MSC Industrial Direct (MSM)

Updated January 20th, 2019 by Eli Inkrot

Key Metrics

Current Price:	$83	**5 Year CAGR Estimate:**	13.4%	**Volatility Percentile:**	75.2%
Fair Value Price:	$104	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	44.8%
% Fair Value:	81%	**5 Year Valuation Multiple Estimate:**	4.4%	**Growth Percentile:**	49.7%
Dividend Yield:	3.0%	**5 Year Price Target**	$139	**Valuation Percentile:**	81.4%
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Total Return Percentile:**	77.3%

Overview & Current Events

Founded in 1941 by Sid Jacobson, MSC Industrial Direct is one the largest direct marketers and distributors of metalworking and maintenance, repair and operations (MRO) products in North America. This includes items like cutting tools, abrasives, measuring instruments, safety equipment, fasteners and welding supplies. The company has 12 fulfillment centers (8 in the U.S., 3 in Canada and 1 in the U.K.) and 100 branch offices (99 of which are in the U.S.). MSC is a $4.6 billion market cap company that employees over 6,500 people. The company is on pace to generate over $3.2 billion sales and earn over $300 million on an annual basis.

On January 9th, 2019 MSC reported Q1 fiscal year 2019 results for the period ending December 1st, 2018. Net sales came in at $832 million, an 8.2% increase compared to the prior year period, and operating income totaled $103 million, a 3.7% increase. Diluted earnings-per-share came in at $1.33 against $1.05 in the year ago period, a 26.7% increase, mainly due to a substantial decrease in the company's tax rate (down to 25.1% from 37.8%).

MSC also provided guidance for Q2 2019. This included sales of between $817 and $833 million – representing a roughly 9% increase compared to Q2 2018 - and diluted earnings-per-share of $1.22 to $1.28.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$2.00	$2.37	$3.43	$4.11	$3.91	$3.94	$3.78	$3.76	$4.00	$5.10	***$5.75***	***$7.70***
DPS	$0.80	$0.82	$0.88	$1.00	$1.20	$1.32	$1.60	$1.72	$1.80	$2.22	***$2.52***	***$3.46***
Shares	63	63	63	63	63	62	62	57	56	56	***56***	***50***

Dating back to fiscal year 2008 (one year prior to what you see above and totaling $3.04 per share), MSC had grown earnings-per-share by a compound annual rate in the 5% to 6% range. Given that the company is not coming off a low today, we believe this sort of growth is a reasonable starting place for the company from this point. During the most recent report management talked about uncertainty related to economic and trade overhangs, and the government shutdown as short-term concerns. On the other hand, given significant supplier price increase activity, MSC is planning on increasing prices themselves.

MSC does have a few growth drivers ahead. For one thing, larger customers are starting to consolidate vendors and focus on nationwide supplies like MSC. In addition, the company has the ability to increase operating margins in the years to come. In recent years the company's margins have been weighed down by acquisition related items and investments. However, after the completion of a new $56 million fulfillment center in Columbus, Ohio – allowing for sales capacity to reach about $4 billion – MSC likely will not need to make significant investments for the next few years. The emergence of Amazon is a threat, as it seems to be in any business; however, MSC's business is difficult to replicate.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	18.3	20.2	18.2	17.2	19.9	21.7	20.1	18.0	21.5	17.0	***14.5***	***18.0***
Avg. Yld.	2.2%	1.7%	1.4%	1.4%	1.5%	1.5%	2.1%	2.5%	2.1%	2.6%	***3.0%***	***2.5%***

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During the past decade shares of MSC have traded hands with an average P/E ratio of about 19 times earnings. We credit this premium multiple to three basic items: a solid and growing business, a conservative balance sheet and a large family stake. MSC is effectively a third generation company (the founder's grandson is now CEO) with the family owning about a fourth of the economic interest of MSC and having over 70% of the voting power. It's not uncommon to see a premium valuation when you combine those factors. We have tempered this expectation slightly, but still notice that shares are trading at a below average multiple historically.

It's also worthwhile to note that MSC paid a special dividend in 2005, 2011 and 2015. The company has been moderately active on the share repurchase front, but this is another type of "release valve" for excess capital.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	40%	35%	26%	24%	31%	34%	42%	46%	45%	44%	***44%***	***45%***

MSC's competitive advantage stems from its superior scale and execution. The company has over 1.6 million skus and yet boasts of a 99% same day order fulfillment rate (against an industry average of 60%). It is true that Amazon is a formidable threat, but thus far MSC has been able to ward off attacks through its niche market relationships. A greater overall threat to the business is the possibility of American manufacturing, especially metalworking, moving overseas.

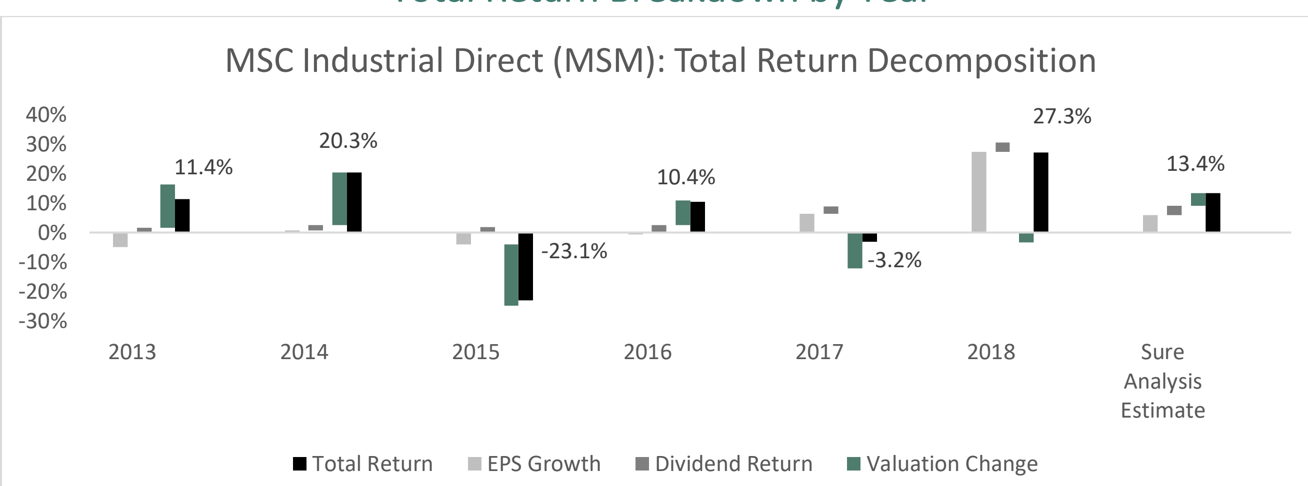
During the last recession MSC's performance was average, posting earnings-per-share of $3.04, $2.00, $2.37 and $3.43 for the fiscal years ending 2008, 2009, 2010 and 2011 respectively. Earnings are likely to be cyclical in the future, but the overall trend has been largely positive.

As of the last quarterly report, long-term debt stood at $312 million against underlying earnings power north of $320 million. This company appears safe and conservatively financed.

Final Thoughts & Recommendation

MSC is one of those companies that can easily slide under the radar unless you're directly involved in the supply chain. The general public doesn't see a strong brand fronting the business, so it can be difficult to conceptualize the company's competitive position. Yet due to MSC's scale, dependability and niche relationships the company has developed a consistent profit machine. Moreover, the business has growth opportunities as a highly fragmented industry consolidates to the larger players. Today the security looks interesting, offering a 3% dividend and trading at a historically low earnings multiple. We rate MSC Industrial Direct as a buy at current prices.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	1490	1692	2022	2356	2458	2787	2910	2864	2888	3204
Gross Profit	688	767	941	1078	1119	1286	1317	1289	1286	1393
Gross Margin	46.2%	45.3%	46.5%	45.8%	45.5%	46.1%	45.2%	45.0%	44.5%	43.5%
D&A Exp.	27	26	29	35	49	65	70	72	63	63
Operating Profit	205	242	350	412	386	383	380	376	379	421
Operating Margin	13.7%	14.3%	17.3%	17.5%	15.7%	13.7%	13.0%	13.1%	13.1%	13.1%
Net Profit	125	150	219	259	238	236	231	231	231	329
Net Margin	8.4%	8.9%	10.8%	11.0%	9.7%	8.5%	7.9%	8.1%	8.0%	10.3%
Free Cash Flow	263	120	184	187	236	202	198	313	200	295
Income Tax	77	90	131	153	145	143	142	141	137	77

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	1158	1153	1244	1445	1943	2061	2100	2065	2099	2289
Cash & Equivalents	226	121	96	168	56	47	38	53	16	46
Accounts Receivable	165	221	267	297	345	383	403	392	472	524
Inventories	247	286	345	393	419	450	507	444	465	518
Goodwill & Int. Ass.	328	321	326	340	786	768	743	729	744	798
Total Liabilities	352	253	251	258	553	662	767	967	874	901
Accounts Payable	55	81	96	97	114	116	114	111	121	145
Long-Term Debt	193	39	0	3	256	337	427	607	533	535
Shareholder's Equity	806	900	993	1187	1390	1399	1333	1098	1225	1387
D/E Ratio	0.24	0.04	0.00	0.00	0.18	0.24	0.32	0.55	0.44	0.39

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	11.1%	13.0%	18.2%	19.3%	14.0%	11.8%	11.1%	11.1%	11.1%	15.0%
Return on Equity	16.5%	17.6%	23.1%	23.8%	18.5%	16.9%	16.9%	19.0%	19.9%	25.2%
ROIC	12.9%	15.5%	22.6%	23.7%	16.8%	14.0%	13.2%	13.3%	13.4%	17.9%
Shares Out.	63	63	63	63	63	62	62	57	56	56
Revenue/Share	23.89	26.89	31.93	37.51	39.00	44.71	47.33	46.88	50.69	56.50
FCF/Share	4.21	1.90	2.91	2.97	3.75	3.24	3.23	5.13	3.52	5.20

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.