MSC Industrial Direct Co. Inc. (MSM)

Updated January 6th, 2022 by Quinn Mohammed

Key Metrics

Current Price:	$84	**5 Year CAGR Estimate:**	8.8%	**Market Cap:**	$4.7B
Fair Value Price:	$87	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	01/10/2022
% Fair Value:	97%	**5 Year Valuation Multiple Estimate:**	0.7%	**Dividend Payment Date:**	01/25/2022
Dividend Yield:	3.6%	**5 Year Price Target**	$111	**Years Of Dividend Growth:**	16
Dividend Risk Score:	B	**Retirement Suitability Score:**	A	**Last Dividend Increase:**	-

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 roughly 6,500 people.

On December 22nd, MSM reported first quarter fiscal 2022 results. Net sales for the quarter came in at $849 million, a 9.9% year-over-year increase. Adjusted operating eked out a minor gain from 11.0% in FY21 Q1 to 11.3% in FY22 Q1. Adjusted net income grew 13% to $70 million and adjusted diluted earnings per share rose 12.6% to $1.25 from $1.11 in the same prior year period.

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 $10 million of gross savings and investments of $7 million in the quarter. The goal is $95 million of gross cost take out through fiscal 2023 versus fiscal 2019. In fiscal 2022, leadership believes their Mission Critical program will allow them to save an additional $25 million and invest an additional $15 million.

Leadership is focused on growing sales by 400 basis points above the Industrial Production Index, and to deliver return on invested capital (ROIC) to the high-teens by the end of fiscal 2023.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$4.11	$3.91	$3.94	$3.78	$3.76	$4.00	$5.10	$5.20	$4.51	$4.81	***$5.62***	***$7.17***
DPS	$1.00	$1.20	$1.32	$1.60	$1.72	$1.80	$2.22	$2.76	$3.00	$3.00	***$3.00***	***$3.83***
Shares[1]	63	63	62	62	57	56	56	56	55	55	***56***	***50***

MSM has an average 9-year EPS compound annual growth rate of 3.4%, and a 5-year average growth rate of 6.8%. We estimate that MSM can grow forward earnings around the mid-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 over the longer term, given current headwinds.

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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	17.2	19.9	21.7	20.1	18	21.5	17	14.4	14.6	14.6	**15.0**	***15.5***
Avg. Yld.	1.4%	1.5%	1.5%	2.1%	2.5%	2.1%	2.6%	3.7%	4.4%	4.4%	**3.6%**	***3.4%***

Over the past nine years, shares of MSM have traded hands with an average P/E ratio of about 17.9 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%	**53%**	**53%**

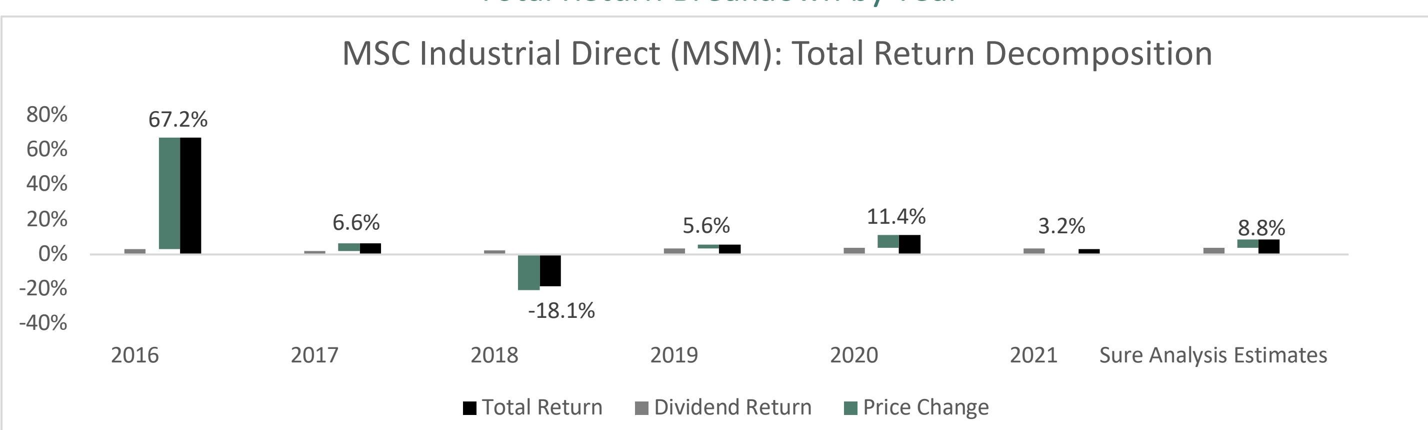
MSM's competitive advantage stems from its superior scale and execution. The company has roughly 1.9 million SKUs and boasts a strong and quick order fulfillment rate. It is true that Amazon is a formidable threat, but thus far MSM has been able to ward off attacks through its niche market relationships. 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 $560 million against underlying earnings power of around $270 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 8.8%, which includes a 3.6% dividend yield, 5% earnings growth and a 0.7% impact from valuation expansion. The company has a very minor margin of safety, and has expected total returns of 8.8%, so we rate MSC Industrial Direct a Hold at current prices.

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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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	2356	2458	2787	2910	2864	2888	3204	3364	3192	3243
Gross Profit	1078	1119	1286	1317	1289	1286	1393	1432	1343	1334
Gross Margin	45.8%	45.5%	46.1%	45.2%	45.0%	44.5%	43.5%	42.6%	42.1%	41.1%
D&A Exp.	35	49	65	70	72	63	63	65	69	69
Operating Profit	412	386	383	380	376	379	421	407	368	339
Op. Margin	259	238	236	231	231	231	329	289	251	217
Net Profit	11.0%	9.7%	8.5%	7.9%	8.1%	8.0%	10.3%	8.6%	7.9%	6.7%
Net Margin	187	236	202	198	313	200	295	277	350	171
Free Cash Flow	7.9%	9.6%	7.2%	6.8%	10.9%	6.9%	9.2%	8.2%	11.0%	5.3%
Income Tax	153	145	143	142	141	137	77	94	82	70

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	1445	1943	2061	2100	2065	2099	2289	2311	2382	2462
Cash & Equivalents	168	56	47	38	53	16	46	32	125	41
Acc. Receivable	297	345	383	403	392	472	524	541	492	560
Inventories	393	419	450	507	444	465	518	559	543	624
Goodwill & Int.	340	786	768	743	729	744	798	794	782	795
Total Liabilities	258	553	662	767	967	874	901	827	1062	1300
Accounts Payable	97	114	116	114	111	121	145	160	126	186
Long-Term Debt	3	256	337	427	607	533	535	442	619	786
Total Equity	1187	1390	1399	1333	1098	1225	1387	1479	1315	1151
D/E Ratio	0.00	0.18	0.24	0.32	0.55	0.44	0.39	0.30	0.47	0.68

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	19.3%	14.0%	11.8%	11.1%	11.1%	11.1%	15.0%	12.6%	10.7%	9.0%
Return on Equity	23.8%	18.5%	16.9%	16.9%	19.0%	19.9%	25.2%	20.2%	18.0%	17.6%
ROIC	23.7%	16.8%	14.0%	13.2%	13.3%	13.4%	17.9%	15.0%	13.0%	11.2%
Shares Out.	63	63	62	62	57	56	56	56	55	55
Revenue/Share	37.51	39.00	44.71	47.33	46.88	50.69	56.50	60.60	57.37	57.82
FCF/Share	2.97	3.75	3.24	3.23	5.13	3.52	5.20	4.98	6.29	3.04

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