MSC Industrial Direct Co. Inc. (MSM)

Updated January 25th, 2023 by Quinn Mohammed

Key Metrics

Current Price:	$80	**5 Year CAGR Estimate:**	11.7%	**Market Cap:**	$4.5B
Fair Value Price:	$95	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date[1]:**	04/11/2023
% Fair Value:	85%	**5 Year Valuation Multiple Estimate:**	3.4%	**Dividend Payment Date[1]:**	04/26/2023
Dividend Yield:	4.0%	**5 Year Price Target**	$121	**Years Of Dividend Growth:**	1
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Rating:**	Buy

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 6 customer fulfillment centers, 10 regional inventory centers and 38 warehouses. MSM is a $4.5 billion market cap company that employees roughly 7,000 people.

On October 11th, 2022, MSC Industrial Direct increased its quarterly dividend by 5% to $0.79 per share.

On January 5th, 2023, MSM reported first quarter 2023 results. Net sales for the quarter came in at $958 million, a 12.9% year-over-year increase. Adjusted income from operations rose 23% to $118 million. The adjusted operating margin was stronger than the prior year, at 12.3% vs 11.3%. Adjusted net income grew by nearly 19% to $83 million and adjusted diluted EPS rose 18% to $1.48 from $1.25 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, resulting in improved adjusted operating margins, which is evident in FY 2022 and Q1 2023 results. The goal is $100 million of gross cost take out through fiscal 2023 versus fiscal 2019.

In the first quarter, MSC Industrial repurchased more than 200,000 shares.

Leadership expects adjusted operating margin to come in around 13.0% for 2023 and for an additional $15 million in savings through its Mission Critical program.

Subsequent to the first quarter, on January 11th, 2023, MSC Industrial acquired Buckeye Industrial Supply Co, an independent metalworking distributor, as well as Tru-Edge Grinding, a custom tool manufacturer. Combined, the two companies generated $28 million in revenue in 2022.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$3.91	$3.94	$3.78	$3.76	$4.00	$5.10	$5.20	$4.51	$4.81	$6.15	***$6.10***	***$7.79***
DPS	$1.20	$1.32	$1.60	$1.72	$1.80	$2.22	$2.76	$3.00	$3.00	$3.00	***$3.16***	***$4.03***
Shares[2]	63	62	62	57	56	56	56	55	55	56	***56***	***50***

MSM has an average 9-year EPS compound annual growth rate of 5.2%, and a 5-year average growth rate of 9.0%. We estimate that MSM can grow forward earnings at around 5%, in line with its historic growth rate. The company has been able to regularly increase product prices as they see continued supplier list price movement. So far, the Mission Critical program appears it will be successful in further increasing margins over the longer term, despite 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. Additionally, the company states their next growth priorities include tuck-in acquisitions, such as the recent purchase of Buckeye Industrial Supply Co., and share repurchases. The emergence of Amazon is a threat;

[1] Estimate
[2] In millions

however, MSM's business is difficult to replicate, and the company has done well over the last several years to keep this threat at bay.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	19.9	21.7	20.1	18.0	21.5	17.0	14.4	14.6	17.9	13.1	***13.1***	***15.5***
Avg. Yld.	1.50%	1.50%	2.10%	2.50%	2.10%	2.60%	3.70%	4.40%	3.50%	3.80%	***4.0%***	***3.3%***

Over the past nine years, shares of MSM have traded hands with an average P/E ratio of about 17.8 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, 2015 and in 2020.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	31%	34%	42%	46%	45%	44%	53%	67%	62%	49%	***52%***	***52%***

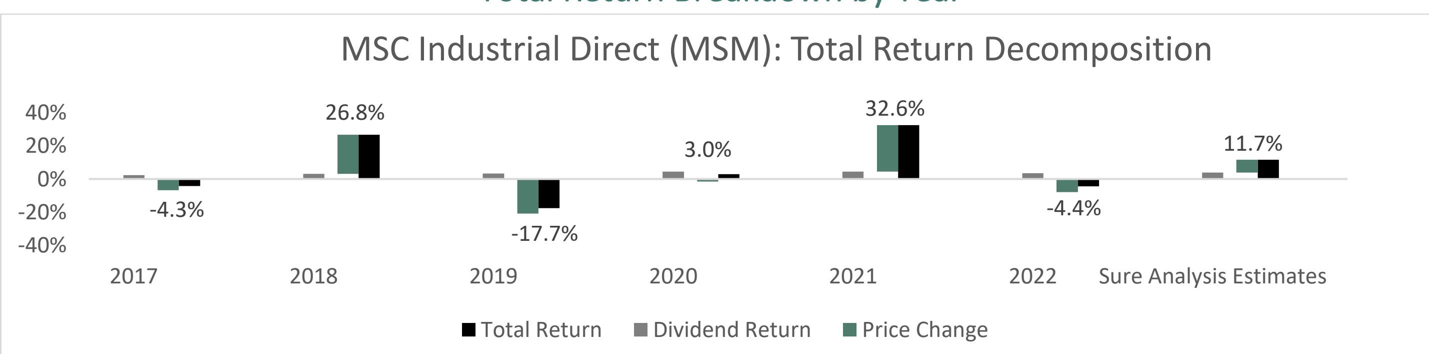
MSM's competitive advantage stems from its superior scale and execution. The company has roughly 2.0 million SKUs and boasts a strong and quick order fulfillment rate. It is true that Amazon is a formidable threat, but thus far MSM has been able to ward off attacks through its niche market relationships. 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 $454 million against underlying earnings power of around $475 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 11.7%, which includes a 4.0% dividend yield, 5.0% earnings growth and a potential 3.4% positive impact from valuation expansion. We rate MSC Industrial Direct a buy 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	2458	2787	2910	2864	2888	3204	3364	3192	3243	3692
Gross Profit	1119	1286	1317	1289	1286	1393	1432	1343	1334	1558
Gross Margin	45.5%	46.1%	45.2%	45.0%	44.5%	43.5%	42.6%	42.1%	41.1%	42.2%
D&A Exp.	49	65	70	72	63	63	65	69	69	70
Operating Profit	386	383	380	376	379	421	407	368	339	474
Op. Margin	9.7%	8.5%	7.9%	8.1%	8.0%	10.3%	8.6%	7.9%	6.7%	12.8%
Net Profit	236	202	198	313	200	295	277	350	171	340
Net Margin	9.6%	7.2%	6.8%	10.9%	6.9%	9.2%	8.2%	11.0%	5.3%	9.2%
Free Cash Flow						295	277	350	171	185
Income Tax	145	143	142	141	137	77	94	82	70	111

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1943	2061	2100	2065	2099	2289	2311	2382	2462	2729
Cash & Equivalents	56	47	38	53	16	46	32	125	41	44
Acc. Receivable	345	383	403	392	472	524	541	492	560	688
Inventories	419	450	507	444	465	518	559	543	624	716
Goodwill & Int.	786	768	743	729	744	798	794	782	795	824
Total Liabilities	553	662	767	967	874	901	827	1062	1300	1367
Accounts Payable	114	116	114	111	121	145	160	126	186	217
Long-Term Debt	256	337	427	607	533	535	442	619	786	795
Total Equity	1390	1399	1333	1098	1225	1387	1479	1315	1151	1350
D/E Ratio	0.18	0.24	0.32	0.55	0.44	0.39	0.30	0.47	0.68	0.59

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	14.0%	11.8%	11.1%	11.1%	11.1%	15.0%	12.6%	10.7%	9.0%	13.1%
Return on Equity	18.5%	16.9%	16.9%	19.0%	19.9%	25.2%	20.2%	18.0%	17.6%	27.2%
ROIC	16.8%	14.0%	13.2%	13.3%	13.4%	17.9%	15.0%	13.0%	11.2%	16.6%
Shares Out.	63	62	62	57	56	56	56	55	55	56
Revenue/Share	39.00	44.71	47.33	46.88	50.69	56.50	60.60	57.37	57.82	65.87
FCF/Share	3.75	3.24	3.23	5.13	3.52	5.20	4.98	6.29	3.04	3.30

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