

Tractor Supply Co (TSCO)

Earnings Update

Hold | Market Perform

William Errett | February 1, 2024



Overview

Summary

Tractor Supply Co is an interesting retail company with a moat that benefits from cost advantages and intangible assets. Tractor Supply Co benefits from cost advantages due to them being by far the largest player when it comes to the products that they sell. Because of this they can spread distribution and other costs over a large quantity of products. Additionally, they benefit from intangible assets due to their knowledgeable employees and personal connection with the customer that they achieve in their "life out here" strategy.

Tractor Supply Co printed results that were roughly in-line with expectations. Revenue missed by almost 1% and earnings per share beat by almost 3%. The difference between these was primarily due to unexpected margin expansion during the quarter. Net Sales for the business came in at \$3.7 Bn, down 9% from the previous quarter. However, in the last Q4 benefited from a 53rd week (a 14th week in the quarter), excluding this Revenue was down nearly 3%. The rest of the metrics finished in the midline of management's expectations, except for slightly lower SGA due to sale leaseback gains. The impact from the 53rd week also impacts comparable for the whole FY23. So, in general, excluding the 53rd week, everything was up between 1-4%.

Comparable store sales, or same store sales (CSS or SSS) decreased by 4.2% compared to the prior quarter. This was due to a 1.5% decrease in average transaction value, this was primarily driven by a mix of products because price increases from last year have already been lapped. The average transaction count during the quarter was also down 2.7%. Growth in new stores was not enough to offset these decreases in performance. During the quarter Tractor Supply opened 19 new stores compared to 39 last year, but that was impacted by the acquisition of Orscheln Farm and Home. Conversion of Orscheln stores to Tractor Supply Co's were finished this year as well. This is good progress on their goal to increase new store openings to 90 a year from 70 a year.

Tractor Supply Co benefitted massively from COVID-19 changes. Due to the work from home culture that started during that time several people in cities and suburbs moved out to more rural settings where Tractor Supply Co is. Due to also because of these there are a large amount of "one-time supplies" that were needed by customers from Tractor Supply Co. Now that most people are done moving due to working from home Tractor Supply Co has shifted these new members into similar positions to the ones that they have previous members. This includes drawing in recurring visits due to selling Consumable, Usable, and Edible products (CUE) that are needed to run a small ranch each month, and adding discretionary items to carts while customers are in the store.

After this quarter Tractor Supply Co released their FY24 guidance. Net sales are expected to come in at \$14.7 Bn to \$15.1 Bn (1-3% growth). SSS is expected to be down 1% to up 1.5%. Operating margin is expected to be close to 10%. Net income guidance is expected to still be around \$1.10 Bn that they had this year. Finally, Earnings per share are expected to be between \$9.85 and \$10.50. Tractor Supply Co also plans to spend almost \$700 Mn on capital expenditures net of their sale leasebacks. And spend around \$600 Mn on share repurchases.

Due to the lower guidance and economic headwinds going forward Tractor Supply Co does not look like a significant buying opportunity currently, despite trading in their undervalued range. Assuming growth on average of 7% in earnings per share for the next 5 years and exit multiples for price to earnings of 18x to 22x there is currently about a negative 15% margin of safety. Due to this I recommend that we hold our shares for now but continue to evaluate them as a possible selling opportunity.

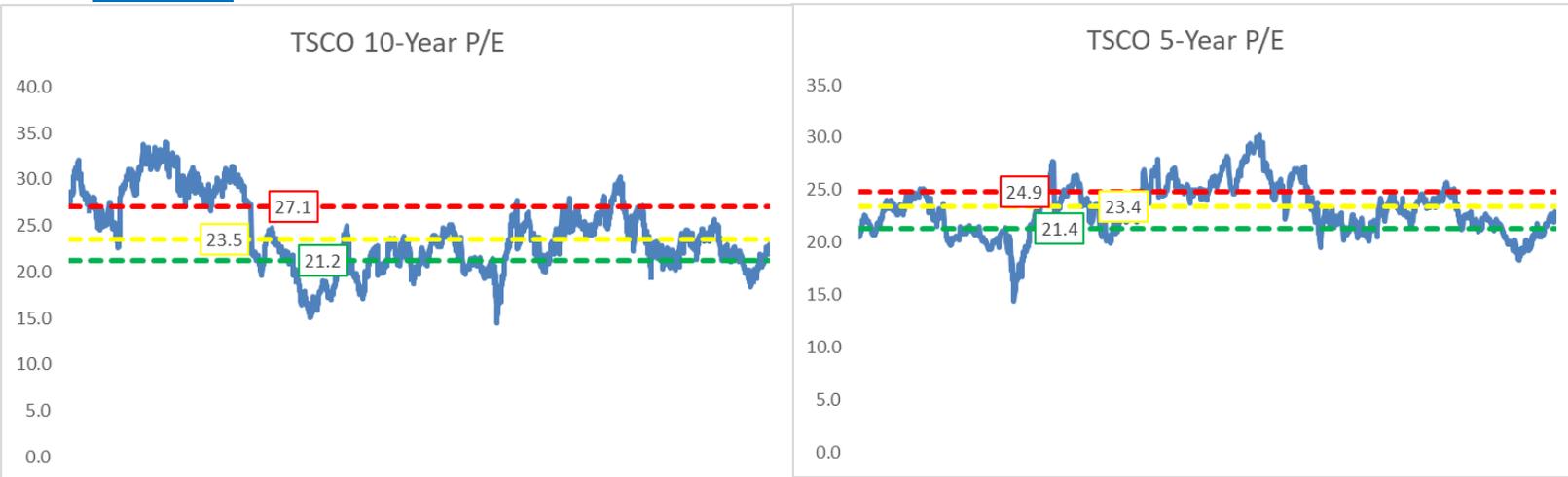
IOFS

Tractor Supply Co passes some of our IOFS (Interpretation of financial statements) thresholds, except margin metrics, capital expenditures, and obligation ratio. Tractor Supply Co has never been a company that has achieved our margin metrics; however, they are close to our margin thresholds in gross and net. Additionally, Tractor Supply Co invests significantly in building new stores each year and expects to continue to invest more and more in building new stores with their new store opening plan, which leads to them failing our capital expenditure metric.

	2013-12	2014-12	2015-12	2016-12	2017-12	2018-12	2019-12	2020-12	2021-12	2022-12	2023-12
IOFS											
Revenue	\$ 5,165	\$ 5,712	\$ 6,227	\$ 6,780	\$ 7,256	\$ 7,911	\$ 8,352	\$ 10,620	\$ 12,731	\$ 14,205	\$ 14,556
Gross profit	\$ 1,754	\$ 1,950	\$ 2,143	\$ 2,325	\$ 2,492	\$ 2,703	\$ 2,872	\$ 3,762	\$ 4,477	\$ 4,972	\$ 5,228
Operating Income	\$ 515	\$ 589	\$ 651	\$ 694	\$ 686	\$ 702	\$ 743	\$ 1,066	\$ 1,307	\$ 1,435	\$ 1,479
Net Income	\$ 328	\$ 371	\$ 410	\$ 437	\$ 423	\$ 532	\$ 562	\$ 749	\$ 997	\$ 1,089	\$ 1,107
EBIT	\$ 515	\$ 589	\$ 651	\$ 694	\$ 686	\$ 702	\$ 743	\$ 997	\$ 1,307	\$ 1,435	\$ 1,479
EBITDA	\$ 615	\$ 704	\$ 774	\$ 837	\$ 852	\$ 879	\$ 939	\$ 1,214	\$ 1,577	\$ 1,778	\$ 1,872
Dividend Yield %	0.63	0.77	0.89	1.21	1.4	1.44	1.46	1.07	0.87	1.62	1.79
Gross Margin	34.0%	34.1%	34.4%	34.3%	34.3%	34.2%	34.4%	35.4%	35.2%	35.0%	35.9%
Operating Margin	10.0%	10.3%	10.4%	10.2%	9.5%	8.9%	8.9%	10.0%	10.3%	10.1%	10.2%
Net Margin	6.4%	6.5%	6.6%	6.4%	5.8%	6.7%	6.7%	7.1%	7.8%	7.7%	7.6%
D&A/ Gross Profit	5.7%	5.9%	5.8%	6.1%	6.7%	6.6%	6.8%	5.8%	6.0%	6.9%	7.5%
SG&A/ Gross Profit	64.9%	63.9%	63.9%	64.0%	65.8%	67.5%	67.3%	65.9%	64.8%	64.2%	64.2%
Capex/ Net Income	66.5%	43.3%	57.6%	51.7%	59.3%	52.3%	38.7%	39.3%	63.0%	71.0%	68.1%
Dividend Payout ratio	473.5%	436.1%	25.3%	28.1%	31.8%	27.8%	29.2%	23.5%	24.2%	37.9%	40.6%
Shares Outstanding	141.7	139.4	136.8	133.8	128.2	123.5	120.7	117.4	115.8	112.1	109.7
Returns %											
ROE	28.9	29.2	30.5	30.7	29.4	35.7	35.9	42.9	50.8	53.8	51.5
ROIC	28.9	29.2	30.5	25.9	23.0	28.4	29.1	27.4	33.8	34.2	28.5
Leverage & Liquidity											
LT Debt	0	0	0	263	401	381	366	984	986	1164	1729
ST Debt	0	0	0	10	25	26	30	0	0	0	0
PF Stock	0	0	0	0	0	0	0	0	0	0	0
Leases*7	1	5	17	26	33	29	2300	2555	2925	3100	3250
Cash	\$ 142	\$ 21	\$ 34	\$ 54	\$ 109	\$ 86	\$ 84	\$ 1,341	\$ 878	\$ 202	\$ 397
Obligation Ratio (1)	(0.4)x	(0.0)x	(0.0)x	0.6x	0.8x	0.7x	4.6x	2.9x	3.0x	3.7x	4.1x
Cash/ Revenue	2.8%	0.9%	1.0%	0.8%	1.5%	1.1%	1.0%	12.6%	6.9%	1.4%	2.7%
Per Share Data											
Earnings	\$ 2.32	\$ 2.66	\$ 3.00	\$ 3.27	\$ 3.30	\$ 4.31	\$ 4.66	\$ 6.38	\$ 8.61	\$ 9.71	\$ 10.09
Dividends	\$ 0.49	\$ 0.61	\$ 0.76	\$ 0.92	\$ 1.05	\$ 1.20	\$ 1.36	\$ 1.50	\$ 2.08	\$ 3.68	\$ 4.12

The largest worry for this business is their obligation ratio. Tractor Supply Co is participating in sales-leasebacks of the stores that they do own. This means that they will be selling the stores they own and leasing them back from the people that they sell to. This can dramatically increase their obligation ratio as all increases in leases are multiplied by 7. This is only compounded by lower expected growth in the next year.

Valuation



Tractor Supply Co is currently trading in their undervalued range on both the 10-year and the 5-year value bands for earnings per share. Due to some high multiples in the first 5 years of the 10-year graph I included that last 5 years in a separate graph to see some more “up to date” ranges that Tractor Supply Co could trade at. Tractor Supply Co previously traded at high multiples due to high growth rates during COVID-19 due to trends that created a large increase in customers. While generally trading near the undervalued range is a sign of a buying opportunity, I do not believe that it is a strong buy due to lower growth rates going forward.

Ticker: TSCO		5 Year Discounted Cash Flow											
Price: \$234.90									Total Return		Annual Return		
									P/E	Price	PV	5 YR Return	Annual Return
Bear	EPS	Current	2024	2025	2026	2027	2028	18.0x	\$ 250.98	\$ 158.08	6.8%	1.3%	
		\$ 10.09	\$ 10.09	\$ 11.00	\$ 11.66	\$ 12.36	\$ 12.98	20.0x	\$ 276.93	\$ 174.19	17.9%	3.3%	
			0.0%	9.0%	6.0%	6.0%	5.0%	22.0x	\$ 302.88	\$ 190.30	28.9%	5.2%	
Base	EPS	Current	2024	2025	2026	2027	2028	18.0x	\$ 275.13	\$ 173.16	17.1%	3.2%	
		\$ 10.09	\$ 10.29	\$ 11.42	\$ 12.34	\$ 13.32	\$ 14.26	20.0x	\$ 303.64	\$ 190.86	29.3%	5.3%	
			2.0%	11.0%	8.0%	8.0%	7.0%	22.0x	\$ 332.16	\$ 208.57	41.4%	7.2%	
Bull	EPS	Current	2024	2025	2026	2027	2028	18.0x	\$ 301.12	\$ 189.39	28.2%	5.1%	
		\$ 10.09	\$ 10.49	\$ 11.86	\$ 13.04	\$ 14.35	\$ 15.64	20.0x	\$ 332.40	\$ 208.81	41.5%	7.2%	
			4.0%	13.0%	10.0%	10.0%	9.0%	22.0x	\$ 363.68	\$ 228.23	54.8%	9.1%	

