Management's Prepared Remarks
Third Quarter 2022 Conference Call
November 1, 2022

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

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 third quarter presentation which can also be found on our website.

Robert Buck
President and Chief Executive Officer
Our third quarter financial results reflect the strength of our operating model and our continuing focus on improving our operational efficiency. Revenue increased 53.8%, 22.6% on a same branch basis, and adjusted EBITDA margins improved at both business segments.

On the Installation side, our volume continues to outpace completions as trades and supply chains ahead of us show improvements accelerating our ability to work through the housing backlog. In addition, our commercial business, both heavy and light, is steadily improving. This resulted in third quarter installation revenue growing 27.8%, 26.1% on a same branch basis.

Our Specialty Distribution segment, on a same branch basis, grew revenue 18.7%, driven by strong execution and improved volume. We saw solid demand from the commercial and industrial end-markets as new projects came on-line.

Our results are a testament to the hard work and dedication of our TopBuild employees and their continued focus on driving operational efficiencies and executing well in the evolving economic environment.

Switching to Distribution International, it's been just over a year since we closed on this acquisition, providing us with a direct entry and leadership position in the highly attractive and growing $5 billion mechanical insulation business. While a talented team, projected synergies and strong growth opportunities were obviously critical factors in our initial evaluation of DI, we also were attracted by the opportunity to enter a new insulation end market, industrial, and increase our penetration in the commercial end market, both of which operate on a different cycle than residential housing.

The integration of this $1 billion acquisition is going extremely well with most DI branches now on our ERP system and supply chains optimized. In addition, we continue to identify opportunities to streamline operations throughout our Specialty Distribution network by leveraging technologies and best practices. As projected, we have met our goal of achieving run-rate cost savings of between $17 million and $20 million in the first year of ownership and we are highly confident we will meet, and likely exceed, total cost savings of between $35 million to $40 million by October of next year at the very latest.

DI's financial performance has also exceeded our expectations, in part due to large-scale commercial and industrial construction and maintenance projects no longer delayed due to the pandemic. The DI team is doing an outstanding job managing the business and working hand in hand with our other operational leaders to identify growth opportunities across our North American branch network.

We were pleased to see our commercial business at both segments, Installation and Specialty Distribution, improving, and we are optimistic our commercial business will continue to demonstrate positive growth, both organically and through targeted acquisitions. Our outlook is based not only on our own bidding activity and backlog, but also on year-to-date non-residential construction data which points to a resurgence in demand. However, we also acknowledge there is still much uncertainty, with labor and supply chain constraints continuing to hamper industry growth and higher interest rates possibly putting some projects on the back burner next year.

Turning to material, fiberglass remains on allocation. Despite signs of a housing slowdown, inflation in our industry has not abated as evidenced by the fact that all four fiberglass manufacturers have announced a 10% cost increase effective either in December or early January. On the other side of the equation, builders are seeing a slowdown in orders and beginning to push back on price in general. While this has created an unprecedented situation in our industry, we will continue to strive to strike the optimal balance and timing, market by market, between price and volume.

Moving to M&A, we completed one small acquisition this quarter and year-to-date have completed five, all of which are residential and light commercial installation companies. In total, these firms are expected to generate over $17 million in annual revenue.

The highly fragmented nature of our three end markets provides us with solid opportunities to continue to execute our acquisition strategy on both the installation and distribution sides of our business. We are steadfast in our belief that acquisitions are the best use of our capital and will generate the strongest returns for our shareholders in both the near and long term. With the successful integration of DI mostly behind us, our team is focused on building and working our robust pipeline of targeted acquisitions.

In the third quarter we also returned capital to our shareholders by repurchasing almost 270,000 shares at an average price of $185.50 per share returning approximately $50 million to our shareholders. Year-to-date, we've repurchased slightly over one million shares returning $200 million to our shareholders.

On the ESG front we were pleased to learn that MSCI upgraded our rating from triple B to A, a recognition of our strong governance platform and our improving disclosures.

One metric we are particularly proud of, and which I mentioned on our last call, is the improvement since 2017 of our safety metrics which continues year-to-date. While the safety of our employees is paramount, improvements in total recordable and lost time case rates provide additional benefits including enhancing our ability to attract and retain talent and reducing total costs to the business.

I also want to again emphasize that the core of our business is inherently environmentally friendly. The insulation we install and distribute drives thermal efficiency, lowers energy usage, and reduces carbon emissions. We are the leader in delivering these benefits for new and existing homes and commercial and industrial facilities across the United States and Canada. The energy savings we deliver far outweigh the impact of our own operations.

And finally, as you know, Florida was hard hit by Hurricane Ian in September. While this storm did not have a material impact on our business, several of our branches in the state were shut down for a few days, directly impacting our employees. To ensure their priorities remained with their families during this difficult time, we paid our team in full for the days their respective branches were closed. This is another example of why we believe we are the employer of choice in our industry.

Looking ahead, we recognize there is a lot of uncertainty around the economy. While there is a general consensus the economy is slowing down, the optimists are predicting a shorter pause in growth while the pessimists see a longer slowdown.

Regardless of how this eventually plays out, we believe our business model in both installation and distribution can outperform in any environment. Our team manages the business with a constant mindset of driving improvements and achieving operational excellence. We have the best and most talented operators in the field and a dedicated and experienced group at our branch support center. Our entire team remains focused on continuing to deliver strong results and creating shareholder value in every operating environment.

Rob Kuhns
Chief Financial Officer
We are pleased to report another excellent quarter of profitable growth delivered by our experienced and talented teams across the U.S. and Canada. As Robert mentioned, both Installation and Specialty Distribution reported strong results with improved sales volume and strong profitability. Our unique business model, and relentless focus on driving operational improvements continues to provide us with a significant competitive advantage and positions us to outperform in any environment. We are keenly aware and are closely monitoring, the changing economic environment and our flexible cost structure, with over 70% variable costs, enables us to make adjustments quickly if conditions warrant.

Moving to the financials, I will start with an overview of our third quarter results, update you on our balance sheet, and provide the latest on our full year guidance.

Third quarter net sales increased 53.8% to $1.3 billion, and 22.6% on a same branch basis. Same branch volume improved both year-over-year and sequentially. Breaking that down, our Installation Segment's third quarter net sales were $783.1 million, an increase of 27.8%. Higher selling prices contributed 13.8%, increased sales volume added 12.3%, and acquisitions accounted for 1.7%. Specialty Distribution's net sales were $583.5 million, an increase of 111.1%.

On a same branch basis revenue grew 18.7% driven by a 13.0% increase in price and a 5.7% increase in volume.

Third quarter adjusted gross margin expanded 80 basis points to 30.4%. On a same branch basis, gross margin expanded 170 basis points to 31.3% driven by operational efficiencies, an increase in sales volume and higher selling prices, partially offset by an increase in the cost of material.

Third quarter adjusted EBITDA increased 63.8% to $259.2 million and our adjusted EBITDA margin was 19.9%, a 120-basis point improvement compared to last year. On a same branch basis, our adjusted EBITDA margin was 20.6%, an improvement of 190-basis points from third quarter 2021. Our third quarter same branch incremental EBITDA margin was 28.8% and our acquisition EBITDA margin came in at 17.4%, primarily driven by strong results from DI.

Third quarter adjusted EBITDA margin for our Installation segment was 21.6% and 18.0% for our Specialty Distribution segment, an improvement of 200-basis points and 10-basis points, respectively.

Third quarter interest expense increased from $5.5 million to $14.6 million, primarily as a result of additional borrowings from our acquisition of DI in the fourth quarter of last year and higher variable interest rates.

Third quarter adjustments to Net Income were $1.3 million and primarily related to acquisition integration costs. Third quarter adjusted earnings per diluted share were $4.80, a 62.7% increase from prior year.

Moving to our balance sheet and cash flows, our September 30 year-to-date operating cash flow was $335.6 million, compared to $309.5 million last year. This was driven by our 67.8% increase in Net Income, which was partially offset by growth in working capital. Working capital as a percent of trailing twelve-month sales was 15.5%, 520 basis points higher than a year ago. This increase was driven by the higher working capital requirements of DI, continued price inflation, ongoing recovery from supply chain disruptions, and certain strategic inventory buys related to our industrial business. Over the long term, our working capital target remains 11% to 13%.

On the capital allocation front September year-to-date CAPEX was $56.0 million, approximately 1.5% of revenue, and consistent with our long-term guidance. In addition, year-to-date we have allocated $20.5 million to acquisitions, and just over $200 million to share repurchases. There were no significant changes to our debt structure and our outstanding short-term and long-term debt balances remained at just under $1.5 billion. Our debt structure is roughly 60% fixed and 40% variable with our current average cost of debt at 3.75% and no near-term maturities.

We ended the third quarter with net debt leverage of 1.49 times trailing 12 months adjusted EBITDA. This is down from 1.68 times at the end of the second quarter and down from our pro forma leverage of 2.2 times at the time of the DI acquisition just over a year ago. We are often asked about where we are comfortable taking leverage and we've noted that between one and two times is a good range for us and is well below our bank covenant of 3.5 times.

Total liquidity at September 30, 2022 was $591.7 million, including cash of $159.4 million and an accessible revolver of $432.3 million.

Moving to annual guidance; we expect to close out 2022 with a strong fourth quarter.

We are projecting total 2022 sales to be between $4.95 billion and $5.0 billion, a $150 million increase on the low-end of the range and a $100 million increase on the high end. We have also raised our 2022 guidance for adjusted EBITDA to be between $915 million and $935 million, a $55 million increase on the low-end of the range and a $35 million increase on the high end. Our long-range modeling targets are unchanged from those we published on February 22nd.

Robert Buck
President and Chief Executive Officer

In closing, the long-term fundamentals of our industry are strong. We recognize in the short term there are many macroeconomic factors beyond our control influencing the environment in which we operate.

What we can control is how we manage our business. TopBuild has a unique operating model that differentiates us from our peers. Our size and scale are key advantages, as is having all of our branches roll up to a common ERP system. This allows us to track daily activity in every branch, enabling us to proactively address business changes in real time. Plus, the three end-markets we serve, residential, commercial, and industrial, represent a $16 billion total addressable market opportunity and, accordingly, we see a long runway of growth for our Company.

With an engaged and energized team, a culture founded on entrepreneurship and local empowerment, and a focus on continuous improvement and operational excellence, we are confident we will perform well in any environment.