Management's Prepared Remarks
First Quarter 2022 Conference Call
May 5, 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 first quarter presentation which can also be found on our website.

Robert Buck
President and Chief Executive Officer
Before discussing our first quarter results, I would like to make a few comments regarding our view of the U.S. housing industry. We recognize that there are concerns that rising home prices, led by higher interest rates and an inflationary environment, could dampen consumer demand. And we agree there is a possibility that some consumers could be priced out of the market. Where we differ is with the sentiment that these factors will cause a material downturn in the US housing industry.

Looking at the macro environment, while interest rates have risen and will likely continue to increase over the year, based on recent commentary from the Fed, they are still far below historical levels. It is also essential to consider long-term supply and demand fundamentals. Average housing starts over the past 10 years have been below historical levels resulting in very low new home and resale inventory. At the same time, we have seen robust household formations, particularly among millennials, fueling the demand for entry level homes. Builders are acutely aware of the shortage of entry level housing and want to take advantage of this strong demand and are adjusting their product to mitigate the impact of higher housing costs, including offering homes with smaller footprints or scaled-back options. Plus, rising wages are helping more consumers manage higher home prices.

From TopBuild's vantage point, our backlog is strong and growing, supported by the widening delta between starts and completions. Our builder customers tell us they still see robust demand and, accordingly, most continue to regulate sales.

So, even if there are some consumers priced out of the market, we believe the demand for housing, based on the macro environment just discussed, and what we are hearing and seeing in the field, is strong enough to support steady growth over the next few years.

We also expect good growth from the commercial and industrial end-markets which are tied to a wide range of construction projects and industries separate from housing. Our mechanical insulation business also benefits from reoccurring revenue tied to maintenance and repair operations. Combined, on a pro forma full year basis, these end-markets contribute about 37% of our revenue with plenty of opportunities to expand our market share.

Over the past seven years we've demonstrated that our diversified business model, combined with our strong operational execution, overall scale, M&A expertise, proven ability to strike the optimal balance between price and volume, and flexible cost structure should enable us to outperform the market in any environment.

Turning to our first quarter results, we again demonstrated the strength of our operating model and our ability to manage material cost increases and selling price adjustments. Revenue increased 57.4% and same branch adjusted EBITDA margin expanded 310 basis points to 18.7%. The construction industry continues to experience material and labor constraints elongating the build cycle and growing the backlog of work. At this time, we don't see any indications that these supply chain or labor constraints are beginning to ease, again supported by the recent starts and completions data.

Fiberglass capacity and pricing remain a fluid situation. We've seen two cost increases this year and will likely see at least one more by year end. Though additional loose fill capacity did come online late last year and in March of this year, manufacturers are performing line maintenance, reducing supply in the short term. While the industry remains on allocation, the quality and reliability of our supply chain is a clear competitive advantage for TopBuild.

Relative to spray foam, we have not yet seen any easing of supply constraints and costs continue to escalate. Unlike fiberglass, spray foam is dependent on imported components, many from Asia. Spray foam manufacturers are also experiencing limited availability of the new closed cell blowing agents required by some states further constraining supply.

Where possible, we continue to invest in extra inventory to service our customers, grow our share and smooth out some of the supply chain disruptions.

While Rob will discuss our business segment results in more detail, I want to recognize our Installation and Specialty Distribution teams for outstanding execution in a difficult and demanding environment. Great job by our Field and Support Teams in driving shareholder value.

Installation revenue, on a same branch basis, grew 17.0%, and the team continues to do an excellent job managing price, labor needs and meeting customer expectations. Our backlog continues to expand as supply and labor constraints remain obstacles to strong industry volume growth.

Specialty Distribution, on a same branch basis, continues to see volume impacted by supply constraints in many of the products we distribute. On the flip side, these constraints enabled the segment to see 22.9% in price realization, compared to the first quarter of 2021.

While we are not breaking out financial results for DI, I will say the DI revenue is growing at a solid pace, given fewer supply chain disruptions and great supply planning, and margins are expanding. The benefits of this strategic acquisition focused on our core business of insulation are exceeding our expectations.

Turning to the integration of DI, with about seven months under our belt, it is proceeding very well thanks in large part to the dedication of our multi-functional team driving this effort. To give you some specifics, supply chain integration is on schedule, many functions are now operating under one umbrella including finance, human resources, legal, safety, and strategic sourcing, and we are beginning to move DI's branches onto our common ERP system. We are extremely confident we will achieve the $35 million to $40 million of synergies by the end of our second year of ownership as projected back in October when we closed this transaction. This has been a tremendous acquisition for our Company, diversifying our revenue stream, providing a strong entry into the Canadian market, expanding both our core product offerings and customer base as well as enhancing our M&A pipeline.

On the capital allocation front, we have completed four residential insulation acquisitions this year, which are expected to contribute close to $16 million of annual revenue. Acquisitions continue to be a great use of our capital, generating strong returns for our shareholders. While we have a solid prospect pipeline and hope to see additional transactions close as we move through the year, the successful integration of DI remains our top priority.

We are also pleased to announce a $100 million accelerated share repurchase which we anticipate executing within the next several days. This program reflects managements and our Board's confidence in the long-term potential of TopBuild and our strong future cash flow position. In summary, we had a great first quarter to start what we believe will be a solid 2022.

Our team continues to execute well and generate strong results, managing rising material costs and achieving selling price increases, while maintaining our unwavering focus on profitable growth. Looking forward, we believe there are several years left in the residential market to facilitate steady growth. Our commercial and industrial markets continue to show strength as well. Our diversified model positions TopBuild to outperform in any environment.

Rob Kuhns
Chief Financial Officer
Our teams continue to execute at a high-level in a challenging business environment. The benefits of these efforts were reflected in our strong first quarter results, which included revenue growth and expanded adjusted EBITDA margins in both our Installation and Specialty Distribution segments.

In the first quarter, net sales increased 57.4% to $1.2 billion, driven by revenue from acquisitions, which increased sales 38.6%. Same branch sales growth, which excludes the impact of acquisitions completed in the last twelve months, was 18.7%, due to higher selling prices and higher sales volume.

First quarter adjusted gross margin expanded 160 basis points to 28.3%, driven by higher selling prices, higher sales volume, synergies from the DI acquisition, and operational efficiencies, partially offset by material inflation.

Adjusted operating profit in the quarter grew 72.4% to $167.5 million, with a corresponding margin improvement of 120 basis points to 14.3%. Keep in mind that our adjusted operating margin includes $9.6 million of incremental purchase price amortization from the DI acquisition. On a same branch basis, operating income margin was 16.4%, an improvement of 330 basis points.

First quarter adjusted EBITDA increased 74.2% to $201.7 million and our adjusted EBITDA margin was 17.3%, a 170 basis point improvement. On a same branch basis, our adjusted EBITDA margin was 18.7%, an improvement of 310 basis points. Both adjusted operating income and EBITDA margin improvements were driven by the previously mentioned factors impacting gross margin, as well as our continued controls and discipline around SG&A costs enabling us to leverage our fixed cost base. Evidence of this leverage was seen in our same branch incremental EBITDA margin which was 35.2% in the first quarter, well ahead of our guided range of 22% to 27%. Our overall incremental adjusted EBITDA margin was 20.2%, which consisted of the 35.2% same branch incremental EBITDA margin and our M&A EBITDA margin of 12.9%.

First quarter interest expense increased from $6.6 million to $12.0 million, primarily as a result of additional interest expense related to our $500 million senior notes offering last October.

Our effective tax rate was 24.9% in the first quarter, compared to 20.7% for the comparable period in 2021. The higher rate was primarily due to a decrease in the benefit related to share-based compensation and state tax adjustments.

Adjusted net income for the first quarter was $115.6 million, or $3.50 per diluted share, an increase of 73.3%, compared to $2.02 per diluted share in the first quarter of last year. First quarter adjustments to net income were $3.5 million, primarily tied to acquisition related costs.

Moving to our balance sheet and cash flows, first quarter CAPEX was $18.4 million, approximately 1.6% of revenue. Working capital as a percent of trailing twelve-month sales was 14.8%, 460 basis points higher than a year ago, primarily as a result of the DI acquisition. As I mentioned on our February call, DI has a higher working capital profile than our legacy business. In addition, another factor impacting working capital this quarter was our taking advantage of the opportunity to build some inventory at both business segments to help mitigate the ongoing supply chain constraints and meet our customer's strong demand. Over the long term, our working capital target remains 11% to 13%.

First quarter operating cash flow was $89.5 million. We ended the quarter with net leverage of 1.84 times trailing twelve months adjusted EBITDA, an improvement from last quarter when our net leverage was 2.02 times. Total liquidity was $556.6 million, inclusive of the available balance on our $500 million revolver of $430.1 million, and cash of $126.6 million.

Now let's turn to our segment results.

In the first quarter, our Installation Segment's net sales increased 27.0% to $676.7 million. Revenue from acquisitions increased sales by 10.0% and same branch sales grew 17.0%, due to higher selling prices and sales volume. First quarter adjusted EBITDA margin for the Installation segment was 19.1%, a 270-basis point improvement compared to first quarter of last year.

Specialty Distribution's first quarter sales were up 116.2% to $543.9 million. Revenue from acquisitions increased sales by 93.3% and same branch sales increased 22.9%, due to an increase in selling prices. First quarter adjusted EBITDA margin was 15.6%, a 60-basis point improvement. As Robert mentioned, DI is performing well and the integration is proceeding as planned. We are already enjoying some synergy benefits and are even more confident today that we will successfully deliver the $35-$40 million of synergies announced at the time of the transaction.

Moving to our annual guidance; we expect 2022 to be a solid year for TopBuild. However, as we noted in February, our guidance assumes continued industry wide material and labor constraints, limiting volume growth in our end markets to the low to mid-single digits.

Based on our first quarter results, current backlog, and conversations with our customers, we are now projecting total sales to be between $4.65 billion and $4.8 billion, a $150 million increase on both the high and low-end of the range. We are also increasing our guidance for adjusted EBITDA to be between $810 million and $860 million, a $40 million increase on both the high and low-end of the range. At the midpoint of our guidance, our adjusted EBITDA margin has increased 30 basis points and we expect to be at the high end of our 22% to 27% incremental organic EBITDA range for the full year. Our long-range modeling targets and assumptions are unchanged from those we published on February 22nd.

Robert Buck
President and Chief Executive Officer
In closing, while we recognize we can't control the macro environment, what we can control is how we operate within it and our focus remains on:

- Growing our market presence,
- Improving operational efficiency,
- Driving profitable growth, and
- Successfully integrating DI.

Our unique business model, which includes installation and specialty distribution in the residential, commercial, and industrial end-markets, offers multiple avenues for growth, and gives us the ability to outperform in any environment.

As a reminder, we are hosting our Investor Day on May 26 in New York City. The key team leaders from Installation and Specialty Distribution will be there as well as our senior leadership team. If you are interested in attending, please contact Tabitha and she will give you the details.

Thanks again to our entire TopBuild team for their hard work, energy, and unyielding focus on delivering continued great customer service and strong results while operating safely every day.