Floor & Decor Holdings, Inc. (FND)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

52WK H-L ($) : 63 - 24  Suitability: Average Risk  Q1 0.29A 0.34A
Market Cap (mil): 5,696  Price Target ($) : 46  Q2 0.34A 0.05E
Shares Out (mil): 105.5  L-Term Rev. Gr Rate Est: 20%  Q3 0.27A 0.15E
Float (mil): 96.1  L-Term EPS Gr Rate Est: 25%  Q4 0.26A 0.26E
Avg. Daily Vol (mil): 1.96  Debt/Cap: 33.9%  Total 1.15A 0.80E 1.15E
Dividend ($) : 0.00  ROE: 17.7%  EV/EBITDA (FY21E): 20.2x  FY P/E 46.9x 67.5x 46.9x
Yield (%): 0.0

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EPS (Net): EPS have been adjusted for certain one-time items; FY20 contains an extra week.

<table>
<thead>
<tr>
<th>Headquartered</th>
<th>IPO/Founded</th>
<th>Dec</th>
<th>2019A</th>
<th>2020E</th>
<th>2021E</th>
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<tr>
<td>CEO</td>
<td>Tom Taylor</td>
<td>2,045.5</td>
<td>2,052.9</td>
<td>2,517.0</td>
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<tr>
<td>President</td>
<td>Lisa Laube</td>
<td>19.6%</td>
<td>0.4%</td>
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<tr>
<td>CFO</td>
<td>Trevor Lang</td>
<td>8.0%</td>
<td>5.8%</td>
<td>6.6%</td>
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<tr>
<td>VP, IR</td>
<td>Wayne Hood</td>
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Company Description

Founded in 2000, Floor and Décor (FND) is a leading specialty retailer of hard surface flooring and related decorative and installation accessories. The company offers the industry's broadest in-stock assortment at everyday low prices through its 123 warehouse-format stores across 30 states. With FY19 sales of ~$2.0B, we believe FND is now the second largest retailer of hard surface flooring products in the U.S. (behind only Home Depot). That said, we estimate FND’s market share is only ~10% today as the brand is still being “discovered” by consumers (just ~13% unaided awareness).

Revenue Profile

FND Quarterly Comp Store Sales Performance
(Traffic vs. Ticket Contribution)

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<tbody>
<tr>
<td>Prior Period Store Count</td>
<td>48</td>
<td>58</td>
<td>70</td>
<td>84</td>
<td>101</td>
<td>121</td>
<td>132</td>
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<tr>
<td>Net New Stores</td>
<td>10</td>
<td>12</td>
<td>14</td>
<td>17</td>
<td>20</td>
<td>11</td>
<td>24</td>
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<tr>
<td>End of Period Store Count¹</td>
<td>58</td>
<td>70</td>
<td>84</td>
<td>101</td>
<td>121</td>
<td>132</td>
<td>156</td>
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<tr>
<td>% change y/y</td>
<td>20.8%</td>
<td>20.7%</td>
<td>20.0%</td>
<td>20.2%</td>
<td>19.6%</td>
<td>9.1%</td>
<td>18.2%</td>
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¹Includes a separate small 5,500 sqft design center in New Orleans, LA.

FND Revenue Mix (% of FY19 Sales)

<table>
<thead>
<tr>
<th>Stores By State (a/o FY19)</th>
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<tbody>
<tr>
<td>State</td>
</tr>
<tr>
<td>Florida</td>
</tr>
<tr>
<td>Texas</td>
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<tr>
<td>California</td>
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<tr>
<td>Georgia</td>
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<td>Illinois</td>
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<td>Arizona</td>
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<td>Virginia</td>
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<td>Colorado</td>
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<tr>
<td>Nevada</td>
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<tr>
<td>New Jersey</td>
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<tr>
<td>Top 10</td>
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</table>

Source: Company reports, Baird Estimates, Baird Research Analysts
Floor & Decor Holdings, Inc.  
May 28, 2020

Competition
Big-box home improvement centers (Home Depot and Lowe’s), specialty flooring chains (Tile Shop, Lumber Liquidators), regional flooring chains (Arizona Tile, Century Tile), and local/mom-and-pop flooring stores

Quick Summary
Maintain Outperform rating. 1Q results were solid, and QTD comps are tracking better than feared despite stores being closed. Looking ahead, the shape of the demand curve remains uncertain; however, sample sales have surged (pent-up demand?), and comps in stores recently opened returned to positive territory. Big picture, while 2Q will be a tough quarter, FND has ample liquidity to weather this storm and is poised for significant share gains once this crisis passes.

Investment Thesis
- Early-stage category killer. FND operates a differentiated store model, with the broadest assortment, lowest prices, and highest in-stock position. Comps have averaged ~14% since 2011, nearly double industry growth. With brand awareness still low, we believe FND is well-positioned to build upon recent share gains (still <10% market share today) and become the dominant specialty player in what is still a fragmented industry.
- Significant whitespace opportunity. With ~20% annual unit growth and the potential to quadruple its footprint to ~400 stores, FND represents one of the longer duration whitespace stories in retail. Importantly, unit-level economics continue to surpass prior vintages (cash payback now <2 years), underscoring improved execution across recent store classes (site selection, grand opening process, assortment localization).
- Still room to improve sales productivity. While comps have moderated from prior years’ double-digit pace, we see several initiatives across merchandising (design services, adjacent categories), marketing/CRM, omni-channel (room visualizer recently added online), and Pro (app, loyalty program, private label credit) to drive sales productivity. When combined with the lift from store maturation (>300bps comp tailwind), we think M-HSD% comps are sustainable in a “normalized” environment.
- Long-term EBIT margin expansion potential is compelling. While the demand shock following COVID-19 will certainly pressure operating margins this year, the longer term margin expansion opportunity for FND remains compelling, in our view. Specifically, we see potential for low double-digit operating margins (vs. FY19’s 8.0%) as the business scales and growth investments plateau.
- Price target rationale. Our $46 price target assumes ~40x FY21E EPS estimate, a multiple in line with the stock’s three-year average of ~40x as we balance likely pressure on big ticket spending with prospects for significant market share gains.

Risks & Caveats
- Prolonged contraction in housing. A sustained downturn in housing turnover and/or declining home prices could negatively impact demand for hard surface flooring and pressure FND’s fundamentals.
- Product innovation wanes. Product innovation, particularly around fashion and durability, has been a key driver of hard surface flooring industry growth over the past decade. A slowdown in the pace of innovation and/or FND’s inability to identify and respond to new/emerging trends could result in decelerating comps.
- Execution risk associated with new store growth. New store growth could cannibalize existing store sales and damage FND’s overall operating results. Additionally, FND’s entry into new markets with lower brand awareness could result in lower new store productivity, exacerbating the deleveraging impact from new stores.
- Rising input costs (including tariffs) and mix shift could pressure gross margin. Rising input costs (raw materials, labor) used in the production of hard surface flooring, as well as tariffs, could have a significant impact on FND’s profitability. Additionally, the mix shift to LVP/LVT could hurt gross margin as these products typically require less higher margin installation accessories.
- Vendor/supply chain risk. While FND has a diversified supplier base (>200 vendors across 20 countries) and has been transitioning away from China (~50% of COGS in FY18; 30%-35% in FY19), any disruption to FND’s global supply chain could lead to lost sales, incremental costs, and/or margin rate pressure.
- Concentration of ownership. FND’s private equity sponsors (Ares and Freeman Spogli) still hold ~20% of the shares outstanding. FND shares could come under pressure as the sponsors look to monetize their investment through follow-on offerings.
- Increased competition from big-box home centers. Any decision by the big-box home centers to increase space allocation to the category and/or sharpen pricing could pressure FND’s fundamentals.
- Geographic concentration of store base. Over 40% of FND’s store base is located in 3 states (Florida, Texas, and California), so FND is more susceptible to macroeconomic conditions in those markets.
- Compliance/regulatory. The hard surface flooring industry is highly regulated. If FND does not maintain compliance with appropriate regulatory bodies, the company could face heighten litigation costs.

Supplemental Information
Valuation (as of 5/27/20):
- NTM P/E: 53.8x, well above the stock's three-year average of 40.4x.
- Relative NTM P/E: 2.83x, well above the stock's three-year average of 2.34x.
Appendix - Important Disclosures and Analyst Certification

Approved on 28 May 2020 08:37EDT/ Published on 28 May 2020 08:42EDT.

Rating and Price Target History for: Floor & Decor Holdings, Inc. (FND) as of 05-27-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of FND.

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Floor & Decor Holdings, Inc.
May 28, 2020

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