

Tractor Supply Co (TSCO)

Earnings Update
Hold | Market Perform
William Errett | November 2, 2023



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 2% and earnings per share beat by almost 2%. The difference between these was primarily due to unexpected margin expansion during the quarter. Net Sales for the business came in at \$3.4 Bn, up 4% from the previous quarter. This was primarily due to lower input costs. Cost of goods sold (COGS) increased by 2.7% to 2.1Bn. This brought gross profit up 7.2% to \$1.2Bn. Operating income came in at \$340 Mn, up from \$306 Mn from Q3 last year. Net income finished at \$255 Mn with a net margin of 7.5%, higher than last year's 7.1%. Earnings per share finished at \$2.33, up 11% off a 9% increase in net income and a 2% decrease in shares outstanding.

Comparable store sales, or same store sales (CSS or SSS) decreased by .4% compared to the prior quarter. This was due to a .3% 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 roughly flat. This means that all the growth during the quarter came from increases in new stores. During the quarter Tractor Supply opened 17 new stores compared to 11 last year. 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 revised their FY23 guidance down. Net sales are expected to come in at \$14.5 Bn from \$14.8 Bn expected prior. SSS is expected to be flat instead of up 1-2%. Operating margin is expected to be closer to 10% instead of 10.5%. Changes in net income guidance from the prior are small are expected to still be around \$1.11 Bn. Finally, Earnings per share are expected to be closer to \$10 instead of \$10.25. Changes in this guidance are primarily due to lower value of each transaction in Tractor Supply, adverse weather conditions during the year, and Increased capital expenditures on new stores.

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 5% 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 10% 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

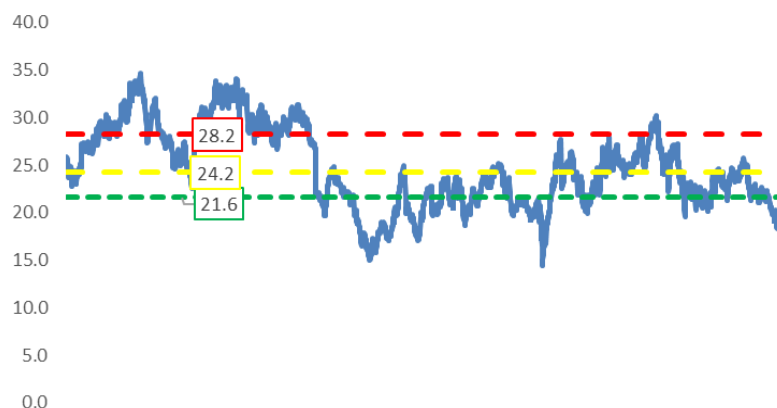
Tractor Supply Co passes some of our IOFS (Interpretation of financial statements) thresholds, except margin metrics, capital expenditures, and obligation ratio. Tractor Supply Co has never been a company that has achieved our margin metrics; however, they are close to our margin thresholds in gross 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.

		2013-12	2014-12	2015-12	2016-12	2017-12	2018-12	2019-12	2020-12	2021-12	2022-12	TTM
IOFS												
Revenue	\$	5,165	\$ 5,712	\$ 6,227	\$ 6,780	\$ 7,256	\$ 7,911	\$ 8,352	\$ 10,620	\$ 12,731	\$ 14,205	\$ 14,902
Gross profit	\$	1,754	\$ 1,950	\$ 2,143	\$ 2,325	\$ 2,492	\$ 2,703	\$ 2,872	\$ 3,762	\$ 4,477	\$ 4,972	\$ 5,299
Operating Income	\$	515	\$ 589	\$ 651	\$ 694	\$ 686	\$ 702	\$ 743	\$ 1,066	\$ 1,307	\$ 1,435	\$ 1,504
Net Income	\$	328	\$ 371	\$ 410	\$ 437	\$ 423	\$ 532	\$ 562	\$ 749	\$ 997	\$ 1,089	\$ 1,130
Free Cash Flow	\$	115	\$ 249	\$ 220	\$ 425	\$ 381	\$ 416	\$ 594	\$ 1,101	\$ 510	\$ 584	\$ 820
EBIT	\$	515	\$ 589	\$ 651	\$ 694	\$ 686	\$ 702	\$ 743	\$ 997	\$ 1,307	\$ 1,435	\$ 1,504
EBITDA	\$	615	\$ 704	\$ 774	\$ 837	\$ 852	\$ 879	\$ 939	\$ 1,214	\$ 1,577	\$ 1,778	\$ 1,888
Dividend Yield %		0.63	0.77	0.89	1.21	1.4	1.44	1.46	1.07	0.87	1.62	2.02
Gross Margin		34.0%	34.1%	34.4%	34.3%	34.3%	34.2%	34.4%	35.4%	35.2%	35.0%	35.6%
Operating Margin		10.0%	10.3%	10.4%	10.2%	9.5%	8.9%	8.9%	10.0%	10.3%	10.1%	10.1%
Net Margin		6.4%	6.5%	6.6%	6.4%	5.8%	6.7%	6.7%	7.1%	7.8%	7.7%	7.6%
FCF Margin		2.2%	4.4%	3.5%	6.3%	5.3%	5.3%	7.1%	10.4%	4.0%	4.1%	5.5%
D&A/ Gross Profit		5.7%	5.9%	5.8%	6.1%	6.7%	6.6%	6.8%	5.8%	6.0%	6.9%	7.3%
R&D/ Gross Profit		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
SG&A/ Gross Profit		64.9%	63.9%	63.9%	64.0%	65.8%	67.5%	67.3%	65.9%	64.8%	64.2%	64.4%
SBC/ Revenue		0.3%	0.3%	0.3%	0.3%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%
Capex/ Net Income		66.5%	43.3%	57.6%	51.7%	59.3%	52.3%	38.7%	39.3%	63.0%	71.0%	75.1%
Dividend Payout ratio		473.5%	436.1%	25.3%	28.1%	31.8%	27.8%	29.2%	23.5%	24.2%	37.9%	39.2%
Shares Outstanding		141.7	139.4	136.8	133.8	128.2	123.5	120.7	117.4	115.8	112.1	109.3
Returns %												
ROE		28.9	29.2	30.5	30.7	29.4	35.7	35.9	42.9	50.8	53.8	56.0
ROTE		29.2	29.4	30.8	32.3	32.2	39.0	39.1	45.2	52.3	58.3	62.8
ROIC		28.1	27.6	26.6	24.8	22.4	26.6	17.9	19.0	21.1	19.1	17.9
ROCE		40.9	42.1	41.6	38.6	35.0	33.7	24.0	21.3	23.7	24.3	23.4
ROA		18.2	18.8	18.6	17.3	15.2	17.9	13.4	12.1	13.5	13.4	13.0
ROC		47.2	46.4	45.0	43.3	40.1	38.0	24.6	24.1	28.5	26.1	24.4
Leverage & Liquidity												
LT Debt		1	5	167	290	434	410	2398	3238	3594	3921	4609
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		0	1	6	9	25	26	1968	2123	2276	2447	2579
Pension SF												
Cash	\$	143	\$ 51	\$ 64	\$ 54	\$ 109	\$ 86	\$ 84	\$ 1,342	\$ 878	\$ 203	\$ 422
Obligation Ratio ⁽¹⁾		(0.4)x	(0.1)x	0.3x	0.6x	0.9x	0.7x	7.7x	5.4x	5.0x	5.7x	6.0x
Cash/ Revenue		2.8%	0.9%	1.0%	0.8%	1.5%	1.1%	1.0%	12.6%	6.9%	1.4%	2.8%
Per Share Data												
Revenue	\$	36.44	\$ 40.96	\$ 45.50	\$ 50.67	\$ 56.60	\$ 64.07	\$ 69.17	\$ 90.44	\$ 109.92	\$ 126.66	\$ 135.04
Owners Earnings	\$	1.89	\$ 2.19	\$ 2.21	\$ 3.68	\$ 3.46	\$ 3.91	\$ 4.86	\$ 9.22	\$ 7.03	\$ 8.65	\$ 11.24
Earnings	\$	2.32	\$ 2.66	\$ 3.00	\$ 3.27	\$ 3.30	\$ 4.31	\$ 4.66	\$ 6.38	\$ 8.61	\$ 9.71	\$ 10.24
Operating Cash Flow	\$	2.35	\$ 2.94	\$ 3.33	\$ 4.86	\$ 4.93	\$ 5.62	\$ 6.72	\$ 11.88	\$ 9.83	\$ 12.10	\$ 15.10
Free Cash Flow	\$	0.82	\$ 1.78	\$ 1.61	\$ 3.17	\$ 2.97	\$ 3.37	\$ 4.92	\$ 9.37	\$ 4.41	\$ 5.20	\$ 7.42
Dividends	\$	0.49	\$ 0.61	\$ 0.76	\$ 0.92	\$ 1.05	\$ 1.20	\$ 1.36	\$ 1.50	\$ 2.08	\$ 3.68	\$ 4.01
Book Value	\$	8.93	\$ 9.49	\$ 10.38	\$ 11.11	\$ 11.32	\$ 12.82	\$ 13.26	\$ 16.55	\$ 17.70	\$ 18.53	\$ 19.40
Tangible Book Value	\$	8.86	\$ 9.41	\$ 10.30	\$ 10.15	\$ 10.33	\$ 11.80	\$ 12.21	\$ 16.07	\$ 17.21	\$ 16.23	\$ 16.95

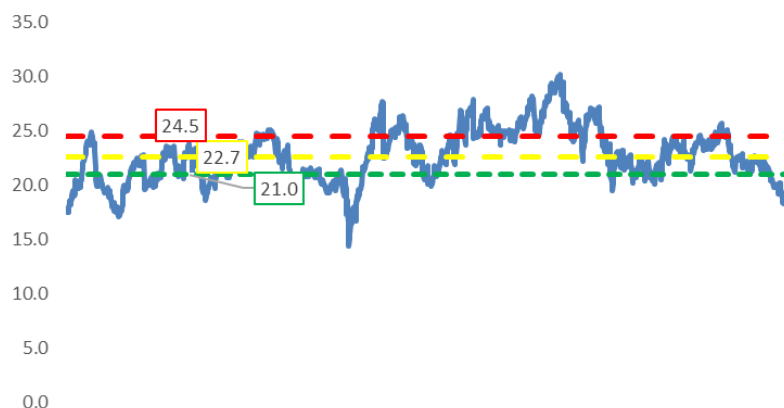
The largest worry for this business is their obligation ratio. Tractor Supply Co is participating in sales-leasebacks of the stores that they do own. This means that they will be selling the stores they own and leasing them back from the people that they sell to. This can dramatically increase their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

Valuation

TSCO 10-Year Price to Earnings



TSCO 5-Year Price to Earnings



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 at an 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 Price: \$197.91 5 Year Discounted Cash Flow													
									P/E	Total Return Price	PV	5 YR Return	Annual Return
Bear	EPS	Current	2024	2025	2026	2027	2028	18.0x	\$	233.69	\$	145.10	18.1%
		\$ 10.24	\$ 10.65	\$ 11.08	\$ 11.41	\$ 11.64	\$ 11.87	20.0x	\$	257.42	\$	159.84	30.1%
			4.0%	4.0%	3.0%	2.0%	2.0%	22.0x	\$	281.16	\$	174.58	42.1%
Base	EPS	Current	2024	2025	2026	2027	2028	18.0x	\$	255.25	\$	158.49	29.0%
		\$ 10.24	\$ 10.85	\$ 11.51	\$ 12.08	\$ 12.56	\$ 13.07	20.0x	\$	281.39	\$	174.72	42.2%
			6.0%	6.0%	5.0%	4.0%	4.0%	22.0x	\$	307.52	\$	190.94	55.4%
Bull	EPS	Current	2024	2025	2026	2027	2028	18.0x	\$	278.52	\$	172.94	40.7%
		\$ 10.24	\$ 11.06	\$ 11.94	\$ 12.78	\$ 13.55	\$ 14.36	20.0x	\$	307.24	\$	190.77	55.2%
			8.0%	8.0%	7.0%	6.0%	6.0%	22.0x	\$	335.96	\$	208.61	69.8%

Market Value vs Intrinsic Value

