MSC Industrial Direct Co. Inc. (MSM)

Updated July 19th, 2020 by Quinn Mohammed

Key Metrics

Current Price:	$85	**5 Year CAGR Estimate:**	5.8%	**Market Cap:**	$4.7B
Fair Value Price:	$75	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	11/09/2021
% Fair Value:	114%	**5 Year Valuation Multiple Estimate:**	-2.6%	**Dividend Payment Date:**	11/24/2021
Dividend Yield:	3.5%	**5 Year Price Target**	$96	**Years Of Dividend Growth:**	16
Dividend Risk Score:	B	**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 $4.7 billion market cap company that employees nearly 6,500 people.

On July 7th, MSM reported third quarter results for fiscal 2021. Net sales for the quarter came in at $866 million, a 3.8% year-over-year increase. Adjusted operating income of $129 million was up 17% from last year's $110 million. Adjusted operating margin of 12.6% was lower than 13.3% reported in the same prior year period.

Basic earnings per diluted share of $1.68 was a 20% increase over the prior year. Adjusted diluted earnings per share of $1.42, however, was identical to the prior year. During the third quarter, the company repurchased 507,000 common shares.

The Mission Critical program first announced in 4Q2020, with the intention to reaccelerate market share and improve profitability, is going along as planned, and delivered $12 million of gross savings in the quarter. The goal is $95 million of gross cost take out through fiscal 2023 versus fiscal 2019. Cumulative savings for fiscal 2021 is $29 million with a goal of $40 million by year end (up from a goal of $25 million at the end of last quarter).

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$3.43	$4.11	$3.91	$3.94	$3.78	$3.76	$4.00	$5.10	$5.20	$4.51	**$4.83**	**$6.16**
DPS	$0.88	$1.00	$1.20	$1.32	$1.60	$1.72	$1.80	$2.22	$2.76	$3.00	**$3.00**	**$3.83**
Shares[1]	63	63	63	62	62	57	56	56	56	55	**56**	**50**

MSM has an average 10-year EPS compound annual growth rate of 3.6%, and a 5-year average growth rate of 4.7%. We estimate that MSM can grow forward earnings around the high point of this historical growth rate, at 5%. Unfortunately, softness in industrial demand other than PPE 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. So far, the new Mission Critical program appears it will be successful in further increasing margins.

The company also 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

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	18.2	17.2	19.9	21.7	20.1	18	21.5	17	14.4	14.6	**17.7**	**15.5**
Avg. Yld.	1.4%	1.4%	1.5%	1.5%	2.1%	2.5%	2.1%	2.6%	3.7%	4.4%	**3.5%**	**4.0%**

Over the past five years, shares of MSM have traded hands with an average P/E ratio of about 17 times earnings. We credit this premium multiple to three basic items: a solid established business, a conservative balance sheet and a large family stake. MSM is effectively a third-generation company 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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	26%	24%	31%	34%	42%	46%	45%	44%	53%	67%	**62%**	**62%**

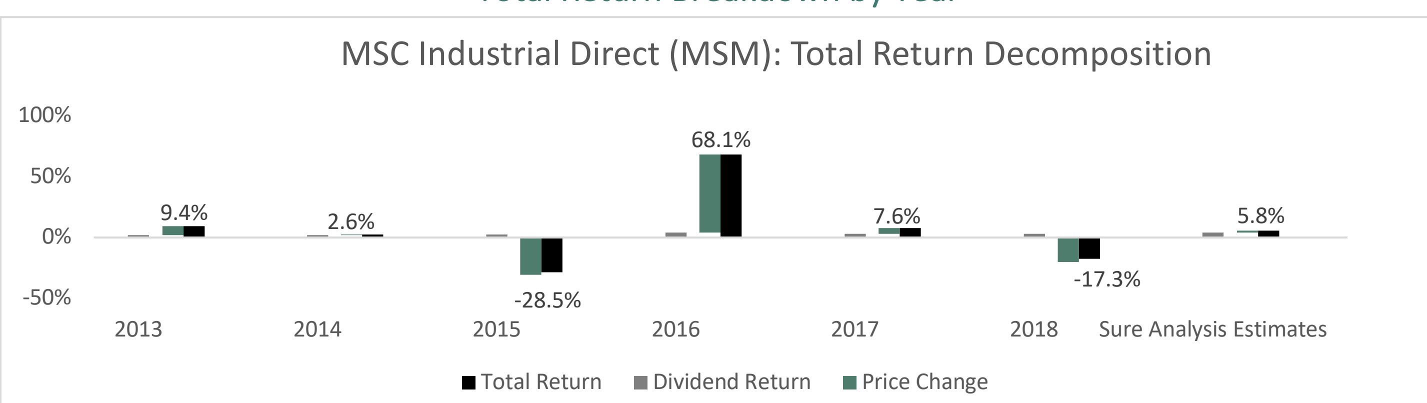
MSM's competitive advantage stems from its superior scale and execution. The company has roughly 1.7 million SKUs and boasts of a 99% same day order fulfillment rate. It is true that Amazon is a formidable threat, but thus far MSM has been able to ward off attacks through its niche market relationships. 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 $350 million against underlying earnings power around $250 million.

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 5.8%, which includes a 3.5% dividend yield and estimates 5% earnings growth but is weighed down by an estimated 2.6% drop in valuation. The company both lacks a margin of safety, and has only fair expected total returns of 5.8%, so we rate MSC Industrial Direct a sell at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	2022	2356	2458	2787	2910	2864	2888	3204	3364	3192
Gross Profit	941	1078	1119	1286	1317	1289	1286	1393	1432	1343
Gross Margin	46.5%	45.8%	45.5%	46.1%	45.2%	45.0%	44.5%	43.5%	42.6%	42.1%
D&A Exp.	29	35	49	65	70	72	63	63	65	69
Operating Profit	350	412	386	383	380	376	379	421	400	351
Op. Margin	17.3%	17.5%	15.7%	13.7%	13.0%	13.1%	13.1%	13.1%	11.9%	11.0%
Net Profit	219	259	238	236	231	231	231	329	289	251
Net Margin	10.8%	11.0%	9.7%	8.5%	7.9%	8.1%	8.0%	10.3%	8.6%	7.9%
Free Cash Flow	184	187	236	202	198	313	200	295	277	350
Income Tax	131	153	145	143	142	141	137	77	94	82

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	1244	1445	1943	2061	2100	2065	2099	2289	2311	2382
Cash & Equivalents	96	168	56	47	38	53	16	46	32	125
Acc. Receivable	267	297	345	383	403	392	472	524	541	492
Inventories	345	393	419	450	507	444	465	518	559	543
Goodwill & Int.	326	340	786	768	743	729	744	798	794	782
Total Liabilities	251	258	553	662	767	967	874	901	827	1062
Accounts Payable	96	97	114	116	114	111	121	145	160	126
Long-Term Debt	0	3	256	337	427	607	533	535	442	619
Total Equity	993	1187	1390	1399	1333	1098	1225	1387	1479	1315
D/E Ratio	0.00	0.00	0.18	0.24	0.32	0.55	0.44	0.39	0.30	0.47

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	18.2%	19.3%	14.0%	11.8%	11.1%	11.1%	11.1%	15.0%	12.6%	10.7%
Return on Equity	23.1%	23.8%	18.5%	16.9%	16.9%	19.0%	19.9%	25.2%	20.2%	18.0%
ROIC	22.6%	23.7%	16.8%	14.0%	13.2%	13.3%	13.4%	17.9%	15.0%	13.0%
Shares Out.	63	63	63	62	62	57	56	56	56	55
Revenue/Share	31.93	37.51	39.00	44.71	47.33	46.88	50.69	56.50	60.60	57.37
FCF/Share	2.91	2.97	3.75	3.24	3.23	5.13	3.52	5.20	4.98	6.29

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