Trex Company, Inc.

Q4 and Full Year 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

Jim Cline - *President, Chief Executive Officer*

Bryan Fairbanks - *Executive Vice President and Chief Financial Officer*

Bill Gupp - *Senior Vice President, General Counsel, Secretary*

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PRESENTATION

Operator
Good evening and welcome to the Trex Company Fourth Quarter and Full Year 2018 Earnings Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on your telephone keypad, to withdraw your question, please press "*" then "2." Please note, this event is being recorded.

I would now like to turn the conference over to Viktoriia Nakhla. Please go ahead.

Viktoriia Nakhla
Thank you all for joining us today. With us on the call are Jim Cline, President and Chief Executive Officer, and Bryan Fairbanks, Executive Vice President and Chief Financial Officer. Joining Jim and Bryan is Bill Gupp, Senior Vice President, General Counsel and Secretary, as well as other members of Trex management.

The company issued a press release today after market close containing financial results for the fourth quarter and full year of 2018. This release is also available on the company's website. This conference call is also being webcast and will be available on the Investor Relations page of the company's website for 30 days.

I would now like to turn the call over to Bill Gupp. Bill.

Bill Gupp
Thank you, Viktoriia. Before we begin, let me remind everyone that statements on this call regarding the company's expected future performance and conditions constitute forward-looking statements within the meaning of federal securities laws. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. For a discussion of such risks and uncertainties, please see our most recent Form 10-K and Form 10-Qs as well as our 1933 and other 1934 act filings with the SEC. The company expressly disclaims any obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

With that introduction, I will turn the call over to Jim Cline.

Jim Cline
Thank you Bill, and thank you all for joining us this evening to review our fourth quarter and full year results and to discuss our outlook heading into 2019. This was another great year for Trex, as we were able to report record results in each quarter of the year and post our sixth consecutive year of record revenue and earnings.

Several factors contributed to this excellent performance, namely our sales and marketing team's successful strategy of focus on our greatest growth opportunity, the conversion from wood, the strong support and execution by our business partners, the proprietary and unique advantages that Trex has through its recycled raw materials use, the manufacturing team with our operations group who have continued to deliver outstanding results through their hard work and commitment, and our ability to introduce new and innovative products to the market.

Looking at the fourth quarter, we are pleased with this strong finish to a record year, reflected in our 15% consolidated sales growth. This represents strong double-digit growth for both international and domestic residential products as well as commercial products. In residential products, the very positive response to our early buy program more than offset lower levels of organic sales as we experienced throughout the quarter as the channel normalized inventory.

Demand was strong supporting our new product introductions, and advanced ordering ahead of the January 2019 price increase on certain decking products. This is our first meaningful price increase on decking since 2011. The decision to take the price increase was due primarily to increased cost for freight and non-recycled raw materials that were experienced throughout much of 2018 and are expected to continue into 2019.

We unveiled two new products in the fourth quarter that we expect will be transformational and accelerating our ability to gain market share from the dominant wood market. These products were specifically designed to penetrate the wood share of the market. The wood market is more often associated with the do-it-yourself consumer segment, which represents about 60% of the total decking market. This market is served by both the pro channel and major retailers.

Our newly re-engineered and expanded line of Trex Enhance is a branded product designed to put pressure on treated lumber. With Enhance basic solid color products targeting the value conscious buyer and Enhance Naturals which features variegated colors at a slightly higher price point thus providing great value and higher aesthetics. Both products carry our 25-year limited warranty including our 25-year paint and stain warranty.

In terms of performance, these products compare favorably with virtually all composite products available in the market today, except for our flagship Transcend product which has unparalleled performance and aesthetics, and is available in the broadest color palette.

Innovation is synonymous with the Trex brand. These new product introductions along with our recent release of Transcend 2.0 monochromatic colors reinforce our market leader position. This has enabled Trex to gain a greater share of the sector growth and to drive similar outperformance, as we continue to take share from the wood market. Wood accounts for approximately 83% of the decking in North America and we estimate that approximately 60% of that market is addressable by our products. We see a significant runway ahead of us.

We reported 110 basis point consolidated gross margin expansion in the fourth quarter, despite two elements that reduced the year-over-year progress which includes start-up costs associated our new residential product launches and increased cost primarily related to certain legacy projects at commercial products. Both of these issues will put pressure year over year margin comparisons primarily in the first half of 2019, which was not unexpected.

At commercial products, the team has implemented operational changes including innovative design changes to some of their custom railings solutions that improve installation flexibility and therefore improve gross margin and EBITDA. They’ve also realigned staff resources and responsibilities in certain areas to further control cost and the execution of all contracts.

Commercial sales were exceptionally strong throughout 2018. It was a big year for stadium completions, including the recent Fiserv Forum, home of the Milwaukee Bucks and Marquette Golden Eagles which was completed in late October.

To sum it up, the fourth quarter represents a strong finish to another record year for Trex, characterized by strong demand trends on our professional and retail channels which converted into double-digit sales growth in both international, domestic residential products and commercial products.

In 2018, we continue to invest in branding and R&D to support our future growth. Earnings before taxes for the year increased by 25% and diluted earnings per share were up 42% year-on-year to $2.28, a showing that we are quite proud of. With the introduction of the next generation Transcend and Enhance product lines, we see demand developing quite well in 2019.

On a separate note, we recently published our sustainability report which showcases our key achievements and ESG related initiatives and reaffirms our commitment to continuous improvement. As the largest recycler of waste polyethylene, sustainability practices are an integral part of our strategy in day-to-day operations.

Now, I will turn the call over to our CFO, Bryan Fairbanks, for the financial review. Bryan.

Bryan Fairbanks
Thank you, Jim. Good evening, everyone. We are pleased to have concluded 2018 with record results across key financial metrics and to share the details of our robust performance in both the fourth quarter and full year 2018.

Fourth quarter 2018 consolidated net sales were $140 million, up 15% year-over-year. Trex residential products net sales amounted to $122 million representing 11% organic growth. This growth was all volume driven demonstrating the strong demand that we are seeing for our decking and railing products.

Residential sales growth benefited from continued favorable market conditions in the remodeling sector, strong consumer demand, expanded international sales and our marketing programs aimed at taking market share from wood. Trex commercial products contributed $18 million to the quarter, up 43% from the year ago quarter.

Consolidated gross margin in the fourth quarter increased 110 basis points year-over-year to 42.8% compared to 41.7% reported in the fourth quarter of 2017. Trex Residential Products gross margin expanded by 50 basis points to 46.4% driven by our ability to source greater variety of the scrap polyethylene material and other cost efficiencies. These factors more than offset inflationary impacts and costs related to the rollout of our new products, Enhance Basics and Enhance Naturals.

Trex Commercial Products gross margin increased to 18.4% from a 5.2% in the year ago quarter due to improved execution and cost reduction initiatives. However, the sequential performance was down compared to the third quarter of 2018, slipping back from 25.9% in the third quarter due to executional and cost challenges primarily related to legacy contracts.

SG&A expenses in the fourth quarter of 2018 were $28 million. The total dollar amount increased by $2 million mainly due to higher R&D expense related to the launch of the new Trex enhanced product line. As a percentage of net sales, SG&A declined 120 basis points to 19.7% from the 20.9% reported in the last year's fourth quarter.

Net income was $25 million or $0.43 per diluted share, up 38% and 39% respectively from $18 million or $0.31 per diluted share reported in the fourth quarter of 2017. Approximately, 75% of this growth was attributed to our strong operating performance with the remainder due to a lower tax rate of 23.2% compared to 27.9% in the year ago quarter.

Now, let me sum up our performance for full year 2018. Sales amounted to $684 million representing a 21% increase from 2017 and mainly driven by a 13% sales increase in our Trex Residential Products segment to $613 million. Again, this was all volume driven. As a reminder, our consolidated net sales for the year included the $6 million charge that we took in the third quarter of 2018 related to additional stocking positions in all residential channels. While this was a significant charge, recall back in 2013 we took a $1.5 million charge for similar reasons that resulted in Trex gaining incremental revenues of $30 million to $40 million over the next few years. We are confident that the charge we took this year will result in considerable revenue growth and accelerated market share conversion from wood in the coming years. The remaining $71 million was Trex Commercial Products net sales for the full year, up from its five month contribution of $22 million in 2017.

Pro forma net sales for Trex Commercial Products were up 32% from 2017. As we have noted in the past, sales growth in the commercial segment is not as consistent as the residential segment. Some years we may see significant growth while other years may show lower growth depending upon the timing of projects.

Consolidated gross margin was 43.1%. Excluding the $6 million charge Trex Residential Products gross margin increased 180 basis points to 46.1%. We continue to benefit from lower input cost due to our ability to use a greater variety of scrap polyethylene material and to benefit from China's restriction on scrap plastic imports. Manufacturing efficiencies that are part of ongoing programs and higher capacity utilization also contributed to the year-over-year improvement. Trex commercial products margin was 21.8%.

Our SG&A expenses for 2018 were $118 million compared to $101 million in the prior year. As a percentage of sales, SG&A declined by 60 basis points to 17.3%. The $17.2 million increase in SG&A resulted primarily from higher personnel related expenses in 2018 as we had the impact of the full year of higher headcount related to the SC company acquisition.

Remaining increase was due to higher residential branding and advertising spend in support of our market growth programs and a $1.1 million increase in amortization expense of intangible assets related to the SC company acquisition. These specific intangible assets were fully amortized by July 2018.

The effective tax rate for 2018 was 23.9%, down from 33% a year ago primarily due to the tax cuts and jobs act enacted in December 2017. This change drove net income for the full year to $135 million or $2.28 per diluted share representing year-over-year increases of 41% and 42% respectively. Excluding the one-time charge, diluted earnings per share were $2.35 reflecting a 46% increase over the prior year of which approximately half of the benefit was related to lower taxes.

Our full year operating cash flows were $138 million, 36% ahead of the prior year. Capital expenditures amounted to $34 million compared to $15 million in 2017 with the increase due primarily to investments supporting increased line throughput, the purchase of certain domain names and website content and new product development.

Please note that we expect our capital spending in 2019 to be approximately $45 million as we continue to invest in increasing capacity and throughput at our plants, upgrading equipment and projects supporting future growth.

Our capital allocation priorities remain the same reinvesting in the business, funding acquisition opportunities and repurchasing shares. In the fourth quarter, we repurchased 209,000 shares for $12 million as a part of our share buyback program. For the full year, Trex repurchased 459,000 shares for $25 million at an average cost of $55 per share.

For financial modeling purposes, please note the following items:

- We expect full year 2019 consolidated incremental gross margin to be approximately 45%. Due to the startup of Enhance, favorable year-on-year gross margin comparisons to occur beginning in the second half.
- As a percentage of sales, SG&A for the full year 2019 is expected to decrease 20 to 30 basis points from full year 2018 reflective of our expectation for higher sales and continued spending efficiency.
- We expect our 2019 tax rate to be approximately 25%.
- And as noted earlier, capital spending is projected at approximately $45 million.

Now, I will turn the call back to Jim for his closing remarks. Jim.

Jim Cline

Thank you, Bryan. We remain very positive with respect to our 2019 outlook and beyond for several reasons. First, we see positive demand dynamics ahead. With the 2019 forecast of mid single-digit growth for the repair and remodeling spend and consumer confidence levels close to record highs, Trex is well-positioned to continue to grow and gain market share. As you know, about 95% of our residential business relates to repair and remodeling.

Second, demand for our products is strong. Traffic on our website reached record levels and Trex dealer events attracted record attendance. The introduction of the new Enhance products significantly expands our addressable market. It is the single greatest opportunity to provide value to the consumer, our business partners and to Trex.

As we discussed in the third quarter earnings call, the new Enhance products have enabled us to significantly expand our stocking positions in 2019 which will not only lead to further expansion of market share that also enable our customers to accelerate the conversion from wood at a more profitable level.

Third, our data shows positive trends for our flagship Transcend product line during the early buy season, supporting what we have learned through extensive market research in advance of our new Enhance product launches, namely that these products are expanding the market for Trex products. We expect this new line of products will have a significantly positive impact on sales and earnings in 2019 and beyond.

As we look to 2019, we also expect higher year-on-year gross margin comparisons beginning in the second half as the new product startup expenses wind down. From there, we expect to continue to progressively expand gross margin and to report full year 2019 gross margin that is above 2018. As a reminder, the fourth and first quarters are primarily load-in quarters with consumer point of purchase being realized primarily in March through September.

Our first quarter 2019 revenue guidance is for net sales of $176 million or 3% ahead of the first quarter in 2018. Taken together, the fourth quarter of 2018 net sales with the first quarter of 2019, this represents 8% growth over similar Q4 and Q1 year ago period.

Operator, I would now like to open the call up for questions.

QUESTION AND ANSWER

Operator
We will now begin the question and answer session. To ask a question you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys, to withdraw your question, please press "*" then "2." At this time, we will pause momentarily to assemble our roster.

And our first question will come from Phil Ng of Jefferies. Please go ahead.

Phil Ng
Hi, guys. It sounds like you won some shelf space in retail for your Enhance product. Can you give us a sense how to think about the timing and cadence for the load-in sales ramp and what the opportunity looks like once it's fully ramped in retail?

Jim Cline
Yes, this is Jim Cline. What we have seen with regard to low end, one of the things you have to remember, the new products that we introduced both the Transcend monochromatic as well as the two Enhance products, require load-in across our entire sales distribution that includes both professional as well the major retailers. So we began seeing the load-in occur beginning in December and that will carry through the end of March. Now take away from those load-ins will began either in March or April and work through the season, as I had mentioned in our comments previously.

Phil Ng
Okay. Is there any way you could kind of help us think about what the opportunity could be once you kind of ramp this up in the next 12 to 18 months?

Jim Cline
Yes, it's been our policy not to provide guidance beyond the quarter, but I think it's fair to say that the primary visibility you will see is in the increased sales during the second and third quarter when we see the maximum takeaway at retail both for the professional channel as well as the major retailers.

Phil Ng
Okay. Do you think this opportunity set is larger in one channel versus the other and in terms of this share gain opportunity, I think you kind of commented you are expecting to gain share from wood, but is there an opportunity to kind of gain share from some of your competitors as well?

Jim Cline
To be perfectly honest, we really aren't focused on gaining share from other composite manufactures. We believe that the gain coming from wood is much more opportunistic for us. We see this being broad-based in both channels. The conversion from wood will be a little bit exaggerated in the retail channel, because of the large amount of pressure-treated wood that's sold through those channels.

Phil Ng
Got it. And just one last one from me. How much tariff costs are you anticipating to incur in 2019 and based on your guidance it sounds like gross margins will likely be down to start the year, but does that turn more flattish in 2Q or any color in terms of the cadence in the front half will be helpful? Thanks.

Bryan Fairbanks
Yes. As Jim mentioned, we are infilling both the pro and retail channel, so that's a significant amount of volume. A large percentage of our capacity is being used now to run those new product lines. So there will be start-up inefficiencies. We expect those to last through the second quarter of this year and then we will start seeing favorable gross margin profiles as we move into Q3 and Q4. We do expect to see that to decline through the first half. So the first quarter will have the largest margin impact, the second quarter will be to a lesser degree and then the back half picking up on margin arriving at our 45% incremental on a full year basis.

Phil Ng
Got it. Very helpful. Thanks a lot guys.

Bryan Fairbanks
Thanks, Phil.

Jim Cline
Thank you.

Operator
Our next question comes from Alex Maroccia of Berenberg. Please go ahead.

Alex Maroccia
Hi, guys. I just have a couple of questions on CAPEX for this year. It looks like in ‘18 you guys were around $34 million. What's with the huge jump going into ‘19? And on the back end of that, does it have to do with the Phase 2 capital improvement that you are talking about?

Bryan Fairbanks
So, yes, that's one of the items that's included in there. We've talked about that in prior calls where we are investing in actions that will improve our throughput and overall capacity to support the growth that we expect to see with the effort in converting it against wood. Those actions relate to throughput. In other efficiencies we will expand as we move into 2019, that's the guidance for the $45 million expected CAPEX for the year.

Alex Maroccia
Got it. And then just to follow-up on that, are you expecting most of that hitting the first half of the year?

Bryan Fairbanks
No, we expect that will hit over the course of the year, not all in the first half.

Alex Maroccia
Okay, great. And one last one from me, it looks like you guys have a decent net cash position currently, are there any plans going forward to use some of that cash outside of the capital improvements?

Bryan Fairbanks
Sure. Our capital allocation priorities are: first, internal growth opportunities, primarily the CAPEX as you mentioned, second would be attractive acquisition opportunities and then third, share buybacks of which we had $25 million in buybacks during 2018 and we have an ongoing approved program by the board of directors.

Alex Maroccia
Alright, great. That's all helpful. Thanks.

Bryan Fairbanks
Thanks.

Operator
Our next question comes from Alex Rygiel of B. Riley FBR. Please go ahead.

Alex Rygiel
Thank you. You commented on your expanded stocking position, is there any way you could possibly quantify that on a year-over-year basis for us?

Jim Cline
Because it's across multiple channels, we have not disclosed what our expectation is on that. I can tell you that as we started to go through this process, we are seeing the initial stocking targets being quite substantially more than what was originally expected and that our Early Buy participation was also materially up from the prior year. But as far as getting into specifics, we would prefer not to go to that level of detail.

Alex Rygiel
And then two additional questions. First, can you comment on the backlog in the commercial segment? Is it flat, up or down versus prior year? And then coming back to the residential product, anything new at Fiberon that's changing the competitive landscape?

Jim Cline
Speaking to the backlog, we don't report the backlog, but we are very pleased with the position that we have going into 2019. I did mention in my prepared comments that, that side of the business is more variable from a growth perspective. So, we are coming off of a very significant growth year and over time we still expect that segment to grow in excess of the residential side of the business.

Related to Fiberon, we are seeing them in the channel at this point not significantly different from where we have seen them in the past. Clearly, we have seen some new marketing actions coming forward with the new ownership. I think we will see more activity as we move through 2019.

Alex Rygiel
Very helpful. Thank you very much.

Operator
Our next question comes from Matt McCall of Seaport Global Securities. Please go ahead.

Matt McCall

Thanks. Good afternoon, guys.

Jim Cline
Good afternoon, Matt.

Matt McCall
So, Bryan, you gave an example of the last time, I think you said it's the last time you had a similar charge to the $6 million in the number I think you gave as 1.5 turned into $30 million to $40 million. We found an instance I think it was 2013, I didn't hear the year you said, but I thought it was the time you talked about a $2 million charge expected to generate $40 million to $60 million, and I think what everybody trying to get at is, were you trying to...what's the relationship between the $1.5 million and the $6 million in the $40 million to $60 million? I mean, is the opportunity that big, is it greater, because the charge was bigger, is that the math we should be doing?

Bryan Fairbanks
Yes, to a certain extent, you are referring to the correct quarter, Q3 of 2013. And by going back to that, we wanted to give the market the idea of the type of returns that we expect when we make an investment like this. And while it's a charge coming through, it is an investment for the company to look at, and we do expect significant outsized returns when we put that sort of capital against the program. So, we're not putting an exact number out there related to the growth side of things, but we expect it to be significant in the coming years.

Matt McCall
And I think originally when you laid out those expectations back in 2013, you had talked about $40 million to $60 million, and I thought it was in year one, and the full benefit layering in over the next three years. Is that the way we should think about not necessarily the numbers or the dollars, but the biggest chunk shows up this year and you get the full benefit over a number of years or is there something different about the structure of this win?

Bryan Fairbanks
Well, that benefit was coming over a number of years. We weren't seeing that level of benefit in the first year, as we took that charge. We will see benefit in 2019 related to sales growth and we expect that will expand as we go forward into 2020, 2021.

Jim Cline
And Matt, one other thing I'd like to point out...

Matt McCall
Yes.

Jim Cline
When you introduce new products, it takes roughly about three years to fully commercialize the product. So, we believe that both the fact that it's a new product commercializing a market that we have not been as active in i.e. conversion from wood, we think that's probably got a little bit longer leg than the three years, but we think the growth curve on that is probably going to be stronger than what you'd normally see on a new product introduction.

Matt McCall
Okay, that's helpful. Thanks, Jim. So the last quarter I think you talked about some delayed stocking from some of your distributors that maybe didn't want to take in the new Transcend 2.0,

and maybe sell more of the old product first. When I look at Q3 and Q4, the seasonality that you just reported seemed to be roughly in line with the range that we've seen over the past handful of years. However, the Q4 to Q1 seasonality looks a little bit lower than normal. Is there continued delayed activity on the stocking front maybe from the new Enhance products? Is there something else that's happening that caused Q1 to be a little bit lower?

Bryan Fairbanks
Yes, I think it's really the timing on when the early-buy takeaway occurred. We saw a stronger early-buy with a requested ship date in Q4 because of the price increase, so that elevated that Q4. As I mentioned in our commentary, that the organic sales in the fourth quarter were down a little bit as people normalized their inventory. I think a number of companies have also commented that they saw a bit of softness in the fourth quarter demand. We saw that but attributed more of that to the fact that we introduced new products and I believe our customers saw the new products coming and therefore, were curtailing their purchases to a fair degree.

Matt McCall
Okay. The gross contribution margin commentary you gave, what's the anticipated impact from new products? I think some are concerned that there's the lower prices are going to impact overall gross profitability. Is the impact solely tied to those start-up costs and other than that, you would be talking about expanded gross margins through every quarter this year?

Bryan Fairbanks
Well, if we go back to the comments that were made earlier that we see start-up costs and the contract costs on commercial, that will put pressure on the margins in the first half, and the fact that the full-year gross margin is expected to expand should indicate to you that we believe overall, we will see an expansion of margins from the incremental volume that we receive, as well as the mix of products that we'll realize. Trex has been very good in the marketplace at introducing products that encourage the consumer, who wants to get better performance and better aesthetics to trade up. All of our research indicates that we will bring people in at the bottom of the funnel and move them up to the next level or the next level beyond that. That's our expectation based on the research that we've done on the Enhance introduction.

Matt McCall
Okay. And then I'll sneak one more in. The SG&A outlook, you've dealt with some of the components in the past, branding, spending, R&D. Any commentary there on expectations for '19 kind of what's keeping that elevated? We expected to see a little bit more leverage, but what's behind some of the changes?

Bryan Fairbanks
We continue to see great benefit from our SG&A spending, especially on the branding side and allowing us to grow our market share and overall sales at a much higher rate than where many building product companies are today. So we see that continued spending as very valuable for our shareholders and we will see some efficiencies as we move into 2019, which will leverage that down 20 basis points to 30 basis points.

Matt McCall
Okay. Thank you, guys.

Operator
Our next question comes from Keith Hughes of SunTrust. Please go ahead.

Keith Hughes
Thank you. I have a question on the price increase. What's the kind of average blended increase you're trying to get and when do you think it will first show up in the numbers?

Bryan Fairbanks
We really won't see much in the way our pricing till we get out into the second quarter. As Jim mentioned, our channel bought heavily before the price increase came through, much of that shipped in the fourth quarter, some of that will move out into the first quarter of this year. So, we don't expect that we'll start to see meaningful impact on that. We'll talk further about what those impacts of pricing are when we issue our Q1 and Q2. We haven't provided guidance on what that average will be for the year at this time.

Keith Hughes
Okay. And you somewhat addressed this earlier. Inventory was up a good bit. I know you've got some new programs we've talked about. Is that primarily to the new programs as you get ready to ship those in the first quarter?

Bryan Fairbanks
Yes, primarily to the new programs and also to support the market for the demand generation that we expect will be in the market.

Keith Hughes
And final question, you've talked about some demand weakness, which you offset here. Are you reading what others are seeing in your channel, other decking, where does that comment derive from?

Jim Cline
That comment was from a number of manufacturers of building products, including Fortune Brands.

Keith Hughes
Okay, alright, that's what I thought. Thank you very much.

Jim Cline
Thank you.

Operator
Again, if you have a question, please press "*" then "1." And our next question will come from John Baugh of Stifel. Please go ahead.

John Baugh
Thank you. Congrats on a great year.

Bryan Fairbanks
Thanks, John.

John Baugh
I wanted to go back to the mix question, I guess, and I'm going to exclude obviously, the start-up expenses in this question. But does the fact that you expect a lot more volume and Trex Enhance will drive that, I guess, are offset, in other words you get volume leverage, so your

gross margin goes up even though the gross margin of the product is clearly going to be lower than Transcend?

Jim Cline
It's really a combination of the same things that we've been doing over the last several years. The mix of products is certainly an influence, but again, it's finding those types of waste polyethylene that enable us to yield a better cost profile. It's the cost reduction initiatives, which have been so great and the contribution of additional dollars to the bottom line. Part of the investment we've been talking about over $30 million this past year, the $45 million in 2019, are really driven to help support that reduction in cost. As we talked about the reason for the price increase, we didn't talk about labor, our people are making more money in 2019 than they did in '18. Our expenses in a variety of areas have gone up, but we're able to cover those and also expand margins by virtue of the fact we've been very successful in these other areas.

John Baugh
And then I doubt it's big enough to influence a number. But you gave that comment about the 8% when you blend Q4 and Q1, that was consolidated revenues. Does the residential look fairly similar, Bryan?

Bryan Fairbanks
We only provided that on the base. We haven't split out the revenues between those two for this report.

John Baugh
Okay.

Jim Cline
Remembering it's 90% of the volume, it's going to be very close to that, John.

John Baugh
Okay. And then my last question is simply on the strong pre-buy. Is there a way to separate how much of that is relating to the timing of the price increase? Versus…I think you made the comment that your stocking for the new stuff is stronger than you thought. I'm just trying to get a sense for what a strong early buy is telling me if anything?

Jim Cline
Well, strong early buy was driven by two things. One, the new product introductions, where all of the pro channel is bringing in inventory to get themselves up to the appropriate stocking levels, as well as, in our dealer channel, they also need to do the same thing. But it's impactful across all categories, including all the major retailers. So I think when you look at both of those, both of those are significant enough, we call them out because we saw a meaningful increase across the board. Now, those people who were buying, for example, our Transcend product to avoid the impact of the price increase early in the year, that certainly was a significant piece of this, but it was broad enough across the other categories that it's pretty widespread across our distribution channel. We believe it bodes well for the future of the decking business throughout the season.

John Baugh
Great. Thank you for that color and good luck.

Jim Cline

Thanks a lot, John.

Operator
Our next question is a follow-up from Matt McCall of Seaport Global. Please go ahead.

Matt McCall
Thanks. Just one more on the gross margins, make sure I understand and following up on John's question. So you had a $2.25 product and went to $1.75. Maybe talk about the expected margin impact there. Did the margin deteriorate? And then the $2.50 product you had…you've previously had a $2.50 product and introduced a new one. How do the profit margins compare? new versus old?

Jim Cline
Yes, Matt. With regard to specific margins on different categories, it's not an area that we disclose individual margins. I think it's fair for you to guess that as you introduce a lower price margin certainly in the first year of introduction, those margins will be lower than what your average fleet average is. What we have found and have been very successful with, and Transcend is a good example, is we have been able over time to cost reduce those products and enable us to hold our pricing at a better level than most other companies are able to do, going back and looking at when our last price increase was with regard to decking products.

So I think when you look at the incremental margin that Bryan mentioned for the year of 45% the fact that we expect average margin to increase for the full-year despite the fact that we'll have these start-up expenses in the first half indicates that the combined mix of products in conjunction with our cost reduction initiatives will drive the kind of improvement that I think everybody would like to see.

Matt McCall
And I am sorry if you've done this, Jim. But have you quantified what the start-up costs will be Has anybody asked that if I missed it?

Jim Cline
We have not.

Matt McCall
Okay. Alight, thank you all.

Jim Cline
Thank you.

Operator
Again, if you have a question, please press "*" then "1." And our next question will come from Keith Hughes from SunTrust. Please go ahead.

Keith Hughes
Yes, just a follow-up on the revenue guidance for the first quarter. Can you give us some sort of feel for what residential will look like versus commercial in the quarter, growth rates, dollar, how do you want to do it?

Bryan Fairbanks

Yes, so Jim mentioned when we look at the growth between the two quarters themselves, you can back into with 3% is what we have out here given that residential is by far the largest segment we have compared to the commercial segment, the revenue growth isn't too far off of that.

Keith Hughes
So they are going to be roughly somewhere between the two. Is that a fair statement?

Bryan Fairbanks
It'll be driven by residential.

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Keith Hughes
Okay. Thank you.

Operator
Our next question comes from Trey Grooms of Stephens. Please go ahead.

Trey Grooms
So quick question for me guys and good afternoon to you.

Bryan Fairbanks
Good afternoon.

Jim Cline
Good afternoon, Trey.

Trey Grooms
And I'm sorry if I missed this too. But just kind of a bigger picture as we are looking at the core decking business, the outlook as you look through 2019. Overall, outlook not necessarily from one channel to the next, but just your core decking market as a whole, what are you guys expecting as far as kind of just overall core market growth this year?

Jim Cline
Yes, when we look at the overall market, we look to the repair and remodeling index which has gone down from maybe a 6% to 7% to the 5% range. As you know Trey, we have been successful over the last four and five years of achieving growth targets that will exceed that. We believe the introduction of the new products and the additional stocking positions that we have with customers across the distribution channels will enable us to achieve a better than mediocre increase in revenue for the year.

Trey Grooms
And any ballpark estimate on how much you guys…and I think you may have touched on earlier in the year and maybe I missed it again. But how much market share you feel like you've gained overall in the full-year of 2018, just against wood specifically? And you've given some parameters around that, but what you did in 2018, as far as, taking that share from wood, as well as, any kind of initial thoughts around expectations for 2019 on taking that share from wood as well?

Jim Cline
Yes, it's a little bit early for us to put a number on that, but that's not an exact science. We do consult with others on that. It's our belief that the conversion is starting to accelerate and has

been for the last couple of years. We believe 2019 will be a year of further acceleration of conversion. I think, if you went to Principia's data, you would find that is directionally where they see it happening. We think we are one of the largest participants in that. And so, our growth curve is probably going to be greater than the average market growth from that conversion.

Trey Grooms
Alright, great. Well, that's super helpful. And I guess, the last one before I let you guys go. What's your thoughts on introducing this lower price point product and do you feel like that opens up any additional opportunity for you to kind of penetrate that new home construction market at all?

Jim Cline
Yes, I think when you look at what most new home construction is comprised of, it's pressure treated lumber. These two products were specifically engineered to attack and show well against the pressure treated lumber market. We are about two times for the that…the basics, a little bit more than that for the naturals. I think the basics will sell well on new construction, although just as a reminder that's only about 5% of our business today.

Trey Grooms
Alright, great. Thanks a lot for taking my questions, and good luck, guys. See you next week.

Bryan Fairbanks
Alright, thanks, Trey.

Jim Cline
Thanks, Trey.

Operator
This concludes our question and answer session. I would like to turn the conference back over to Jim Cline for any closing remarks.

Jim Cline
Thank you for your interest and support of the Trex Company. I want to thank our Trex team around the world. Their commitment and engagement with their company is second to none and continues to be our greatest strength. We look forward to seeing the investors and analysts at upcoming conferences and the International Builders' Show, and we thank you for participating this evening. Goodnight.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.