Tractor Supply Company (TSCO)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

Price ($) (5/27/20): 119.76
52WK H-L ($) : 120 - 64
Market Cap (mil): 14,060
Shares Out (mil): 117.4
Float (mil): 115.2
Avg. Daily Vol (mil): 1.91
Dividend ($) : 1.40
Yield (%): 1.2
Rating: Outperform
Price Target ($) : 130
L-Term Rev. Gr Rate Est: 6%
L-Term EPS Gr Rate Est: 10%
Debt/Cap: 43.8%
ROE: 38.2%
EV/EBITDA (FY21E): 13.5x
Outperform Average Risk: Q1 0.63A Q2 1.80A Q3 1.04A Q4 1.21A Total 4.68A 5.55E 5.45E
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Company Description

Tractor Supply Company is the largest retail farm and ranch chain in the U.S., with ~2,000 stores operating under the names Tractor Supply Company and Petsense. Tractor Supply is focused on supplying the "Out Here" lifestyle needs of recreational farmers and ranchers and serving the maintenance needs of those who enjoy the rural lifestyle. Stores are located in towns outlying major metropolitan markets and in rural communities. Tractor Supply offers the following comprehensive selection of merchandise: (1) equine, pet and animal products, including items necessary for health, care, growth, and containment; (2) maintenance products for agricultural and rural use; (3) hardware products and tools; (4) seasonal products, including lawn and garden power equipment; (5) truck, trailer, and towing accessories; and (6) work/recreational clothing and footwear.

Revenue Profile

Source: Company reports

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<tbody>
<tr>
<td>Prior Period Store Count</td>
<td>1,382</td>
<td>1,488</td>
<td>1,738</td>
<td>1,853</td>
<td>1,940</td>
<td>2,024</td>
<td>2,112</td>
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<tr>
<td>New/Open/Reopened Stores</td>
<td>114</td>
<td>257</td>
<td>126</td>
<td>98</td>
<td>86</td>
<td>89</td>
<td>100</td>
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<tr>
<td>Closed/Relocated Stores</td>
<td>8</td>
<td>7</td>
<td>11</td>
<td>11</td>
<td>4</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>End of Period Store Count</td>
<td>1,488</td>
<td>1,738</td>
<td>1,853</td>
<td>1,940</td>
<td>2,024</td>
<td>2,112</td>
<td>2,212</td>
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<tr>
<td>% change y/y</td>
<td>7.7%</td>
<td>16.8%</td>
<td>6.6%</td>
<td>4.7%</td>
<td>4.3%</td>
<td>4.3%</td>
<td>4.7%</td>
</tr>
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</table>

*Includes acquisition of 136 Petsense stores

Source: Company Reports, Baird Estimates

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Revenue Profile

Source: Company reports

<table>
<thead>
<tr>
<th>Stores by State (a/o FY19 end)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of Stores</td>
</tr>
<tr>
<td>Texas</td>
</tr>
<tr>
<td>North Carolina</td>
</tr>
<tr>
<td>Pennsylvania</td>
</tr>
<tr>
<td>Tennessee</td>
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<tr>
<td>Ohio</td>
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<tr>
<td>Georgia</td>
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<tr>
<td>Michigan</td>
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<tr>
<td>New York</td>
</tr>
<tr>
<td>Florida</td>
</tr>
<tr>
<td>Kentucky</td>
</tr>
<tr>
<td>Top 10</td>
</tr>
</tbody>
</table>

Source: Company Reports
Competition
Independent farm/ranch retailers, privately held farm retailers (i.e., Orscheln’s Farm & Home, Rural King), Home Depot, Lowe’s, PETCO, PetSmart, Sears, True Value, Wal-Mart

Quick Summary
Bullish 2Q update reinforces our positive thesis. Anticipated 2Q results are extremely robust, with comps/EPS seen at 20%-25%/ $2.45-$2.65 (vs. Street’s ~4%E/$1.77E). While TSCO is using top-line strength to reinvest in its team members and technology, management expects to offset these investments over time, and we see durable long-term benefits as the company deepens its relationship with new, lapsed, and existing customers during these unprecedented times.

Investment Thesis
- **Widening the moat.** While evolving consumer behaviors and ongoing digital innovation are changing the face of retail, TSCO remains uniquely positioned to serve the rural lifestyle customer for years to come. Management has invested in several initiatives across merchandising, CRM, omni-channel, and supply chain which should drive profitable growth longer term as TSCO increasingly leverages its physical and digital capabilities to take share from less sophisticated farm/ranch competitors.
- **Merchandising engine remains in high gear.** While the company's "test and learn" merchandising mentality hasn't changed, we are encouraged by the level of newness on tap for this year. Specifically, new brands (Toro, Triple Crown equine feed), new space productivity technology (allowing for greater SKU localization), and an enhanced shopping experience (branded "store-within-a-store" shops) represent incremental sales drivers for this year.
- **Store growth opportunity remains plentiful.** As customer attribution rates have improved in recent years, TSCO has gained a better understanding of who shops its stores. Two key learnings have emerged in support of management's 2,500 store target: (1) density of "core" TSCO households is actually higher than previously thought, and (2) TSCO stores are appealing to an even broader group of non-core households. With no comparable No. 2 competitor jockeying for real estate, the quality of TSCO's future store runway is key differentiator relative to other retail growth stories.
- **ONETractor top-line initiatives should continue to drive profitable share gains.** TSCO's Neighbor's Club represents a transformational asset that should continue to benefit the business, and the company's private label credit appears poised to scale further in FY20. When combined with TSCO's omni-channel/digital capabilities (BOPIS, Stockyard, Mobile POS), prospects for profitable share gains in the years ahead remain good.
- **Margin stabilization.** Recently completed operational efficiency work with McKinsey suggests an opportunity for TSCO to bend the curve on several cost buckets, including transportation, store/DC labor, and indirect spend. When combined with benefits from price management tools, initial FY20 guidance assumed a stable EBIT margin profile (at ~8.9%). While incremental operating costs will weigh on profitability near-term, we would expect a recovery in FY21.
- **Price target rationale.** Our $130 price target assumes ~23.5x FY21E EPS, a premium to the stock's five-year average NTM multiple of ~20x given TSCO's enviable position as a needs-based retailer in today's uncertain economic environment.

Risks & Caveats
- **Inflationary pressures,** which could squeeze margins if TSCO is unable to raise retail prices at the same rate as costs increase.
- **Deflationary impact on comps.** While deflation has historically benefited gross margin, reported comps could moderate in a deflationary environment, which could pressure the stock's multiple.
- **Seasonality and weather.** TSCO's business is highly seasonal, with sales and profits the highest in the spring (2Q) and winter (4Q) selling seasons due to demand seasonality of its merchandise offering. Unseasonable weather, heavy precipitation, drought conditions, and early or late frosts have the potential to negatively impact sales and profitability in any given quarter.
- **Managing unit growth.** A key component of TSCO's long-term strategy is predicated on expanding its store base. New store performance is dependent upon TSCO's ability to effectively integrate new stores into its existing operations, as well as recruiting and retaining qualified store managers and associates. If TSCO's rate of expansion were to slow as a result of unforeseen circumstances (e.g., inability to find suitable locations, construction and/or site approval delays), sales and earnings growth could be impeded.
- **Systems implementation.** Any potential disruptions associated with the implementation of IT systems (price optimization, warehouse management) could negatively impact financial results.
- **Increased competition.** While the company's unique product assortment and targeted focus on serving a specialized customer niche helps differentiate itself from the competition, a more aggressive marketing or pricing campaign, particularly from regional farm/ranch chains or "big box" retailers, could have an adverse impact on TSCO's financial results.
- **Economic conditions.** A contraction in consumer spending resulting from macroeconomic factors such as higher interest rates, rising fuel/energy costs, increased unemployment levels, and lack of credit availability could negatively impact sales.

Supplemental Information
Valuation (as of 5/27/20):
- NTM P/E: 21.7x, above the stock's three-year average of 18.3x.
- Relative NTM P/E: 1.14x, below the stock's three-year average of 1.07x.
Appendix - Important Disclosures and Analyst Certification

Approved on 28 May 2020 08:26EDT/ Published on 28 May 2020 08:31EDT.

Rating and Price Target History for: Tractor Supply Company (TSCO) as of 05-27-2020

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

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