Snap-On Inc. (SNA)

Updated February 15th, 2020 by Josh Arnold

Key Metrics

Current Price:	$155	**5 Year CAGR Estimate:**	8.2%	**Market Cap:**	$8.6B
Fair Value Price:	$175	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	02/21/20
% Fair Value:	89%	**5 Year Valuation Multiple Estimate:**	2.4%	**Dividend Payment Date:**	03/10/20
Dividend Yield:	2.8%	**5 Year Price Target**	$203	**Years Of Dividend Growth:**	9
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	13.7%

Overview & Current Events

Snap-On Inc. 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, diagnostics equipment, repair information and system solutions instruments. Snap-On also operates a sizable financial services business that finances its customers' purchases in-house. The company's market capitalization is $8.6 billion, and it should generate around $3.8 billion in revenue this year.

Snap-On reported Q4 earnings on February 6th and results were in line with expectations. Total net sales were $955 million during the quarter, up fractionally from the year-ago period. Organic growth was 0.6%, while acquisitions added a small increase that was more than offset by unfavorable currency exchange translation.

Operating earnings before financial services came to 17.9% of sales, compared to 19.1% of sales in 2018's Q4. Excluding a one-time legal settlement from Q4 of 2018, operating income declined 80bps instead of 120bps, but Q4 of 2019 was unequivocally weak on the margin front.

Financial services revenue was $83.9 million, up slightly from the same period in 2018. Operating earnings increased very nicely, however, rising from $56 million to $62 million year-over-year as Snap-On's financial services business continues to outperform the sale of products.

Consolidated operating earnings were $233.6 million, down from $238.2 million. As a percentage of revenue, operating earnings 22.5% in Q4, down slightly from the same period in 2018.

Total earnings were $3.08 in Q4, up from the adjusted $3.03 in 2018's Q4. We see weak revenue and flat margins driving roughly equal earnings-per-share for 2020; our initial estimate is for $12.50.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$3.19	$4.50	$5.20	$5.93	$7.14	$8.10	$9.20	$10.12	$11.81	$12.41	***$12.50***	***$14.49***
DPS	$1.22	$1.28	$1.36	$1.58	$1.85	$2.20	$2.54	$2.95	$3.41	$3.93	***$4.32***	***$6.35***
Shares[1]	58	58	58	58	58	58	58	57	57	55	***54***	***52***

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 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. However, we see just 3% earnings-per-share growth annually going forward as Snap-On continues to acquire brands, produce low single-digit organic growth, and small gains from its cost savings program. Growth of 3% a year would represent a material slowdown from Snap-On's historical rate of growth, but based upon slowing rates of revenue and margin growth, we believe this caution is warranted. Indeed, we believe 2019 results support this outlook.

[1] Share count 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.

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

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	14.4	12.3	12.7	15.6	16.8	19.1	17.1	16.3	13.7	12.9	***12.4***	***14.0***
Avg. Yld.	2.7%	2.3%	2.1%	1.7%	1.5%	1.4%	1.6%	1.8%	2.1%	2.5%	***2.8%***	***3.1%***

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 12.4 times earnings. This compares favorably to our estimate of fair value at 14 times earnings. As a result, we see a modest tailwind to total returns from the valuation moving higher over time.

We see the yield rising to the 3% area, and Snap-On's impressive dividend growth, coupled with its decent current yield, make it a nice choice for dividend investors.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	38%	29%	27%	26%	26%	27%	27%	28%	29%	32%	***35%***	***44%***

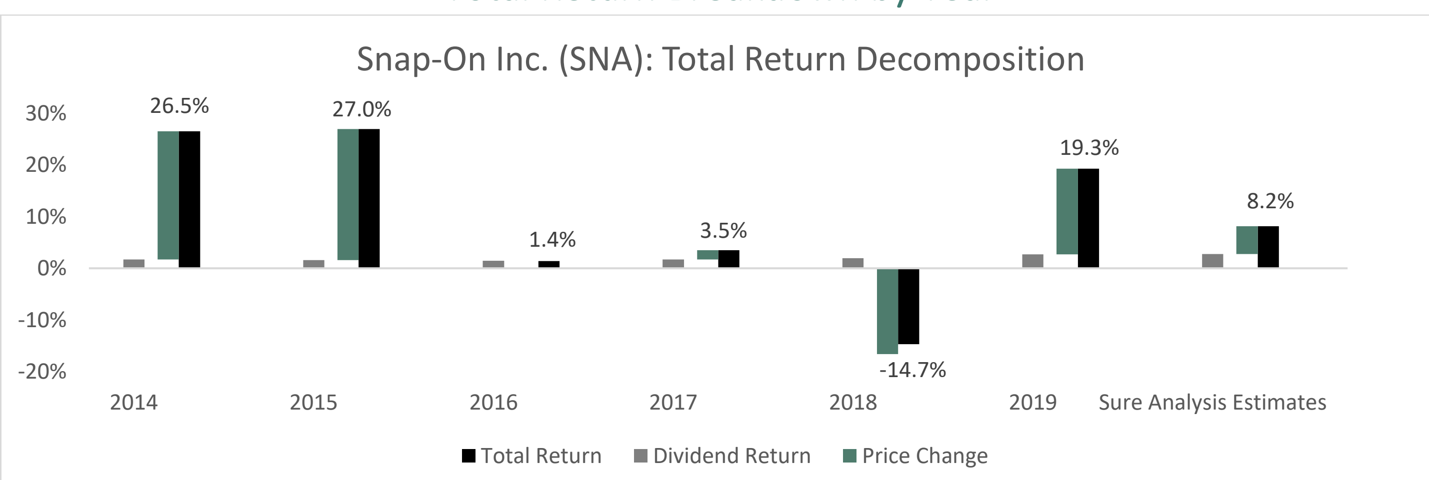
The payout ratio is still very low and should remain under 40% unless management decides to ramp up its dividend growth strategy, which we view as unlikely at this point given already-strong growth rates.

Snap-On's 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. Earnings suffered mightily during the Great Recession.

Final Thoughts & Recommendation

After four years of below market total returns, Snap-On is still undervalued. We now see total annual return potential of 8.2% going forward, consisting of the 2.8% current yield, 3% earnings growth, and a small tailwind from the valuation. Snap-On has been able to produce strong growth for many years consecutively, but we see reasons to be cautious. Snap-On looks suitable for value and dividend growth investors, but we are moving the stock from buy to hold on the lowered total return outlook.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	2682	2979	3099	3238	3493	3593	3712	4000	4070	4068
Gross Profit	1226	1411	1497	1599	1733	1819	1908	2042	2100	2090
Gross Margin	45.7%	47.4%	48.3%	49.4%	49.6%	50.6%	51.4%	51.1%	51.6%	51.4%
D&A Exp.	73	75	77	77	80	83	86	93	94	92
Operating Profit	331	457	516	586	685	765	854	882	956	962
Operating Margin	12.4%	15.3%	16.7%	18.1%	19.6%	21.3%	23.0%	22.0%	23.5%	23.7%
Net Profit	187	276	306	350	422	479	546	558	680	694
Net Margin	7.0%	9.3%	9.9%	10.8%	12.1%	13.3%	14.7%	13.9%	16.7%	17.0%
Free Cash Flow	89	67	250	322	323	427	502	527	674	575
Income Tax	88	134	148	167	200	221	244	251	214	212

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	3729	3673	3902	4110	4310	4331	4723	5249	5373	5694
Cash & Equivalents	572	186	215	218	133	93	78	92	141	185
Accounts Receivable	443	741	821	906	953	1010	1071	1181	1211	1325
Inventories	329	386	404	434	476	498	531	639	674	760
Goodwill & Int. Ass.	991	984	995	1029	1014	985	1080	1178	1135	1158
Total Liabilities	2325	2126	2083	1980	2085	1900	2088	2277	2255	2263
Accounts Payable	254	125	143	156	145	148	171	178	201	199
Long-Term Debt	1171	984	976	972	919	880	1010	1187	1132	1150
Shareholder's Equity	1389	1531	1802	2113	2208	2413	2617	2954	3099	3409
D/E Ratio	0.84	0.64	0.54	0.46	0.42	0.36	0.39	0.40	0.37	0.34

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	5.2%	7.5%	8.1%	8.7%	10.0%	11.1%	12.1%	11.2%	12.8%	12.5%
Return on Equity	13.9%	18.9%	18.4%	17.9%	19.5%	20.7%	21.7%	20.0%	22.5%	21.3%
ROIC	7.5%	10.8%	11.5%	11.9%	13.5%	14.8%	15.7%	14.3%	16.2%	15.7%
Shares Out.	58	58	58	58	58	58	58	57	57	55
Revenue/Share	45.92	50.74	52.62	54.78	59.10	60.80	62.49	68.26	71.04	72.77
FCF/Share	1.53	1.15	4.24	5.45	5.46	7.22	8.45	8.98	11.76	10.29

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

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