MSC Industrial Direct Co. Inc. (MSM)

Updated November 1st, 2019 by Quinn Mohammed

Key Metrics

Current Price:	$75	**5 Year CAGR Estimate:**	10.3%	**Volatility Percentile:**	72.3%
Fair Value Price:	$78	**5 Year Growth Estimate:**	5.5%	**Momentum Percentile:**	16.1%
% Fair Value:	96%	**5 Year Valuation Multiple Estimate:**	0.8%	**Growth Percentile:**	55.3%
Dividend Yield:	4.0%	**5 Year Price Target**	$102	**Valuation Percentile:**	70.5%
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Total Return Percentile:**	73.0%

Overview & Current Events

Founded in 1941 by Sid Jacobson, MSC Industrial Direct (MSM) is one the largest direct marketers and distributors of metalworking and maintenance, repair and operations (MRO) products in North America. The company has 12 fulfillment centers (8 in the U.S., 3 in Canada and 1 in the U.K.) and 99 branch offices. MSM is a $4.1 billion market cap company that employees over 6,500 people.

On October 24th, MSM reported fourth quarter and full year fiscal 2019 results. Net sales for the full year came in at $3.4 billion, a 5.0% year-over-year increase. Diluted earnings per share for the full year was $5.20, a 10.3% drop from the $5.80 EPS posted a year earlier. Excluding severance and separation costs, adjusted diluted EPS would have come in at $5.29. For the fourth quarter alone, net sales increased 0.6% YoY to $842.7 million. Adjusted diluted earnings per share of $1.30 exceeded management's Q4 guidance laid out last quarter by $0.06.

Management has provided guidance for the first quarter of 2020 and is expecting between $811 million and $827 million in total net sales, 1.5% below this year's first quarter. Diluted earnings per share are expected to be between $1.12 and $1.18, while adjusted EPS are expected between $1.15 and $1.21.

Progress on initiatives announced last quarter are humming along as the company has been eliminating the bottlenecks in new business conversion, deepening their supplier partnerships to drive future profitability and market share gains, and begin to reshape and resize the organization.

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	***$5.20***	***$6.80***
DPS	$0.80	$0.82	$0.88	$1.00	$1.20	$1.32	$1.60	$1.72	$1.80	$2.22	***$2.76***	***$3.52***
Shares[1]	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), MSM had grown earnings-per-share by a compound annual rate in the 5% to 6% range, and we rate this a fair expectation going forward. Unfortunately, product demand has dropped in the second half of 2019 and uncertainty remains in the pricing environment largely due to tariffs and trade. The company still struggles to increase margins even after completing a stream of acquisitions and investments, and efforts to reduce headcount and other expenses. The three-part action plan being implemented aims to improve sales execution and new account implementations, increase profitability in supplier programs and further increase expense control and productivity. On the bright side, pace of new accounts and vending implementations are growing quickly. The emergence of Amazon is a threat; however, MSM's business is difficult to replicate and the company has thrived over the last several years.

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	***14.4***	***15.0***

[1] In millions

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.

Avg. Yld.	2.2%	1.7%	1.4%	1.4%	1.5%	1.5%	2.1%	2.5%	2.1%	2.6%	***3.7%***	***3.5%***

During the past decade shares of MSM 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. MSM 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 MSM and having majority of the voting power. Regardless, we have tempered this expectation due to the uncertainties hanging over the company and the trade environment of today.

It's also worthwhile to note that MSM 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%	***53%***	***52%***

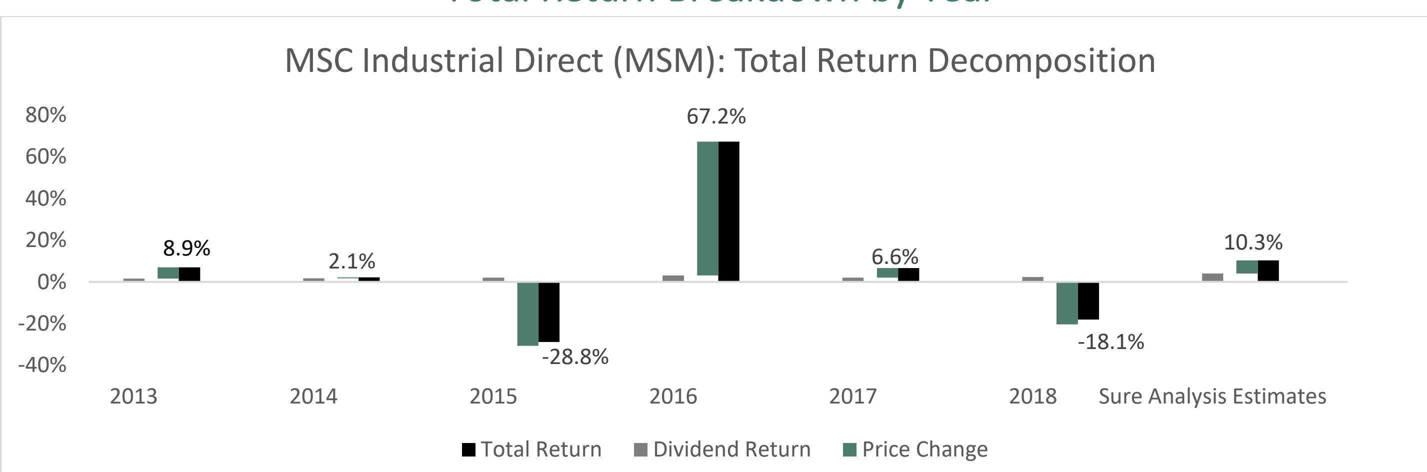
MSM's competitive advantage stems from its superior scale and execution. The company has over 1.6 million skus and yet boasts of a 99% same day order fulfillment rate. It is true that Amazon is a formidable threat, but thus far MSM has been able to ward off attacks through its niche market relationships.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

During the last recession MSM'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 $266 million against underlying earnings power around $300 million. This company appears safe and conservatively financed.

Final Thoughts & Recommendation

MSM 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 MSM'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. Total returns going forward are estimated at 10.3%, which includes a 4.0% dividend, 0.8% growth from multiple expansion, and 5.5% growth in earnings. While expected total returns exceed 10%, the stock trades near fair value, so we rate MSC Industrial Direct a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
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
Op. 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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	1158	1153	1244	1445	1943	2061	2100	2065	2099	2289
Cash & Equivalents	226	121	96	168	56	47	38	53	16	46
Acc. Receivable	165	221	267	297	345	383	403	392	472	524
Inventories	247	286	345	393	419	450	507	444	465	518
Goodwill & Int.	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
Total 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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
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.

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