Snap-On Tools (SNA)

Updated July 21st, 2019 by Josh Arnold

Key Metrics

Current Price:	$150	**5 Year CAGR Estimate:**	15.1%	**Volatility Percentile:**	50.5%
Fair Value Price:	$188	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	24.3%
% Fair Value:	80%	**5 Year Valuation Multiple Estimate:**	4.6%	**Growth Percentile:**	75.9%
Dividend Yield:	2.5%	**5 Year Price Target**	$276	**Valuation Percentile:**	85.3%
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Total Return Percentile:**	87.5%

Overview & Current Events

Snap-On Tools was founded in the early 1920's and since that time, has grown from a fledgling direct sales distributor of sockets to a full-service, global distributor of a wide array of common and specialty tools. The company's market capitalization is $8.3 billion, and it should generate almost $4 billion in revenue this year.

Snap-On reported Q2 earnings on 7/18/19 and results lined up with our expectations. Total revenue was essentially flat at $951 million against the year-ago period, as organic sales rose 1.6%, but were offset by a similar amount of unfavorable currency translation.

Financial services revenue was up 2.6% to $84 million, as that segment of Snap-On's business continues to grow in importance. Commercial & Industrial revenue was down fractionally to $335 million, Snap-On Tools revenue was off 1.5% to $406 million, and Repair Systems and Information revenue was up 1.7% to $349 million. Management said the company saw headwinds from particular geographic regions and unfavorable currency movement, but it appears the weakness in Q2's sales was fairly subtle, and nothing to be concerned about just yet.

Gross margins did decline in Q2, falling 122bps to 49.8%, and operating margin excluding financial services revenue fell fractionally to 20% of revenue. Snap-On has been struggling with growing margins for some time, but in our view it is due mostly to the fact that its margins are already so high. At 20% of revenue, Snap-On has few peers with margins that are as strong, so we see it as understandable that operating margins would plateau. Margin growth isn't necessary for Snap-On to grow earnings as its revenue expansion has largely taken care of that in recent years.

Diluted earnings-per-share came to $3.22 in Q2, up from $3.12 in the year-ago period. The company earned $6.38 in the first half of the year, and we reiterate our expectation for $12.50 in 2019.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$2.32	$3.19	$4.50	$5.20	$5.93	$7.14	$8.10	$9.20	$10.12	$11.81	***$12.50***	***$18.37***
DPS	$1.20	$1.22	$1.28	$1.36	$1.58	$1.85	$2.20	$2.54	$2.95	$3.41	***$3.80***	***$6.12***
Shares	58	58	58	58	58	58	58	58	57	57	***56***	***55***

With the exception of 2009, Snap-On has produced materially higher earnings every year in the past decade. The company's constant focus on acquisitions, as well as its own organic revenue growth in concert with a rapidly growing financial services business, has created a growth outlook that is tough to rival. The company continues to buy back its own stock as well, providing another tailwind for earnings-per-share. Indeed, it has managed to compound earnings at an average rate of nearly 20% annually in the past decade. We see 8% earnings-per-share growth annually going forward as Snap-On continues to acquire brands, produce low single-digit organic growth, see a low single-digit tailwind from buybacks, and small gains from its cost savings program. Growth of 8% a year would represent a slowdown from Snap-On's historical rate of growth, but based upon slowing rates of revenue growth, we believe this caution is warranted. Indeed, we believe Q2 and first half results support this outlook.

The dividend should keep increasing at double digit rates as the payout ratio is still low, and earnings are growing nicely. Snap-On produces more cash than it can use to profitably invest in the business, so shareholders should see the benefit.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	14.2	14.4	12.3	12.7	15.6	16.8	19.1	17.1	16.3	13.7	***12.0***	***15.0***
Avg. Yld.	3.6%	2.7%	2.3%	2.1%	1.7%	1.5%	1.4%	1.6%	1.8%	2.1%	***2.5%***	***2.2%***

Snap-On's price-to-earnings multiple has spent the past several years in the mid-teens; however, after a recent period of weakness, it stands at just 12 times earnings. This compares very favorably to our estimate of fair value at 15 times earnings. As a result, we see a meaningful 4.6% tailwind to total returns from the valuation moving higher over time.

We see the yield remaining near where it is today as the share price and dividend growth should roughly mirror each other. Snap-On is getting closer to being an income stock with its 2.5% yield, but it is also a very strong dividend growth issue and will remain so for the foreseeable future, increasing its attractiveness for investors.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	51%	38%	29%	27%	26%	26%	27%	27%	28%	29%	***30%***	***33%***

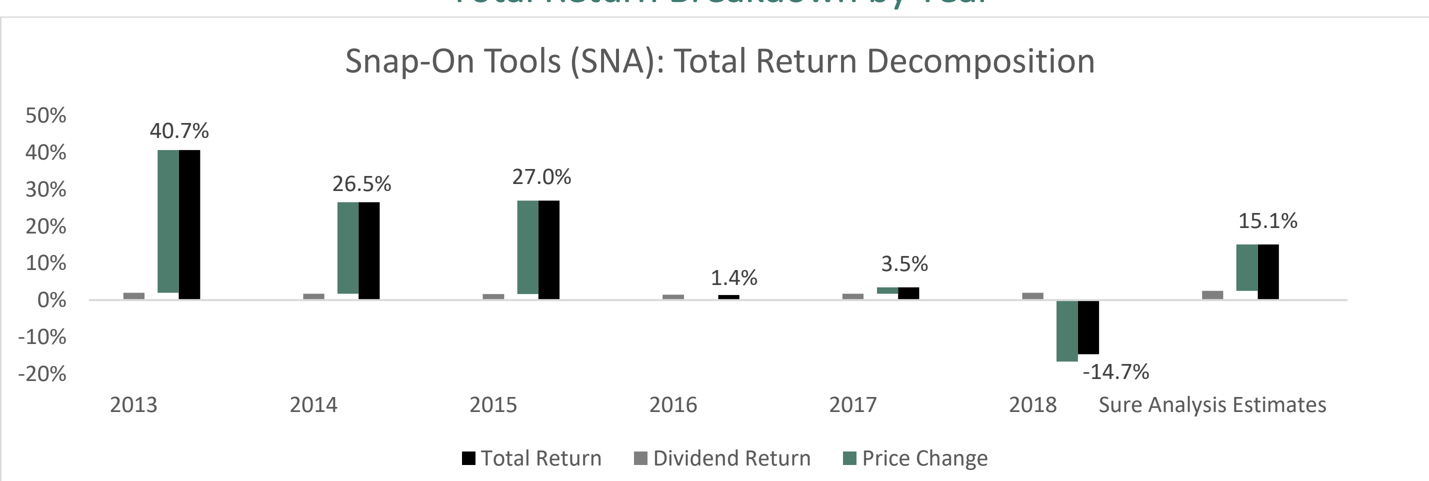
The payout ratio is still very low and should remain in the low-30% range unless management decides to ramp up its dividend growth strategy, which we view as unlikely at this point given already-strong growth rates.

Its main competitive advantage is in its very broad and deep assortment of all kinds of specialty tools. In addition, its global reach and in-house financing is a unique combination not found elsewhere. The financing business could pose a problem during a recession as customers may become past due on their accounts, so this would be the principal risk for Snap-On during the next economic downturn. Indeed, earnings suffered mightily during the Great Recession.

Final Thoughts & Recommendation

After three years of below market total returns, Snap-On is still undervalued. We now see total annual return potential of 15.1% going forward, consisting of the 2.5% current yield, 8% earnings growth and a 4.6% tailwind from the valuation. Snap-On has been able to produce strong growth for many years consecutively and its focus on buybacks, acquisitions and margins should continue that streak. Snap-On looks suitable for growth and dividend growth investors and after the Q2 report, we continue to like the stock. The company's combination of value, earnings growth and dividend potential is a rare one, causing Snap-On to earn a buy recommendation from Sure Dividend 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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	2363	2682	2979	3099	3238	3493	3593	3712	4000	4070
Gross Profit	1058	1226	1411	1497	1599	1733	1819	1908	2042	2100
Gross Margin	44.8%	45.7%	47.4%	48.3%	49.4%	49.6%	50.6%	51.4%	51.1%	51.6%
D&A Exp.	75	73	75	77	77	80	83	86	93	94
Operating Profit	233	331	457	516	586	685	765	854	882	956
Operating Margin	9.9%	12.4%	15.3%	16.7%	18.1%	19.6%	21.3%	23.0%	22.0%	23.5%
Net Profit	134	187	276	306	350	422	479	546	558	680
Net Margin	5.7%	7.0%	9.3%	9.9%	10.8%	12.1%	13.3%	14.7%	13.9%	16.7%
Free Cash Flow	283	89	67	250	322	323	427	502	527	674
Income Tax	63	88	134	148	167	200	221	244	251	214

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	3447	3729	3673	3902	4110	4310	4331	4723	5249	5373
Cash & Equivalents	699	572	186	215	218	133	93	78	92	141
Accounts Receivable	414	443	741	821	906	953	1010	1071	1181	1211
Inventories	275	329	386	404	434	476	498	531	639	674
Goodwill & Int. Ass.	1021	991	984	995	1029	1014	985	1080	1178	1135
Total Liabilities	2142	2325	2126	2083	1980	2085	1900	2088	2277	2255
Accounts Payable	201	254	125	143	156	145	148	171	178	201
Long-Term Debt	1067	1171	984	976	972	919	880	1010	1187	1132
Shareholder's Equity	1290	1389	1531	1802	2113	2208	2413	2617	2954	3099
D/E Ratio	0.83	0.84	0.64	0.54	0.46	0.42	0.36	0.39	0.40	0.37

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	4.4%	5.2%	7.5%	8.1%	8.7%	10.0%	11.1%	12.1%	11.2%	12.8%
Return on Equity	10.8%	13.9%	18.9%	18.4%	17.9%	19.5%	20.7%	21.7%	20.0%	22.5%
ROIC	6.6%	7.5%	10.8%	11.5%	11.9%	13.5%	14.8%	15.7%	14.3%	16.2%
Shares Out.	58	58	58	58	58	58	58	58	57	57
Revenue/Share	40.80	45.92	50.74	52.62	54.78	59.10	60.80	62.49	68.26	71.04
FCF/Share	4.88	1.53	1.15	4.24	5.45	5.46	7.22	8.45	8.98	11.76

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