Management's Prepared Remarks
Third Quarter Conference Call
November 7, 2017

Tabitha Zane
Vice President, Investor Relations
Thank you and good morning. On the call today are Jerry Volas, Chief Executive Officer, Robert Buck, President and Chief Operating Officer, and John Peterson, Chief Financial Officer.

Please note, we have posted senior management's formal remarks on the Investor Relations section of our website at topbuild.com.

Many of our remarks will include forward-looking statements concerning the company's operations and financial condition. These forward-looking statements include known and unknown risks, 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. In addition, we will also discuss non-GAAP financial measures which can be reconciled to the most comparable GAAP measures in a table included in today's press release.

Jerry Volas
Chief Executive Officer
We are pleased to report another quarter of strong results. Despite severe weather issues in certain regions of the country, revenue grew 7.9%, adjusted operating margin expanded 160 basis points to 10.3%, and adjusted EPS increased 31.7% to $0.83 per share. Adjusted EBITDA increased 28.9% to $57.6 million, and our adjusted EBITDA margin improved 190 basis points to 11.8%. Our incremental EBITDA margin, a key metric for us, was 36.0% for the quarter. John will discuss what drove these solid results.

Our third quarter results were impacted, to some degree, by Hurricanes Harvey and Irma. We estimate lost revenue of around $6 million to $8 million as we closed facilities in the impacted areas but still paid our employees during the period. We believe that at some point next year, we could potentially see an acceleration of activity in Florida and Texas as the rebuilding effort takes shape.

From a macro viewpoint, all signs point to continued improvement in housing starts. Ninety-day lagged starts are up 6.3% for the first nine months, a steady and respectable rate of growth. However, even at this level, starts are well below the 50-year historical average. In addition, general economic conditions are positive with capital markets strong and interest rates low. All of this is driving demand for housing that exceeds current supply. All in all, a good environment for TopBuild.

While we didn't complete any acquisitions this quarter, our pipeline is robust and our team continues to add prospects. We are looking at residential, commercial and distribution companies and expect to bring a number of these over the finish line. To reiterate what we have said on prior calls, we believe that funding organic growth and acquisitions is the best use of our capital.

TopBuild has a unique operating model that differentiates us from our peers. Our size and scale give us key advantages in the procurement of both materials and labor. We have two distinct businesses which together enhance our reach into a fragmented residential housing market. Our commercial business, another unique element of our overall value proposition, is growing rapidly as we offer bundled solutions to general contractors. We see a long runway of growth for our Company.

Finally, I want to thank those of you who joined us for our Investor Day last month, either in-person or via the webcast. We hope you saw the strength and depth of our team and better understand why we are so excited about our future.

John Peterson
Chief Financial Officer
We had a solid third quarter. Consolidated revenue increased 7.9% to $489 million, primarily driven by sales volume and improved selling prices at both TruTeam and Service Partners, as well as $24.4 million of revenue from companies acquired since August 2016. On a same branch basis, revenue increased 2.7% compared to third quarter 2016. These results were negatively impacted by adverse weather in the range of $6 to $8 million.

Gross margin expanded 80 basis points to 24.7%, compared to the same period a year ago. Adjusted operating profit grew 27.0% to $50.3 million, with a corresponding margin improvement of 160 basis points. Both gross margin and operating margin improvements were driven by volume leverage, higher selling prices, and improved labor productivity; partially offset by higher health insurance costs, higher material costs and some inefficiencies tied to weather. Third quarter 2017 adjustments totaled $700,000, primarily related to the consolidation of certain back office operations and acquisition related expenses.

Third quarter adjusted EBITDA was $57.6 million, compared to $44.6 million in 2016, and our EBITDA margin was 11.8%, a 190-basis point improvement from third quarter 2016 and a 350-basis point improvement from third quarter 2015. This margin improvement is a direct result of the transformative changes we have made at TopBuild to improve our operations, increase labor and sales productivity, optimize our footprint and streamline many of our processes and procedures. Profitable growth continues to be a key focus for everyone in our business.

We were also pleased to report a strong drop-down to adjusted EBITDA margin of 36.0%. On a same branch basis, adjusted EBITDA was $53.7 million, a 20.3% increase, and our drop-down to adjusted EBITDA was 74.2%, driven by improved selling prices, strong cost control and continued leveraging of our platform.

For the first nine months of 2017, adjusted EBITDA grew 36.3% to $139.7 million, and our drop-down to adjusted EBITDA was 35.0%.

Incremental margin related to our seven acquisitions was 16.3%, a 380 basis-point improvement from last quarter. This clearly demonstrates our success in acquiring high value businesses, successfully integrating them into TopBuild and delivering strong returns to our shareholders. Acquisitions remain our number one capital allocation priority after internal investments.

TopBuild's third quarter SG&A increased $2.2 million, or 3.2%, to $71.3 million, but declined 60 basis points as a percent of revenue to 14.6%. The majority of the increase was driven by the impact of acquisitions as well as higher stock based compensation.

Adjusted income from continuing operations for the third quarter was $29.7 million, or $0.83 per diluted share compared to $23.8 million, or $0.63 per diluted share. For the first nine months of 2017, adjusted income from continuing operations was $71.6 million, or $1.94 per diluted share, compared to $51.9 million, or $1.37 per diluted share.

CAPEX for the first nine months of the year was $13.1 million, and working capital as a percent to sales for the trailing twelve months was 10.0%. Working capital as a percent of sales was 110 basis points higher than prior year due to a higher commercial sales mix, driven primarily by the impact of our two large commercial acquisitions earlier this year, Midwest Fireproofing and Canyon Insulation. Commercial projects typically have a longer collection cycle than residential jobs. To a lesser degree, adverse weather conditions in September also had some impact on our quarter-end collections due to closed TopBuild branches and customer pay offices in the affected regions. We expect working capital to be in our targeted range of 7-8% of sales for year-end 2017.

Operating cash flow was $54.6 million for the first nine months and cash on the balance sheet was $18.5 million at 9/30. Net leverage for the quarter was 1.28% with total liquidity available of $316.4 million, inclusive of the available balance on the revolver of $197.9 million, the delayed draw of committed funds on our term loan of $100 million and cash of $18 million.

Our effective tax rates for the third quarter and nine months were 33.4% and 33.8%, respectively, lower than the 38% tax rate we guide to. The lower rate was primarily due to excess tax deductions driven by share-based compensation.

I want to turn to annual guidance which was published in today's press release. As we announced, and commenced, on our recent Investor Day, we are now providing guidance for revenue and adjusted EBITDA. For full year 2017, we expect revenue to be between $1,890 to $1,905 million, a tightening of the range previously provided of $1,880 to $1,905 million. For adjusted EBITDA we're guiding to $190 to $195 million, versus previous guidance of $183 to $193 million.

Going forward, we anticipate updating annual guidance quarterly. On our fourth quarter call next February, we will provide annual revenue and adjusted EBITDA guidance for 2018.

At investor day, we also provided 3-year targets, which included some changes to what we've modeled in the past. For Residential growth, we've combined repair and remodel with residential new construction and we are now projecting $60 million of residential revenue for every increase of 50,000 housing starts.

Commercial is unchanged, with annual revenue growth expected to be at least 12% per year. Both Residential and Commercial growth assumptions exclude any impact of future acquisitions.

CapEx, which we've traditionally guided to 1% of revenue, is now being projected at 2% - 2.5% of sales. The increase is driven by a change in how we will be acquiring our vehicles. Starting this quarter, we are moving to low cost debt financing for fleet acquisitions and away from full service lessors. Over time, our historical operating leases will wind down and be replaced with depreciable assets. For the first two years of the transition we expect negligible impact to operating profit.

We are now breaking out incremental EBITDA on sales growth between our organic business and acquisitions. For acquisitions, we expect incremental EBITDA margins for the first year to be between 11-16%. Incremental EBITDA margins on organic growth are now projected at 22% to 27%.

For those of you who model our company, due to the change in how we will be acquiring and financing our vehicles, we expect to see an additional addback of depreciation as the historical operating leases expire and are replaced with depreciable assets. This should add an incremental $1.0 to $1.5 million of depreciation in 2018, $4.0 to $5.0 million in 2019 and $7.0 to $8.0 million in 2020.

So, keeping 2017 annual guidance and these long-term metrics in mind, here is what TopBuild, without additional acquisitions could potentially look like, assuming we reach 1.5 million starts in 2021. We would be generating almost $2.5 billion of revenue and reporting EBITDA between $312 million and $340 million with corresponding margins of 12.6% to 13.7%. This doesn't include the additional addback of depreciation just discussed. Of course, we will make additional acquisitions, the results of which will further enhance these estimates.
We think that's a great story for shareholders.

Robert Buck
President and Chief Operating Officer
TruTeam and Service Partners performed very well this quarter, despite the impact of Hurricane's Harvey and Irma. While many of our operations in Texas and Florida were shut down for a full week, we worked hard to ensure our customers were serviced. Taking care of our employees and their families during this difficult time was also a high priority and we paid our teams impacted by the hurricanes in full during this period.

Despite these adverse conditions, we were able to expand margins in the quarter by 160 basis points. This is nothing short of a fabulous job by all of our employees at TopBuild, TruTeam and Service Partners and we thank everyone for pulling together as a team. This is very representative of our culture and the operational excellence throughout our organization.

Looking at TruTeam' s results, third quarter sales increased 11.1%, benefitting from higher same branch volume, acquisitions and a 1.5% increase in selling prices Adjusted operating margin was 12.3%, a 150-basis point improvement from third quarter 2016. Although volume leverage was a key contributor in the quarter, results were also favorably impacted from higher selling prices and continued improvement in sales and labor productivity. On a same branch basis, TruTeam's revenue increased 3.2%, outpacing third quarter lagged starts of 1.5%.

Labor continues to be a gating factor in our industry amongst all trades. We believe it has extended the lag in certain areas and continues to keep a damper on housing starts growth. At TruTeam, we are seeing wage inflation in many markets which we continue to successfully offset with selling price increases. In addition, in certain regions we are making conscious decisions when bidding jobs to ensure we are driving profitability through a balance between price and volume.

On the commercial side, in the third quarter TruTeam grew its revenue by almost 29%. While much of this increase was generated from acquisitions, it also reflects our continued focus on growing this segment of our business. Today, commercial represents about 20% of total revenue, and under the scenario John outlined a few minutes ago, it should account for almost 26% by year-end 2021. Our backlog for commercial work is very robust heading into 2018 and we are already bidding jobs that are expected to start in late 2019 and early 2020.

Our push to expand our spray foam business continues in earnest. Installation revenue from this product has increased 18% year-to-date. We expect spray foam's growth to remain strong, particularly as new building codes are implemented and builders as well as consumers continue to recognize the many benefits of spray foam.

At Service Partners, sales were up 4.0% in the quarter driven by sales volume growth and higher selling prices. As we discussed at the outset of the year, we expected selling prices to improve, and they have, increasing 1% compared to a year ago. Both strong cost control, and an improved alignment between selling prices and material costs were the major contributors to the 120-basis point improvement in third quarter operating margins.

Distribution revenue from spray foam has increased 23% at Service Partners year-to-date.

As we discussed at Investor Day, we are concentrating on a few key opportunities to grow our distribution business. One area of focus is increasing the average order size which can be accomplished through improved sales training and add-on products. We are also piloting a new program whereby we will provide spray foam rig repair and parts service in the field to our customers. Remember, Service Partners' customers are generally smaller contractors in the industry and they have about $100,000 of capital tied up in their spray foam rigs. When these rigs are down or need to be serviced, that is lost revenue to that customer and right now there is no easy and quick solution to get their spray foam rigs back into production. We are first movers in this arena and, assuming the pilot program is a success, which we believe it will be, we will roll this program out nationally over the next 12-18 months.

As 2017 draws to a close, we are pleased with our progress in managing our supply chain and leveraging our existing network of branches, while doing a great job with our targeted acquisitions. We continue to make operational improvements throughout our organization as our teams drive for growth and profitability. I thank the entire TopBuild team for their focus on working safely to deliver value, quality and service to our customers.

Jerry Volas
Chief Executive Officer
Thanks Robert. As you have heard today and seen in our results, we are leveraging our footprint, operating efficiently and continuing to deliver solid returns to our shareholders. M&A will remain an important component of our growth and you can expect to see us announce additional transactions.