Tractor Supply 3Q Update
Analyst: Ellie, Monique, Nestor
BIC 10/24/2021
July, Aug., Sept.

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Business Summary

Ticker symbol TSCO. The current price hovers between 200-210. In addition to closing the with diluted EPS of $1.95, increased 20.4%, TSCO's comparable sales have grown more than 10% for the sixth consecutive quarter. Growth continues to remain robust as they continue to gain market share despite pressure across their supply chain. During the first nine months of 2021, the company opened 44 new Tractor Supply stores and six new Petsense stores and closed 11 Petsense stores, and anticipated capital expenditures include new store growth of approximately 80 new Tractor Supply and 10 new Petsense store openings. As TSCO advances their multiyear "Life Out Here Strategy," consumer trends remain sound and the company's outlook is on track for a record year of sales and earnings. We suggest we hold.

<u>News Updates</u>

- TSCO just finished their 2nd round of fundraising for their Paper Clover Campaign. Semi-annually the company performs this event and donates 90% of the proceeds to youth for scholarships. TSCO will match dollar for dollar any spending on TSCO credit caps. (No cap.) Now in its 11th year of partnership for this initiative TSCO has raised more than $15 million.
- Reminder: In June TSCO raised its minimum opening wage to $11.25 per hour. Q3 is the first full quarter completed at the new wage level.
- Retention Rate for Customers remains > 95%.
- Acquisition of Orscheln Farm and Home is still pending approval by FTC.

<u>Third Quarter Highlights</u>

Q3 Comp Sales Rose 13.1% - 9.5% to transaction count increases, and 3.6% to transaction count increases.

E-Commerce sales increased over 40% and mobile app sales now represent over 10% of e-commerce sales.

Sales grew in all categories and share gain has been consistent in both online and physical store locations.

Loyalty Program (Neighbors Club Loyalty) continues to grow north of 20%. Members spend 3x the rate of non-members. Loyalty sales account for nearly 70% of all sales.

Due to strong performance and projected outcomes for Q4 TSCO raised sales and earnings guidance for 2021.

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Cost environment remains elevated for TSCO. Certain price increases TSCO cannot offset have been passed to the consumer but their merchant and supply chain team carefully analyze these decisions. *Customer purchasing behaviors are closely monitored.

Gross profit increased 14.5% to $1.09 billion from $948.0 million in the prior year's third quarter, and gross margin decreased 41 basis points to 36.0% from 36.4% in the prior year's third quarter. (Comp 2019 Q3 gross margin was 35%.)

Selling, general and administrative ("SG&A") expenses, including depreciation and amortization, increased 13.3% to $788.1 million from $695.8 million in the prior year's third quarter. As a percent of net sales, SG&A expenses improved 58 basis points to 26.1% from 26.7% in the third quarter of 2020.

Operating income increased 17.9% to $297.2 million compared to $252.2 million in the third quarter of 2020.

Net income increased 17.7% to $224.4 million from $190.6 million, and diluted earnings per share increased 20.4% to $1.95 from $1.62 in the third quarter of 2020.

Balance sheet remains strong with an increase of merchandise inventory of $2.2 billion due to the strong sales performance.

Updated Guidance for Fiscal 2021

Net Sales around $12.6 Billion with comp. store sales growth of 16%.

Operating Margin of 10.2% - 10.3%

Diluted EPS of $8.4-$8.5

For 2021 TSCO remains on track for anticipated share repurchases in the range of $750-800 million.

	Updated	Previous
Net Sales	~$12.6 billion	$12.1 billion - $12.3 billion
Comparable Store Sales	~+16%	+11% - +13%
Operating Margin Rate	10.2% - 10.3%	9.7% - 9.9%
Net Income	$972 million - $985 million	$895 million - $930 million
Earnings per Diluted Share	$8.40 - $8.50	$7.70 - $8.00
Effective Tax Rate	22.1% - 22.3%	22.1% - 22.4%
Capital Expenditures	$550 million - $600 million	$500 million - $600 million
Share Repurchases	$750 million - $800 million	$700 million - $800 million

Anticipated capital expenditures include new store growth of approximately 80 new Tractor Supply and 10 new Petsense store openings.

The Company continues to have a strong liquidity position with current cash and cash equivalents of approximately $1.11 billion.

IOFS & Management Update

Exhibit 1. IOFS Graphs with Thresholds & Team News

TSCO - Q3.pptx

TSCO meets the majority of our IOFS thresholds. Revenue, ROIC, and ROE continue to climb. Net profit margin is below our threshold, but has held consistent for the past decade and is slowly trending upwards. The other concerning metric is capital expenditures to net income, which currently is above our threshold. (We want to be below the threshold.) However, because TSCO continues to increase revenue and hold net profit margin consistent we believe TSCO is still a worthwhile investment. Supply chain shortages and the current inflationary environment are contributing to TSCO risings costs. TSCO is carefully monitoring these costs and has passed a portion to the consumer.

Overall, TSCO performs well on IOFS metrics and passes the majority of our thresholds.

Obligation Ratio

TSCO - Obligation Ratio - Millions		
Total Debt	1020.8	
Pension	0	
PS	0	
Leases*	3,039	
Cash/Cash Equiv.	-1412	
NI	930	
Threshold <5Yrs	2.85	Pass

*Leases are not multiplied by seven as this amount reflects TSCO annual lease obligation.

Moat

Tractor Supply's strong brand intangible asset allows the company a unique position in this niche market. The recreational outdoor nature of this business lends it to higher-income demographics and as a result, less at the mercy of revenue cyclicality. Less than 10% of customers classify as full-time farmers, with the largest customer segment not farming at all, and this resilient customer base allows for consistent revenue growth. Competition with Home Depot and Lowe's in similar product categories is relatively protected due to the company's presence in more rural areas. With sources for gross margin improvements in areas such as seasonal offerings, private label, and price management initiatives, management has reasons to believe this sustained growth will continue.

Valuation –

Value Bands Analysis

TSCO appears to be trading around fair value to overvalued. Price to Sales, Price to Book, EV to Revenue, EV to EBITDA, and EV to EBIT demonstrate TSCO is overvalued trading above the 80th percentile of historical valuation for the last ten years. However, Price to OE, Price to Earnings less Cash, Price to Earnings, Price to Cash Flow, and Price to Free Cash flow all demonstrate TSCO is trading right at fair value.

Exhibit 2. Value Bands for TSCO

TSCO Value Bands.xlsx

Discounted Cash Flow

	Bear	Base	Bull
Current Price	$ 208.21	$ 208.21	$ 208.21
Fair Value	$ 155.89	$ 179.30	$ 206.29
MOS	-34%	-16%	-1%
EPS	$ 8.00	$ 8.00	$ 8.00
Growth Rate	9%	11%	13%
Discount Rate	8%	8%	8%
Years	10	10	10
Terminal	4%	4%	4%
As of 10/24/2021			
Management Predicts 11% Future Growth			

	Bear	Base	Bull
Current Price	$ 208.21	$ 208.21	$ 208.21
Fair Value	$ 142.35	$ 163.32	$ 187.47
MOS	-46%	-27%	-11%
EPS	$ 8.00	$ 8.00	$ 8.00
Growth Rate	9%	11%	13%
Discount Rate	9%	9%	9%
Years	10	10	10
Terminal	4%	4%	4%
As of 10/24/2021			
Management Predicts 11% Future Growth			

	Bear	Base	Bull
Current Price	$ 208.21	$ 208.21	$ 208.21
Fair Value	$ 230.66	$ 264.86	$ 304.07
MOS	10%	21%	32%
EPS	$ 8.00	$ 8.00	$ 8.00
Growth Rate	16%	18%	20%
Discount Rate	9%	9%	9%
Years	10	10	10
Terminal	4%	4%	4%
As of 10/24/2021			
10 year historical growth rate is 20.5%			

Left Side Scenario

Using a discount rate of 8% and modeling around management's projected earnings growth rates, TSCO is overpriced in each case scenario.

Middle Scenario

Using a more conservative discount rate of 9% and modeling management's projected earnings growth rates, TSCO is overvalued in each case scenario.

Right Side Scenario

Using a conservative discount rate of 9% and modeling around TSCO growth rate average of the past ten years (TSCO grew 20.5% on average), we see that TSCO is fairly valued with a low MOS for a 16% growth rate. And is slightly undervalued with a growth rate of 18-20% modeled in.

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Executive Summary

Upon reflection of our Q2 earnings report, we suspected TSCO would start to see performance level off for the last two quarters of 2021. Overall, the pandemic boosted sales for TSCO, and the "high" should start to dissipate. While management agrees with this conclusion, the earnings reports have continued to show strong performance, and the growth reduction has yet to materialize.

Expenses have increased compared to prior quarters, but the increase has come hand in hand with sales growth. Profit margins were fairly consistent with last year with SG&A showing slight improvement. Customer retention rates remain high and e-commerce sales and mobile app sales continue to show improvement. TSCO continues to open new stores, attempt acquisitions, and repurchase shares.

Management favorably increased 2021 projections, and future earnings growth is projected at approximately 11% for the next few years. Valuation indicates the company is split 50/50 between being fairly valued and overvalued. With management's growth rate predictions, the company is overvalued. When taking a more historical approach and using prior growth rates, the company is fairly valued. Because consumer trends remain sound and the company's outlook is on track for a record year of sales and earnings, we suggest a hold.