

TopBuild Corp

TopBuild: incrementally bullish following management meetings

Reiterate Rating: BUY | PO: 475.00 USD | Price: 411.50 USD

Incrementally bullish following management meetings

We hosted investor meetings with TopBuild CFO Rob Kuhns and Investor Relations PI Aquino. We came away incrementally bullish: 1) guidance is conservative relative to our expectations on single-family starts and insulation pricing, 2) BLD still has opportunity to drive elevated incremental margins from productivity initiatives, and 3) increased penetration of spray foam could drive relative outperformance vs industry at a high profit dollar contribution. We raise our PO to \$475 (from \$410) based on ~13X EV/2025 EBITDA (previously ~11X EV/2025 EBITDA) driven by higher sector multiples and an improved single-family/pricing outlook. Reiterate Buy. See our key takeaways below:

Single-family momentum improved into February

TopBuild had a slow start to 2024 due to adverse weather in January, but trends improved in February. TopBuild's guidance conservatively assumes single-family starts roughly in-line with the current trend (low-to-mid single% YoY in 2024) but we see upside to the starts outlook and expect single-family starts to increase ~9%. Builders (both public and private) appear optimistic on the starts pace in 2024 (and into 2025). TopBuild's multi-family (estimate mid-teens % of residential and 10% of total) backlog carries through 2024.

Plenty of offsets to office softness in non-residential

Urban office and warehouse end markets are soft, but this should be more than offset by data centers, semi-conductor plants (Chips ACT), EV battery plants and LNG refiners. BLD is already bidding out to 2025 for some projects. Commercial pricing increased slightly in 1Q24 and mineral wool capacity is tight.

We see upside to fiberglass pricing outlook

Fiberglass insulation capacity is already tight (expect flattish industry capacity overall in 2024 with 3% growth from Knauf Texas facility opening offset by maintenance downtime). The mid-point of guidance implies realization of the already announced 1Q pricing (we interpret as low-single digit) and additional hikes would be upside. Given the tight capacity and increased pace of single-family starts, we anticipate an additional price increase from manufacturers later in 2024.

Margins could benefit from productivity improvements

BLD has been driving incremental margins above its long-term target of 22-27% due to productivity gains, acquisition synergies and favorable price-cost. We see potential upside to the 2024 guidance of 22-27% (excluding \$25mm in benefit of multi-family shipments in 2023) on additional productivity gains and pricing. There is still a wide spread between BLD's most and least productive branches, which leaves plenty of efficiency headroom.

See below for outlook on spray foam, M&A and SPI.

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12670377

Timestamp: 14 March 2024 05:00AM EDT

14 March 2024

Equity

Key Changes

| (US\$) | Previous | Current |
|------------|----------|---------|
| Price Obj. | 410.00 | 475.00 |

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Stock Data

| | |
|--------------------------------|-------------------------|
| Price | 411.50 USD |
| Price Objective | 475.00 USD |
| Date Established | 14-Mar-2024 |
| Investment Opinion | B-1-9 |
| 52-Week Range | 184.50 USD - 421.75 USD |
| Mkt Val (mn) / Shares Out (mn) | 13,076 USD / 31.8 |
| Free Float | 99.3% |
| Average Daily Value (mn) | 102.50 USD |
| BofA Ticker / Exchange | BLD / NYS |
| Bloomberg / Reuters | BLD US / BLD.N |
| ROE (2023E) | 27.9% |
| Net Dbt to Eqty (Dec-2022A) | 63.1% |
| ESGMeter™ | Medium |

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SPI- Specialty Products & Insulation

BLD – TopBuild

Spray foam is a meaningful opportunity

Spray foam is currently 15-20% of residential sales (roughly half that in units) and growing faster than the overall business. If housing starts increase, given tight capacity in fiberglass insulation, we expect outsized growth in spray foam. Spray foam is very accretive to TopBuild's profit dollars per house and open cell spray foam revenue equates to around \$10,000 per house vs fiberglass at \$5,000. Builders can at least partially offset the incremental cost of spray foam through 45L tax credits which offer up to \$5,000 per home for constructing energy efficient homes.

SPI timing remains uncertain but M&A pipeline still robust

TopBuild has responded to a 2nd request for information from the Antitrust Division of the Department of Justice related to the SPI acquisition, which is common in the current regulatory environment. BLD does not have visibility on the timing of the closing or if the DOJ will decide to challenge the acquisition. That said, SPI's market share position in mechanical insulation and spray foam distribution (combined 85% of business) is relatively low. If BLD is unable to close the deal, there is still a significant pipeline of smaller deals and we would also anticipate BLD to increase the pace of share repurchase.

Price objective basis & risk

TopBuild Corp (BLD)

Our \$475 price objective (PO) is based on a 13x EV/2025E EBITDA multiple, above its average from 2017-2023 due a stronger growth outlook and improved margin profile.

Upside risks to our PO: 1) faster-than-expected recovery in new home starts, 2) further residential market share gains through organic growth and M&A, 3) continued strength in the commercial/industrial market, 4) continued price increases on insulation products.

Downside risks: 1) a downturn in the housing market leading to less starts, 2) deflation in insulation products leading to weaker revenue growth and margin pressure, 3) a broad pullback in commercial/industrial activity.

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TopBuild (BLD) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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|-------------------|-------|---------|--|-------|---------|
| Buy | 39 | 44.83% | Buy | 22 | 56.41% |
| Hold | 18 | 20.69% | Hold | 11 | 61.11% |
| Sell | 30 | 34.48% | Sell | 8 | 26.67% |

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

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|-------------------|-------|---------|--|-------|---------|
| Buy | 1895 | 53.62% | Buy | 1083 | 57.15% |
| Hold | 832 | 23.54% | Hold | 454 | 54.57% |
| Sell | 807 | 22.84% | Sell | 383 | 47.46% |

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|-------------------|---|--|
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| Neutral | ≥ 0% | ≤ 30% |
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