day from March 15th to May 26th, 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.

Robert Buck (25:53):

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 onto our operating platform, successfully managing input cost and pricing, and identifying a creed of acquisitions that support our core business, insulation.

Robert Buck (26:24):

In closing I want to thank our entire TopBuild team, TruTeam service partners, 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. Operator, we are now ready for questions.

Operator (26:48):

Thank you. At this time we will be conducting a question and answer session. If you would like to ask a question, please press star one on your telephone key pad. A confirmation tone will indicate your line is in the question queue. You may press star two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please, while we poll for questions. Our first question is from Trey Grooms with Stephens. Please go ahead.

Trey Grooms (27:33):

Hey, good morning. First off, congrats on a strong finish to the year and, John, congrats and wish you the best on your next chapter.

John Peterson (27:41):

Great, Trey. I appreciate that, thank you.

Trey Grooms (27:44):

Okay. So I guess first question is, looking at the guide for this year and understanding that there is a growing backlog due to the constraints you talked about, you mentioned that you have the expectation for supply to remain tight, but with this assumption of low to mid single digit volume, it sounds like you're expecting maybe some easing here with some of these constraints in the back half. I guess, number one, thoughts around what's going to help create this easing kind of situation, number one. Number two, I guess trying to get at the cadence there as well, and could it be more back half loaded with the volume, given the comment around the easing and these constraints?

Rob Kuhns (28:42):

Hey, Trey, this is Rob. Looking at next year we see strong demand across all three end markets. To your point, we're expecting low to mid single digit volume growth and that's really being driven by the continuing constraints. Certainly, without the constraints our volume growth would be significantly higher than that. So we are optimistic that it'll sort itself out a little bit more towards the backend, but we're not expecting a stack function change in availability in the back half.

Trey Grooms (29:16):

Oh, okay. All right, that's helpful. So nothing monumental, just slight improvement, hopefully in the back half. One last one here for the longer term guide, the residential revenue, for every 50,000 starts you're $107 million up from I think the last update, and I may have missed something in between, but I thought at the end of 2020 it was $90 million per 50,000. So if you can help us unpack that a little bit, how much is pricing put in place since then versus market share gains?

Rob Kuhns (29:54):

Yeah, Trey, this is Rob again. There's really two main drivers to that, it's M&A we've done over the past year and then as well as price over the past year. So those are the two big drivers of that.

Trey Grooms (30:10):

Okay. And I guess lastly, the billion dollars of capital you put to work, big year for M&A obviously, and you noted in the prepared remarks that the DI integration is at top of mind, but did still mention M&A as possibility. Just given how heavy the M&A was in '21, should we be thinking about maybe a little bit of a dial back on the M&A appetite, just as you get that integration worked through? Was that the messaging? Or just help us think about your appetite there as we look through this year, given what we saw in the past.

Robert Buck (30:58):

Hey, Trey, good morning, it's Robert. So yeah, DI integration absolutely our priority, but you've seen since we acquired DI we've completed four additional acquisitions, three in the residential space, another one in the specialty distribution space. So the pipeline is still really healthy, we're definitely focused on the quality of targets, so I think you'll see activity from us this year, really looking across all three end markets. But you're also going to see us do a great job of this integration with DI, which I think you heard me say my prepared remarks, we're off to a great start. That's a great acquisition for us and we feel so confident with what we're doing there. So it's going to be a good balance, it's going to be a great integration of DI and we've got a really nice pipeline across all three end markets as well.

Trey Grooms (31:45):

Okay. Thank you, Robert and Rob, and I'll pass it on. Thanks again.

Robert Buck (31:49):

Thank you.

Operator (31:53):

Thank you. Our next question is from Adam Baumgarten with Zelman & Associates. Please go ahead.

Adam Baumgarten (32:01):

Hey, good morning. I guess maybe sticking with the volume guidance, just the low to mid single digits. Any way you can break down further how you're thinking about residential versus commercial and industrial? Or if they're all in a similar boat.

Rob Kuhns (32:15):

Yeah, Adam, this is Rob. So across the three markets we serve we'd say it's not going to be drastically different, a point or two different between the three, but we're expecting similar environments of really strong demand, tight supply, which is always, again, also lead to an inflationary environment next year as well.

Robert Buck (32:38):

[crosstalk 00:32:38] Adam, this is Robert. Maybe just to add on to what Rob said, the backlogs are really healthy. If we look across residential the backlog there, given that extension that's happened in the cycle time, as well as our backlogs in commercial and industrial, so really healthy backlogs really across. And we would say also, a really great start to the year here in 2022, also. So really happy with what we've seen thus far early in the new calendar year.

Adam Baumgarten (33:08):

Okay, got it. And then just a couple on distribution, the pricing delta between the distribution business and TruTeam continues to widen. Maybe if you could walk through some of the driving factors there, as well as if you expect that gap to narrow at some point. And then just on volume, should we expect negative volumes through the first half of that business, given the still tough comps you face?

Rob Kuhns (33:31):

Hey, Adam, this is Rob again. So as far as the pricing differential between installation and distribution, it's really driven primarily by the material content. So on the install side, within the cost of sales you have labor and material, and on distribution it's purely material. So you always are going to have a higher pricing dynamic on the distribution side of things. And then, I'm sorry, repeat the second part of your question.

Adam Baumgarten (33:59):

Yeah, just on the volumes for the first half in distribution, should we expect those to remain negative, given the pretty similar tough comps that you have?

Rob Kuhns (34:07):

Yeah, first quarter is going to be another tough comp for service partners for sure year over year, so that's probably a likely trend.

Adam Baumgarten (34:17):

Got it. Thanks guys.

Operator (34:22):

Thank you. Our next question is from Phil Ng with Jefferies. Please go ahead.

Phil Ng (34:28):

Hey guys, congrats on another strong quarter. John, appreciate working with you all these years, it's been super helpful. And Rob, looking forward to working more with you going forward.

John Peterson (34:39):

Thank you, Phil, much appreciated.

Phil Ng (34:42):

I guess, Rob, for you to kick things off, heading into 1Q, in a lot of companies we cover they're still playing catch up on price costs, you guys have obviously done a really good job on that front. Just want to get some color on, have you taken all the pricing actions you need to maintain the type of incrementals you've been putting up for some time now, starting the year?

Rob Kuhns (35:04):

Hey, this is Rob. Going into Q1 we've got some more price increases coming, so we had some cost increases from suppliers that hit December in the beginning of Q1, so we're trying to get out in front of those. But based on our results last year, I think, you'd see our team in the field just does an excellent job of managing that, and we anticipate doing that throughout 2022 as well.

Phil Ng (35:29):

Got it. Super. And then the question for you, bigger picture, Robert, can you give us a sense how much backlog do you have in your business today? And is there a good way to compare that to call it mid 2018 levels? The reason why I'm asking, there's no denying that underlying demand for housing is actually very strong right now, but if we do go through an air pocket like 2018 with rates going up, which you frankly managed quite well and saw very limited slippage, but just curious, how are you set up this time around versus 2018?

Robert Buck (36:00):

Yeah. Morning, Phil. So let me talk about commercial and industrial first. Obviously there's good visibility to that business, given our contracts, given what we see in our bidding activities. So those backlogs on the commercial side have actually grown, as we saw projects get slowed down some, given the spike in COVID and some of the supply chain constraints, so we've seen backlogs grow there. Residential, a little harder to quantify, but I think there's a few things to point to. Number one would be looking at that delta between starts and completions. Major delta there that builders have continued to sell homes and stuff, so if you see like starts have dropped plus 16% and a completions rate that's more like that 3%, that's obviously continued to add to the backlog.

Robert Buck (36:48):

We've seen more multifamily coming along, as we look at our contracts and work we've secured on the multifamily side. And I think that's also why, even though there was weather in January, you heard us talk about it on our third quarter call, we didn't really expect to see seasonality as we left 2021 and went into 2022. And you heard us say, "Hey, great start to the year here in '22." So I think all that points to a solid backlog and we definitely see that contract wise and stuff on the commercial, industrial side of the business as well.

Phil Ng (37:22):

Okay, that's helpful. And Robert, I'm obviously less familiar with DI but from what I understand material availability there might not be as tight. Any color on how to think about your ability to grow in that business? I suspect it's probably a little less constrained than resi, but any color would be helpful.

Robert Buck (37:38):

Yeah, sure. So a few things, if you think about the industrial side of the business, that impact of the material in the supply chain was a little bit delayed. And so there are some materials that are tight there, but not as tight as we'd say on the resi side and on some of the building insulation side of the business. DI, like TopBuild, great relationships with the supplier base. They did a really nice job of building some inventory last year in their supply chain and their facilities as well. Great relationships, so I think we've got some great growth paths there, you've heard us talk about it, some Greenfield opportunities. DI did a really nice job, how they manage their inventory, how they manage their service levels, which drove to some share gain in 2021. So no, I think, Phil, we're really confident in that supply chain. Several mutual relationships, mutual suppliers, so I think good level of confidence of being able to service and grow those customers in 2022 here.

Phil Ng (38:35):

Great color, thanks a lot, Robert. Appreciate it.

Robert Buck (38:37):

Thank you, Phil.

Operator (38:40):

Thank you. Our next question is from Michael [inaudible 00:38:44] with JP Morgan. Please go ahead.

Michael (38:48):

Great, thanks. Good morning, everyone, and congrats to both John and Rob. First question, and I apologize if this is something you addressed earlier, I might have missed it. In terms of the sales guidance for '22, I know you said that it incorporates an end market up low to mid single digits from a volume growth perspective, but I was trying to get a sense, the other two major components, how you're thinking about price and acquisitions also in terms of contributing to that number.

Rob Kuhns (39:33):

Yeah. Michael, this is Rob. Obviously if you break down our sales growth year over year, our guides about $1.1 billion above year over year. Obviously M&A is going to be a significant portion of that year over year with the DI acquisition happening in the fourth quarter. And then with the volume guide we've given, if you factor those two things in, we don't disclose what our price assumption is, we've obviously got price baked in there, assuming an inflationary environment, but doing that math you could get in the ballpark to where we are.

Robert Buck (40:12):

And in the guidance there'd be no additional M&A that would be in that as well, Michael, but the drops point additional pricing that we think could be coming here in 2022 is included.

Michael (40:25):

Okay, well maybe we could talk a little more offline then on that. I think secondly, just the margin path for DI, I think you said it's performing better than expected. Any sense on over time where you want that business to be, from a comparable margin rate standpoint? And obviously you can talk about it through EBITDA or EBIT, I know obviously amortization near term is going to make things a little less comparable, but any way to think about the DI margins over time?

Robert Buck (41:14):

Yeah. Michael, this is Robert. So we think about it just... that's a great acquisition, and the more we've gotten closer to the business and stuff the more confident we end... So directly to your question about margins, you've heard us talk about our $35 to $40 million run rate synergies by the end of year two. Highly confident in that, and if I take that plus the good momentum that DI had in the business, continued operational improvements we expect, we absolutely expect that business to get in that mid teens type of margin projection here within the next couple of years, and we think we have line of sight to that as well. So they've got a really nice proven track record in that business, we've got a nice proven track record of integrations. So I think really, really confident in DI becoming accretive and really adding to that specialty distribution platform that we've built there.

Michael (42:11):

Okay. All right, thanks. Just one last quick one on DI, again, just trying to triangulate a little bit on the sales contribution for '22. It came in at about $750 million annualized sales, but at the same time you're looking at another year with some growth and price perhaps on top of that. So again, any way to just try and dimensionalize the contribution of DI in '22 sales, again, would be helpful if possible?

Rob Kuhns (42:49):

Yep, Michael, this is Rob. I think your number for DI is probably coming in a little low there, I think you might be annualizing the two and a half months. But we would also say that that two and a half months was very strong, and I think their number is going to be somewhere probably north of $800 million for next year net. So a strong fourth quarter, and we're expecting that momentum to continue in the next year.

Michael (43:22):

Okay. Thanks a lot.

Robert Buck (43:24):

Thank you.

Operator (43:28):

Thank you. Our next question is from Keith Hughes with Truist Securities. Please go ahead.

Keith Hughes (43:37):

Thank you. As you look at the year, and you've given us your guidance for organic contribution margin, would that be one of these years that's lower at the beginning and then improves as the year goes along, or is it going to be more of a straight line?

Rob Kuhns (43:54):

Hey Keith, this is Rob. I think the way to think about it is we'll show consistent improvement on the core business throughout the year, if you were to break that EBITDA down. So on the M&A piece we should be right in the middle of our guided range of 11% to 16%, probably just slightly lower than the midpoint of that. And then from a same branch perspective we expect our incremental EBITDA to be more towards the high end of our guided range next year.

Keith Hughes (44:29):

But reliably through the year to get to that high end number, is that how you're looking at it?

Rob Kuhns (44:37):

Yeah, we're not breaking out the seasonality of it right now, but I would expect those incrementals to be consistent throughout the year. [crosstalk 00:44:46] M&A is obviously going to be heavier the first three quarters than the back half, or the fourth quarter with the...

Keith Hughes (44:52):

Right, Rob. Well, then, thank you.

Operator (45:04):

Thank you. Our next question is from Stephen Kim with Evercore. Please go ahead.

Stephen Kim (45:09):

Thanks very much, guys. Congratulations, and yeah, we'll miss you, John, but we really do appreciate all the help over the years.

John Peterson (45:19):

Thanks, Stephen.

Stephen Kim (45:21):

Sure. I guess most of my questions have been asked already, but I wanted to delve into this question of the shortages and the limited availability. You said it was both across spray foam and fiberglass, so I guess, first of all from a numbers perspective, is there a way that we can think of quantifying what that headwind, from just strictly availability, what that was? And then looking to qualitatively understand the situation, are your customers willing to wait longer to get product? Or are you seeing that you're just losing those sales altogether? Is there a practical limit to which these delays can extend on your customers part? Just give us a little bit of insight into what's going on actually at the branch.

Robert Buck (46:15):

Yeah. Hi, Stephen, this is Robert. So I guess, first off I'll hit the entire industry. So there's these delays and shortages that elongated the cycle really in trades, quite honestly, before us. And I think you've heard us probably talk about, if we were getting on the job site in 90 days, that elongated probably out to 30 to 60 days more in 2021, and we even saw that in Q4 actually get a little bit worse than that. So it's really, I'd say, other trades that are stalling relative to when we're getting on the job site. From our perspective, fiberglass has remained tight, we know that we're getting our fair share of the allocation, I think you heard us talk about, even with the new lines coming back we got more than our fair share relative to that new capacity.

Robert Buck (47:00):

So I'd say it's more, more been of an industry type of constraint than it's necessarily been... definitely not labor for us necessarily. And on the material side spray foam has probably been the bigger issue from that perspective. And the reason being, I think you're probably familiar with it, if you go back to end of '20, constraints of input materials coming overseas to what happened in the deep freeze this time last year to just input materials overall. So between the two I'd say spray foam has probably been more the limiting factor, but no doubt fiberglass remains tight.

Robert Buck (47:32):

I'd say relative to losing sales, definitely as we look at the residential side of the business we're really confident in what's happened there as we look at our growth from a residential perspective, both businesses. So there could be some trade off on the distribution side between some customers, but I'd say overall keeping our share for sure. And we do a great job between our install branches separately and our distribution branches separately moving material around and servicing those customers. So that advantage we have of the visibility as well as how we allocate the material completely separately between the two, I think we've got ourselves in a great shape and I think we've maintained and probably picked up a little bit of share in some areas.

Stephen Kim (48:17):

Yeah, no, that would make sense. Thinking a little bit longer term, which obviously the rise in interest rates and subsequently mortgage rates has gotten everybody doing. I'm wondering whether or not you're anticipating that you might see more of a move to affordably priced homes, and if that's having any longer term ramifications on people's interest in spray foam, or rather, I should say, more interest in going with a fiberglass product just to keep the overall price tag down relative to spray foam. Are you hearing anything like that from the residential side of the business?

Robert Buck (49:00):

I think to your first point, you're going to see, I think we are seeing for sure, and you're hearing about it, more entry level homes that are from the production home builders, as they're thinking about interest rates, as they're thinking about affordability and stuff as well. They're doing a great job of modifying the product they're going to market with. And then relative to that, no doubt there's been significant increases in the spray foam prices over the past 12 to 18 months. And so given that, we see custom builders and others are still absolutely on the spray foam wagon, if you will, given its benefits, but you do see some smaller builders that are moving back towards fiberglass as well. So overall, dollars are healthy on the spray foam side, given the inflation, and no meaningful move on the units. But we've seen some builders that have made a choice there to go back to fiberglass versus foam in some instances, as an example.

Stephen Kim (49:58):

Yeah, makes sense. Okay, great. Thanks very much, guys.

Robert Buck (50:05):

Thank you.

Operator (50:06):

Thank you. Ladies and gentlemen, we have reached the end of the question and answer session, and I would like to turn the call back to Mr. Robert Buck for closing the remarks.

Robert Buck (50:17):

Yeah. Thank you, everyone, for joining us today, we look forward to talking with you in May, whenever we report our Q1 results.

Operator (50:26):

Thank you. This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.