Management's Prepared Remarks
Fourth Quarter 2022 Conference Call
February 23, 2023

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

Robert Buck
President and Chief Executive Officer
As you can see from today's press release, we had an outstanding fourth quarter and a record 2022. Our diversified business model and seasoned management team once again delivered strong top-line and bottom-line growth. Our team successfully balanced expected cost increases with selling price adjustments and did an excellent job managing both material and labor constraints by efficiently moving resources across our network to meet the needs of our customers and grow our business.

While Rob will discuss our financial results in detail, I'd like to give a brief overview of our operating results. Compared to fourth quarter 2021, revenue increased 18.9%, our adjusted gross margin expanded 160-basis points, and our adjusted EBIDTA margin increased 170-basis points. Both business segments reported double digit revenue growth and EBITDA margin expansion.

Installation had an outstanding fourth quarter with volume growth of 12.4% and price increasing 8.2%. We are working through the single and multi-family backlog, and believe we are getting more than our fair share of this work. Specialty Distribution's volume did decline in the fourth quarter, in part due to the lumpiness of large-scale mechanical insulation projects which we've discussed on previous calls. Specialty Distribution's pricing was strong in the quarter, growing 11.5%.

In addition to reporting a record quarter and year of financial growth and profitability, our team realized several other significant accomplishments in 2022. Specifically, we:

- Reported our best year ever with regards to our safety and personal injury rate;
- Successfully integrated Distribution International into our Specialty Distribution segment and now expect to achieve the high end of our forecasted $35 to $40 million of synergies;
- Continued to improve labor and sales productivity and drive overall operational improvements as part of our overall strategy to grow our business. Our technology tools have enhanced our installers' efficiency and improved the sales process, and our back-office technology initiatives have resulted in appreciable cost savings;
- We completed five strategic residential acquisitions that are expected to generate over $17 million of net annual revenue;
- Returned capital to our shareholders, acquiring 1.4 million shares for approximately $250 million;
- Enhanced our disclosures related to ESG, including publishing Scope 1 emissions data, and added human capital management statistics including more detailed workforce demographic data, and enhanced safety performance information; and,
- We provided you with a better understanding of our long-term growth strategy and the depth and experience of our leadership team at our Investor Day last spring.

All in all, a very productive and profitable year for TopBuild.

We enter 2023 financially strong and well-prepared to outperform in any environment. While we cannot predict the direction of the economy, our unique business model differentiates us from our peers and provides multiple avenues for growth. We also have several key competitive advantages that position us well for the future.

First and foremost is our experienced and cycle-tested leadership team. They understand what it takes to execute our business plan successfully and they are 100% focused on growing our Company, driving improvements, and creating value for our shareholders.

A second key advantage is having all our branches roll-up to a single, sophisticated ERP system. This allows us to track activity in every branch daily, enabling us to proactively address business changes through real time data-driven decisions.

A third is the command we have of our business coupled with our strong track record of successfully navigating an inflationary environment along with material and labor constraints. We expect fiberglass capacity to remain tight for most of this year and, not unexpectedly, the December industry cost increase has had good traction. Our builder customers recognize the supply and labor constraints our industry is operating under, and they value the quality and service we provide.

A fourth competitive advantage is our core competency around identifying, evaluating, and integrating acquisitions which continue to drive shareholder value. While we have market-leading scale, we see lots of white space for growth in all three of end-markets we serve, residential building insulation, commercial building insulation, and mechanical insulation. Combined, they represent a $16 billion total addressable market opportunity where we currently have just over a 20% market share.

In our residential end market, following the pandemic, we saw demand soar and builders forced to limit sales as they raced to obtain permits and start new homes while facing significant supply and labor constraints. Of course, with demand far exceeding supply, made worse by years of underbuilding, and material and labor shortages, new and existing home prices rose significantly. This created affordability issues for many consumers which has been further impacted by rising mortgage rates.

So where are we today? There is still a strong backlog of single and multi-family homes that need to be insulated. This backlog provides us with visibility on the single-family market through the first half of the year, and into late 2023/early 2024 for the multi-family market. While there is still uncertainty around the second half of the year, we are encouraged by the recent optimism from several builder customers.

However, if housing starts continue to slow or remain at current levels, given our strong track record of execution, we still have opportunities to grow both organically and through acquisitions.

Moving to our commercial building insulation end-market, we see multiple avenues for growth including heavy and light installation and product distribution. As we've noted on past calls, most of our residential installation branches also perform light commercial work. With the help of our proprietary lead generation application, which we highlighted at our May Investor Day, we are hitting these prospects hard in all our markets with solid resulting growth. As a reminder, light commercial follows residential expansion as new home communities require businesses to support them including retail, restaurants, and healthcare facilities.

For heavy commercial installation, we are looking at a solid backlog and strong bidding activity. We have roughly 20 branches focused on this business and the projects on which we work run the gamut from distribution centers, warehouses, and hospitals, to airports, arenas, and hotels, providing significant diversity in end market exposure.

While we are the biggest player in the commercial building insulation space, we estimate we have approximately 11% share of this $5.5 billion dollar end-market, so there is clearly significant incremental room for growth. Organically, our expansion will be driven through existing and new relationships with general contractors, from market intelligence into new project leads gained from our proprietary technology tools, and from the hard work of our local teams bidding and winning more projects.

Moving to the distribution of mechanical insulation in the commercial and industrial end-markets, once again we have a long runway for growth. While we are the biggest player in this space in both the U.S. and Canada, we estimate our share of this $5 billion end-market is only 10%. Half of our mechanical insulation revenue is derived from maintenance and repair work, and the other half from new projects including both the types of heavy commercial projects I discussed earlier and major industrial projects such as liquid natural gas facilities, food and beverage plants, chemical refineries, and manufacturing plants.

We believe we will see another year of solid growth in our mechanical insulation business both organically and through targeted acquisitions.

As far as capital allocation, our strategy remains intact. Our number one priority after internal investments in technology, innovation, and equipment, remains focused on acquiring high quality residential and commercial installation contractors and specialty distribution companies. Our team has the experience and proven ability to realize meaningful synergies from these transactions, which drive, by far, the greatest returns for our shareholders. We have substantial liquidity and expect to continue to generate strong free cash flow, enabling us to target the right deals that meet our specific criteria.

Since 2018, we have acquired and successfully integrated 24 companies which are contributing over $1.6 billion of annual revenue. This includes SRI Holdings, a $62 million residential installation company, we acquired in January. This well-managed high-quality company brings with it a strong customer base in markets in the Southeast and Midwest and its focus on its employees and safety fits well with TopBuild's culture.

Looking ahead, our pipeline of prospects is strong. We remain focused on our core of insulation and are targeting companies that will enhance our scale, expand our customer base, and generate strong returns for our shareholders. As I've mentioned, we have multiple avenues for growth, and you can expect us to remain active on the acquisition front.

In addition, we will continue to evaluate returning cash to shareholders through share repurchases. Our share repurchase program reflects managements and our Director's confidence in the long-term potential of TopBuild, our strong cash flow position and our firm commitment to optimizing the efficiency of our capital structure.

Rob Kuhns
Chief Financial Officer

As Robert noted, our operational teams throughout the US and Canada delivered another stellar performance, producing record results for both the fourth quarter and the full year. This is a direct result of our continued focus on driving top line growth and bottom-line profitability, coupled with an emphasis on operational excellence at every level of the organization. Our track record points to the success of our operating model. Over the past four years we have more than doubled our revenue, more than tripled our adjusted EBITDA and expanded our adjusted EBITDA margins by 690-basis points.

Moving to the financials, I will start with an overview of our fourth quarter results, update you on our balance sheet, and provide our full year guidance for 2023.

Fourth quarter net sales increased 18.9% to $1.3 billion, and 14.2% on a same branch basis. Breaking that down, our Installation segment's fourth quarter net sales were $761.3 million, an increase of 21.4%, driven by strong volume growth and higher selling prices. Specialty Distribution's net sales were $563.1 million, an increase of 15.9%, primarily driven by price and M&A. Specialty Distribution's volume declined in the fourth quarter as project related volumes for Mechanical Insulation were lower than prior year. As I've noted on previous calls, volumes on the mechanical insulation side can be a little choppy due to the project nature of the business.

For the full year, total sales increased 43.7% to $5.0 billion, and 18.8% on a same branch basis. Installation's revenue grew 24.9%, primarily driven by increased prices and volume. Specialty Distribution's full year revenue increased 77.0%, primarily driven by contributions from M&A and improved pricing.

Our adjusted gross margin for both the fourth quarter and full year was 29.7%, which equates to a 160-basis point expansion in the fourth quarter and 130-basis points for the full year. This was driven by operational efficiencies, fixed cost leverage, and our continued success in managing inflation.

Fourth quarter adjusted EBITDA increased 30.4% to $237.4 million and our adjusted EBITDA margin was 18.8%, a 170-basis point improvement compared to 2021. Full year adjusted EBITDA increased 55.2% to $940.6 million and our adjusted EBITDA margin was 18.8%, a 140-basis point improvement. On a same branch basis, our EBITDA margins improved by 210-basis points for the full year of 2022. Our fourth quarter and full year same branch incremental EBITDA margins were both 30.8%.

Fourth quarter adjusted EBITDA margin for our Installation segment was 20.8% and 16.7% for our Specialty Distribution segment, an improvement of 140-basis points and 170-basis points, respectively. For the full year, adjusted EBITDA margin for Installation expanded by 190-basis points to 20.6%. Specialty Distribution's full year adjusted EBITDA margin expanded 90-basis points to 16.9%.

Interest expense increased from $10.9 million to $16.8 million in the fourth quarter, and from $29.1 million to $56.7 million for the full year, primarily as a result of additional borrowings from our acquisition of DI in the fourth quarter of 2021 and higher variable interest rates. Our current debt is approximately 60% fixed and 40% variable with no upcoming maturities until 2026.

In the fourth quarter adjustments to Net Income were $1.4 million and $7.8 million for the full year, primarily related to acquisition integration related costs. Fourth quarter adjusted earnings per diluted share were $4.40, a 41.0% increase from prior year. Full year adjusted earnings per diluted share were $17.11, a 57.7% increase.

Moving to our balance sheet and cash flows, our 2022 operating cash flow was $495.8 million, compared to $403.0 million in the prior year. This was driven by our 71.6% increase in Net Income, partially offset by growth in working capital. The increase in working capital was driven by continued price inflation, higher fourth quarter sales volumes, and normal Q4 seasonality. This is an area where we see opportunities for improvement, and we are targeting a long-term range of 12% to 14% of sales.

CAPEX in 2022 was $76.4 million, approximately 1.5% of revenue, and consistent with our long-term guidance. Regarding capital allocation, for the full year, we spent approximately $15 million on acquisitions, and approximately $250 million on share repurchases. Over the long term, we will continue to prioritize a healthy balance sheet, internal investments, synergistic acquisitions, and opportunistic share repurchases. In terms of acquisitions, we have opportunities for growth in all three end markets we serve as well as a healthy pipeline of acquisition targets.

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. We ended the fourth quarter with net debt leverage of 1.31 times trailing 12 months adjusted EBITDA. This is down from 1.49 times at the end of the third quarter and down from our pro forma leverage of 2.2 times after we acquired DI in October 2021.

Total liquidity on December 31, 2022, was $672.4 million, including cash of $240.1 million and an accessible revolver of $432.3 million.

Moving to annual guidance, the backlog of single-family units under construction should continue to support our residential sales into the second quarter of 2023, while the backlog of multi-family units is stronger and should support our residential sales for the full year. At this time, given this current backlog and the recent trend on housing starts, we are expecting our residential sales to decline mid to upper single digits in 2023 as we expect single-family activity to be slower in the back half of the year.

However, we believe the long-term fundamentals of the housing industry are solid and we were very pleased to hear some of the recent optimism expressed by a number of the public builders. Moreover, we are confident our leadership team, technology tools, and flexible cost structure will ensure that TopBuild will continue to outperform in any environment.

Our expectation for our commercial and industrial end markets, which is now 35% of our total revenues, is more optimistic. We have a strong backlog and bidding activity on new projects is very active. As a result, we are expecting sales in these end markets to expand by low to mid-single digits.

Putting all of that together, we are projecting total 2023 sales to be between $4.7 billion and $4.9 billion and adjusted EBITDA to be in the range of $820 million to $910 million.

Robert Buck
President and Chief Executive Officer
In closing, as we look to the rest of this year, we recognize we cannot control the macro environment. What we can control is how we manage within it and we are well prepared to operate and outperform if a more challenging environment develops. This is evidenced by our strong track record of executing on our plan, producing solid results, and creating value for our shareholders.

We are also excited about our multiple avenues for growth. As I mentioned earlier, we have a combined 20% share of the three end-markets we serve, which together represent over a $16 billion total addressable market. We are confident in our ability to successfully source and execute strategic acquisitions to further fortify our competitive advantages.

As always, I thank our entire TopBuild team for their hard work, energy, and unyielding focus on delivering continued great customer service, and strong bottom line results while operating safely every day.