MSC Industrial Direct Co. Inc. (MSM)

Updated November 3rd, 2020 by Quinn Mohammed

Key Metrics

Current Price:	$77	**5 Year CAGR Estimate:**	6.6%	**Market Cap:**	$4.1B
Fair Value Price:	$68	**5 Year Growth Estimate:**	5.5%	**Ex-Dividend Date:**	11/09/2019
% Fair Value:	114%	**5 Year Valuation Multiple Estimate:**	-2.5%	**Dividend Payment Date:**	11/24/2020
Dividend Yield:	3.9%	**5 Year Price Target**	$88	**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 $3.8 billion market cap company that employees over 6,500 people.

On October 27th, MSM reported fourth quarter and full year results for fiscal 2020. Net sales for the fourth quarter came in at $748 million, an 11.3% year-over-year decrease. Operating income of $73 million was down 19.4% from last year's $91 million. Diluted earnings per share was $0.94, a 22% drop from the $1.20 posted a year earlier.

For the full year of 2020, MSM reported net sales of $3.2 billion, lower by 5.1% compared to 2019. Operating income of $351 million was down by 12% compared to last year. Diluted EPS of $4.51 was within our expectations but lower than 2019 by 13%.

In light of the ongoing coronavirus pandemic, results remain stable overall. Weakness in industrial demand persisted, as most manufacturing end markets (like automotive, aerospace, and oil and gas) remained soft due to the uncertainty surrounding the pandemic.

Progress on growth initiatives announced in 2019 are pushing along. The most recent update is that the company plans to reaccelerate market share capture and improve profitability, in a new program named Mission Control. The company is expecting this program to provide results at least 400 basis points above market growth. Management has not provided any earnings or sales guidance for the following quarter or year.

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	***4.51***	***$5.89***
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[1]	63	63	63	63	62	62	57	56	56	56	***56***	***50***

MSM has an average 10-year EPS compound annual growth rate of 7.4%, and a 5-year average growth rate of 3.6%. We estimate that MSM can grow forward earnings around the mid-point of this historical growth rate, at 5.5%. Unfortunately, softness in industrial demand continues to persist against the solid execution of the company. However, the company has been able to regularly increase product prices as they see continued supplier list price movement. 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 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 done well over the last several years to stave off this threat.

[1] In millions

MSC Industrial Direct Co. Inc. (MSM)

Updated November 3rd, 2020 by Quinn Mohammed

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	***17.0***	***15.0***
Avg. Yld.	1.7%	1.4%	1.4%	1.5%	1.5%	2.1%	2.5%	2.1%	2.6%	3.3%	***3.9%***	***4.3%***

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 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%	***67%***	***65%***

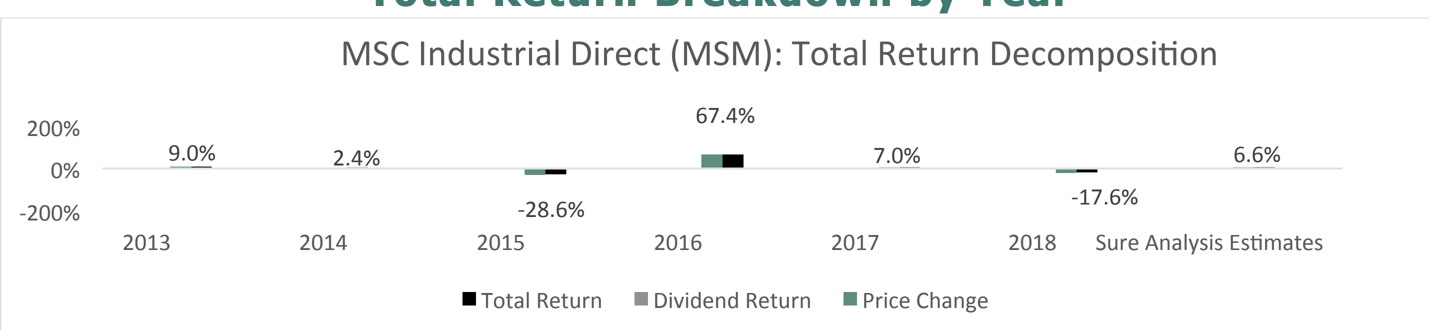
MSM's competitive advantage stems from its superior scale and execution. The company has roughly 1.7 million SKUs and boasts of a 99% same day order fulfillment rate. It is true that Amazon is a formidable threat, but thus far MSM has been able to ward off attacks through its niche market relationships. A greater threat to the business is the possibility of American manufacturing, especially metalworking, moving overseas; however, this seems less and less likely.

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 positive. As of the last quarterly report, long-term debt stood at $497 million against underlying earnings power around $350 million. Debt has grown quite a bit since coronavirus began; however, the company appears safe and conservatively financed as they are holding roughly $125 million in cash and cash equivalents.

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. Total returns going forward are estimated at 6.6%, which includes a 3.9% dividend and an expected 2.7% change in share price. The company both lacks any margin of safety and has expected total returns of 6.6%, so we rate MSC Industrial Direct a sell at current prices.

Total Return Breakdown by Year



Click here to rate and review this research report. Your feedback is important to us

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.

MSC Industrial Direct (MSM)

Updated November 3rd, 2020 by Quinn Mohammed

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.