MSC Industrial Direct Co. Inc. (MSM)

Updated May 14th, 2020 by Quinn Mohammed

Key Metrics

Current Price:	$57	**5 Year CAGR Estimate:**	14.9%	**Market Cap:**	$3.2B
Fair Value Price:	$73	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date[1]:**	07/22/2019
% Fair Value:	79%	**5 Year Valuation Multiple Estimate:**	4.9%	**Dividend Payment Date[2]:**	08/06/2019
Dividend Yield:	5.2%	**5 Year Price Target**	$98	**Years Of Dividend Growth:**	16
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	19%

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 $3.2 billion market cap company that employees over 6,500 people.

On April 8th, MSM reported second quarter results for fiscal 2020. Net sales for the quarter came in at $786 million, a 4.5% YoY decrease. Operating income of $77.7 million was down 19% from last year's $96 million. Diluted earnings per share was $1.00, at the midpoint of the guidance range, and 19% below the quarterly results published last year.

Management reiterates that their main journey is to reposition MSC as a mission critical partner on the plant floor. However, the near-term has shifted to focusing on navigating through the COVID-19 crisis.

Management has opted not to provide guidance given the unprecedented uncertainty the country and the economy is facing right now, as well as the pace that things are changing. However, the company has decided to publish monthly updates on average daily sales. On May 12th, MSM reported that average daily sales dropped 10.5% compared to last year, far from a cataclysm on sales. In fact, the company has seen solid gross margins through March and April due to its mid-year price increase. The order backlog increased substantially and is above $100 million. Many of these bookings should invoice in May and Q4. Bookings have increased due to a surge in large safety and janitorial orders, scarcity of product and longer lead times.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.37	$3.43	$4.11	$3.91	$3.94	$3.78	$3.76	$4.00	$5.10	$5.20	***4.13***	***$5.53***
DPS	$0.82	$0.88	$1.00	$1.20	$1.32	$1.60	$1.72	$1.80	$2.22	$2.76	***3.00***	***$3.83***
Shares[3]	63	63	63	63	62	62	57	56	56	56	***56***	***50***

Dating back to fiscal year 2008 (where EPS was $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. The company still struggles to increase margins even after completing a stream of acquisitions and investments, and efforts to reduce headcount and other expenses; however, price increases realized mid-year have started to improve this. The company has implemented a three-part action plan to improve sales execution and new account implementations, increase profitability in supplier programs and further increase expense control and productivity, and they report it is going as planned. 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.

[1] An estimate based on last year
[2] An estimate based on last year
[3] In millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	20.2	18.2	17.2	19.9	21.7	20.1	18.0	21.5	17.0	14.6	***13.9***	***15.0***
Avg. Yld.	1.7%	1.4%	1.4%	1.5%	1.5%	2.1%	2.5%	2.1%	2.6%	3.3%	***5.2%***	***4.6%***

Over the past five years, shares of MSM have traded hands with an average P/E ratio of about 18.2 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 is also worthwhile to note that MSM paid a special dividend in 2005, 2011 and 2015 and now in 2020.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	35%	26%	24%	31%	34%	42%	46%	45%	44%	53%	***73%***	***69%***

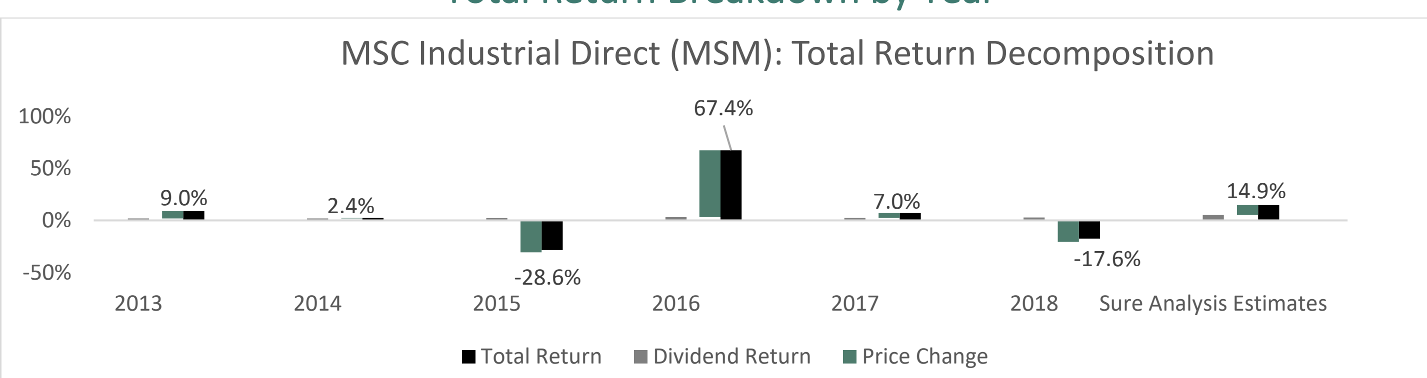
MSM's competitive advantage stems from its superior scale and execution. The company has roughly 1.7 million SKUs and boasts of a 99% same day order fulfillment rate. It is true that Amazon is a formidable threat, but thus far MSM has been able to ward off attacks through its niche market relationships. 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 $267 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 are directly involved in the supply chain. The general public does not 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 14.9%, which includes a 5.2% dividend and an expected 9.7% change in share price. With expected total returns exceeding 10%, and a margin of safety above 10%, so we rate MSC Industrial Direct a buy.

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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Updated January 27th, 2019 by Quinn Mohammed

Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	1692	2022	2356	2458	2787	2910	2864	2888	3204	3364
Gross Profit	767	941	1078	1119	1286	1317	1289	1286	1393	1432
Gross Margin	45.3%	46.5%	45.8%	45.5%	46.1%	45.2%	45.0%	44.5%	43.5%	42.6%
D&A Exp.	26	29	35	49	65	70	72	63	63	65
Operating Profit	242	350	412	386	383	380	376	379	421	400
Op. Margin	14.3%	17.3%	17.5%	15.7%	13.7%	13.0%	13.1%	13.1%	13.1%	11.9%
Net Profit	150	219	259	238	236	231	231	231	329	289
Net Margin	8.9%	10.8%	11.0%	9.7%	8.5%	7.9%	8.1%	8.0%	10.3%	8.6%
Free Cash Flow	120	184	187	236	202	198	313	200	295	277
Income Tax	90	131	153	145	143	142	141	137	77	94

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	1153	1244	1445	1943	2061	2100	2065	2099	2289	2311
Cash & Equivalents	121	96	168	56	47	38	53	16	46	32
Acc. Receivable	221	267	297	345	383	403	392	472	524	541
Inventories	286	345	393	419	450	507	444	465	518	559
Goodwill & Int.	321	326	340	786	768	743	729	744	798	794
Total Liabilities	253	251	258	553	662	767	967	874	901	827
Accounts Payable	81	96	97	114	116	114	111	121	145	160
Long-Term Debt	39	0	3	256	337	427	607	533	535	442
Total Equity	900	993	1187	1390	1399	1333	1098	1225	1387	1479
D/E Ratio	0.04	0.00	0.00	0.18	0.24	0.32	0.55	0.44	0.39	0.30

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	13.0%	18.2%	19.3%	14.0%	11.8%	11.1%	11.1%	11.1%	15.0%	12.6%
Return on Equity	17.6%	23.1%	23.8%	18.5%	16.9%	16.9%	19.0%	19.9%	25.2%	20.2%
ROIC	15.5%	22.6%	23.7%	16.8%	14.0%	13.2%	13.3%	13.4%	17.9%	15.0%
Shares Out.	63	63	63	63	62	62	57	56	56	56
Revenue/Share	26.89	31.93	37.51	39.00	44.71	47.33	46.88	50.69	56.50	60.60
FCF/Share	1.90	2.91	2.97	3.75	3.24	3.23	5.13	3.52	5.20	4.98

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