

Floor & Decor Holdings, Inc. (FND)

INCREASE TARGET PRICE

Rating	OUTPERFORM
Price (01-Nov-18, US\$)	31.73
Target price (US\$)	(from 33.00) 37.00
52-week price range (US\$)	57.50 - 24.32
Market cap(US\$ m)	3,087
Enterprise value (US\$ m)	3,267

Target price is for 12 months.

Research Analysts

Seth Sigman

Kieran McGrath

Lavesh Hemnani

Finding a Floor; Unique Model Helping Navigate Uncertain Housing and Tariff Period

- **FND reported slightly better Q3 results**, while Q4 guidance was slightly below owing to lapping last year's hurricane, but not materially different, in our view. We view the results favorably in light of recent negativity on FND, and continue to see value in stock after the recent pullback. We also realize this quarter alone won't fully ease the concerns on the stock; there are a number of challenges ahead (incl. housing uncertainty, tariffs, competition). But, the fact that comps accelerated from Q2 and that margins were less impacted by mix - a key concern for investors - supports the relief. Looking ahead, we recently outlined a scenario of more modest growth for the sector ([Home Improvement Retail: Taking Some Time Away from Home](#)), but we believed that FND stock was more than reflecting that vs. other players in the space and that it should have numerous opportunities to navigate that through share gains, through store growth and growing awareness, and cost management.
- **Key changes**; No change to 2018, but we raise 2019 slightly, to \$1.09 from \$1.06. We raise comps to 7%, incl. some inflation and based on the better current run-rate, lower GM (now down 25 bps) based on transport costs, slightly lower SG&A (we assume corporate expenses grow below sales growth). We expect lower growth in 1H, due to hurricane comparisons, new stores and higher run-rate for certain costs (transport). Our TP goes to \$37, driven by our long-term EPS analysis, and equates to ~35x 2019 EPS, 18x EV/EBITDA, a slight premium to its home peer group. Key risks include housing turnover/home price appreciation, product mix, including competition in the hard surface flooring space, tariffs, and execution of store growth.

Share price performance



On 01-Nov-2018 the S&P 500 INDEX closed at 2736.89
Daily Nov01, 2017 - Nov01, 2018, 11/01/17 = US\$38.79

Quarterly EPS	Q1	Q2	Q3	Q4
2017A	0.13	0.20	0.17	0.19
2018E	0.26	0.27	0.24	0.17
2019E	0.27	0.31	0.30	0.21

Financial and valuation metrics

Year	12/17A	12/18E	12/19E	12/20E
EPS (CS adj.) (US\$)	0.69	0.94	1.09	1.37
Prev. EPS (US\$)	-	-	1.06	1.33
P/E rel. (%)	211.1	190.2	181.8	159.5
Revenue (US\$ m)	1,384.8	1,707.5	2,098.6	2,547.4
EBITDA (US\$ m)	158.8	190.0	225.2	280.1
OCFPS (US\$)	1.06	1.66	2.84	3.19
P/OCF (x)	45.9	19.1	11.2	9.9
EV/EBITDA (current)	20.6	17.2	14.5	11.6
Net debt (US\$ m)	189	180	171	161
ROIC (%)	19.41	16.69	14.10	15.64
Number of shares (m)	97.28	IC (current, US\$ m)		631.37
BV/share (Next Qtr., US\$)	-	EV/IC (x)		-
Net debt (Next Qtr., US\$ m)	-	Dividend (current, US\$)		-
Net debt/tot eq (Next Qtr., %)	-			-

Source: Company data, Thomson Reuters, Credit Suisse estimates

DISCLOSURE APPENDIX AT THE BACK OF THIS REPORT CONTAINS IMPORTANT DISCLOSURES, ANALYST CERTIFICATIONS, LEGAL ENTITY DISCLOSURE AND THE STATUS OF NON-US ANALYSTS. US Disclosure: Credit Suisse does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

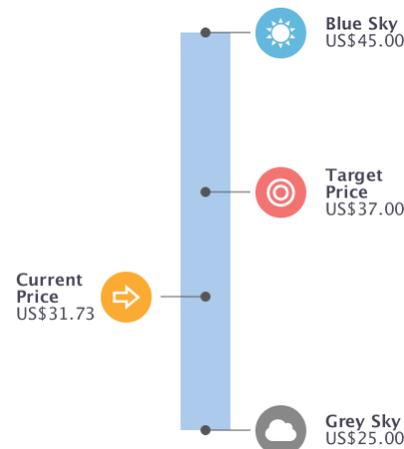
Floor & Decor Holdings, Inc. (FND)

Price (01 Nov 2018): **US\$31.73**; Rating: **OUTPERFORM**; Target Price: (from 33.00) **37.00**; Analyst: **Seth Sigman**

Income Statement	12/17A	12/18E	12/19E	12/20E
Revenue (US\$ m)	1,384.8	1,707.5	2,098.6	2,547.4
EBITDA (US\$ m)	159	190	225	280
Depr. & amort.	(38)	(47)	(112)	(71)
EBIT (US\$)	118	133	158	199
Net interest exp	(14)	(8)	(9)	(9)
PBT (US\$)	104	125	149	190
Income taxes	4	(9)	(35)	(44)
Profit after tax	108	116	114	145
Other NPAT adjustments	0	0	0	0
Cash Flow	12/17A	12/18E	12/19E	12/20E
Cash flow from operations	109	174	299	339
CAPEX	(102)	(165)	(170)	(175)
Free cashflow to the firm	7	9	129	164
Cash flow from investments	(102)	(165)	(170)	(175)
Net share issue/(repurchase)	201	0	0	0
Dividends paid	0	0	0	0
Changes in Net Cash/Debt	202	9	9	10
Balance Sheet (US\$)	12/17A	12/18E	12/19E	12/20E
Cash & cash equivalents	1	2	4	6
Account receivables	54	58	63	76
Other current assets	21	10	12	13
Total fixed assets	221	339	450	554
Investment securities	-	-	-	-
Total assets	1,068	1,191	1,414	1,651
Total current liabilities	359	371	466	573
Shareholder equity	443	561	688	812
Total liabilities and equity	1,068	1,191	1,414	1,651
Net debt	189	180	171	161
Per share	12/17A	12/18E	12/19E	12/20E
No. of shares (wtd avq)	103	105	105	106
CS adj. EPS	0.69	0.94	1.09	1.37
Prev. EPS (US\$)	-	-	1.06	1.33
Dividend (US\$)	0.00	0.00	0.00	0.00
Free cash flow per share	0.07	0.08	1.22	1.54
Earnings	12/17A	12/18E	12/19E	12/20E
Sales growth (%)	31.8	23.3	22.9	21.4
EBIT growth (%)	52.3	13.3	18.5	25.7
Net profit growth (%)	74.4	39.0	15.8	27.1
EPS growth (%)	70.0	36.6	15.3	25.8
EBITDA margin (%)	11.5	11.1	10.7	11.0
EBIT margin (%)	8.5	7.8	7.5	7.8
Pretax margin (%)	7.5	7.3	7.1	7.5
Net margin (%)	5.1	5.8	5.5	5.7
Valuation	12/17A	12/18E	12/19E	12/20E
EV/EBITDA (x)	20.6	17.2	14.5	11.6
P/E (x)	45.9	33.6	29.1	23.2
Returns	12/17A	12/18E	12/19E	12/20E
ROIC (%)	19.4	16.7	14.1	15.6
Gearing	12/17A	12/18E	12/19E	12/20E
Net debt/equity (%)	42.6	32.0	24.8	19.8
Quarterly EPS	Q1	Q2	Q3	Q4
2017A	0.13	0.20	0.17	0.19
2018E	0.26	0.27	0.24	0.17
2019E	0.27	0.31	0.30	0.21

Company Background
 Floor & Decor retails tile, wood, laminate, and natural stone flooring along with decorative and installation accessories, serving customers in the United States.

Blue/Grey Sky Scenario



Our Blue Sky Scenario (US\$) (from 40.00) 45.00

Our Blue Sky valuation of \$45 is based on 35x blue sky EPS of \$1.25, based on 1) greater mature store comp contribution, 2) higher new store productivity, and 3) incremental expense leverage driving EPS upside.

Our Grey Sky Scenario (US\$) (from 20.00) 25.00

Our Grey Sky valuation of \$25 is based on 25x grey sky EPS of \$1.00, based on 1) weaker mature store comp contribution, 2) lower new store productivity, and 3) a weaker housing market, implying lower earnings growth compared to recent history.

Share price performance



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Source: Company data, Thomson Reuters, Credit Suisse estimates

Incremental takeaways from Q3

- 1. Comps ex-hurricanes remain strong, +10%**, vs. 8.6% in Q2, accelerating within the quarter, as well. That was partly helped by greater contribution from newer stores entering the comp base. Guidance implies similar 9.5-10.0% base comps in Q4. Our sense is that business took a step down in Q2 from the prior run-rate, but has stabilized for now.
- 2. Some ticket trends to monitor;** Ticket was down 1.4%, which compares to down 0.5%. While consumers still seem to be trading up within product categories, we think project size per square foot was down slightly. Meanwhile transactions were +12.7%, up from 12.0% last quarter.
- 3. GM down but trending slightly better;** While transportation costs are rising, FND more effectively managed the mix towards LVP - by reducing product costs, and focusing on better attachments. GM is expected to decline more in Q4 primarily due to the comparison, and we still expect greater pressure in 1H18 than in consensus, but potentially stabilizing in 2H18.
- 4. Still some tariff uncertainty - but NT manageable,** with minimal impact in Q4, helped by cost renegotiations and currency offsets. Management discussed reducing costs, shifting sourcing, and select price increases to help mitigate the 25% tariff rate. While we see plenty of uncertainty in this scenario and would still expect GM rate to be down, we do believe that FND can maintain its value proposition, particularly in the “better” and “best” assortment vs. the many small players in its space that will be grappling with these issues as well.
- 5. SG&A leverage in comp stores better than expected;** Comp store SG&A leveraged 90bps vs. 50bps in Q2, due to leverage of occupancy expenses. Looking ahead, we think SG&A could be a key lever to support EPS should comps begin to moderate. For example, we expect corporate expenses to grow below sales growth.

Q3 Details

- **Q3 adj. EPS of \$0.24 came in above consensus \$0.22** and \$0.21-0.23 guidance. Stronger than expected sales in the quarter helped drive better expense leverage, while mix was less impactful for GM relative to Q2.
- **Comps of +11.1% were ahead of consensus +9.9%** and 9.5-10.5% guidance. Comps included transactions +12.7% and ticket -1.4%. Hurricanes from last year contributed 110bps to Q3 comps, implying underlying comps of 10%, which would imply an acceleration on a three year basis. This includes ~40bps headwind related to Hurricane Harvey demand, called out separately in the 10Q.
- **Gross margins declined 54bps vs. consensus -64bps** and was better than -60 to -80bps guidance. This compares to 44bps of deleverage last quarter. The Q3 deleverage was mainly driven by lower product margins due to higher transportation expenses and higher inventory shrinkage. FND was lapping 55bps of better product margins helped by a favorable product mix and lower inventory shrinkage, offset by 5bps headwind related to distribution center costs.
- **Adjusted SG&A leveraged 8 bps vs. consensus expectations for 12bps of deleverage;** this was helped by 91bps of occupancy leverage from comparable stores, accelerating from 50bps last quarter, although still below historical run-rate of 100bps+. FND was lapping about 30bps of expense leverage from stronger sales last year.
- **EBIT deleverage lower than expected;** The combination of lower than expected GM deleverage and better SG&A leverage helped limit EBIT deleverage to -46bps vs. consensus -75bps, much better than -70 to -100bps guidance. This marks a significant

improvement from -134bps in Q2. Adjusted EBITDA margins were down 32bps vs. -77bps consensus, improving from -103bps in Q2.

Q4/ 2018 Outlook

- **Full year EPS/comps unchanged, EBITDA slightly lower;** EPS is still expected in the \$0.93-0.96 range vs. consensus \$0.96 but also includes less than half a penny benefit from lower share count. Comps are unchanged at 9-10%, however low end of revenue guidance is up slightly (\$1,702-1,710mn vs. prior \$1,696-1,710mn). Adjusted EBITDA is now expected to be about 0.5-0.8% lower at \$187.7-191.6mn vs. 188.7-193.2mn prior, implying 100bps lower EBITDA margin at 11.0-11.2%. This is due to ~\$1mn of costs related to SOX compliance not embedded in prior guidance. FND still expects to end the year with 100 stores in operation.
- **Q4 guidance below expectations;** Q4 EPS is expected in the \$0.16-0.19 range vs. consensus \$0.21 and prior expectations of \$0.19-0.20, which seems to be driven by lower revenue expectations (flat to 2% comps vs. prior +1 to 4%) and weaker gross margins (-70bps vs. consensus -50bps). Actual sales dollars are now expected to be +10-12%, about 100bps below prior expectations. Adjusted EBITDA guidance of \$40.3-44.2mn implies 9.4-10.1% in margins, down 100-180bps y/y and 50-85bps below prior expectations.
- **Q4 comps guidance of flat to +2% brackets consensus +1.8% but is below 1-4% prior expectations.** The Houston market is expected to be a 900bps headwind to Q4 comps, driven by strong recovery sales last year. Adjusting for this, guidance would imply comps of 9-11% and imply an acceleration on a two-year basis. This compares to 10.5-12.5% comps at the high end based on prior expectations, which included a 650-850bps hurricane headwind.

Figure 1: FND Income Statement

Credit Suisse Earnings Model

FLOOR & DÉCOR QUARTERLY INCOME STATEMENT

FY ends December, in thousands except per share data

	2013	2014	2015	2016	1Q17	2Q17	3Q17	4Q17	2017	1Q18	2Q18	3Q18	4Q18E	2018E	2019E	2020E
Net Sales	443,995	584,588	772,118	1,050,759	307,296	344,047	343,923	389,501	1,384,767	402,948	434,279	435,882	434,425	1,707,534	2,098,609	2,547,352
Cost of Sales	274,172	355,051	464,450	621,497	181,825	201,819	201,432	227,127	812,203	237,562	256,641	257,656	256,094	1,007,953	1,243,885	1,513,637
Gross Profit	169,823	229,537	307,668	429,262	125,471	142,228	142,491	162,374	572,564	165,386	177,638	178,226	178,331	699,581	854,724	1,033,716
Selling and Store Operating Expenses	106,834	146,486	200,372	271,876	80,751	85,650	85,023	102,223	353,647	102,567	108,626	109,182	119,356	439,731	542,384	649,125
Pre-Opening and Relocation Expenses	5,196	7,412	7,380	13,732	4,167	2,958	6,700	2,660	16,485	2,974	6,588	8,330	7,516	25,408	32,528	40,758
Store Level Costs	112,030	153,898	207,753	285,608	84,918	88,608	91,723	104,883	370,132	105,541	115,214	117,512	126,872	465,139	574,913	689,883
General and Administrative	30,530	41,958	49,637	64,025	17,881	19,518	22,172	25,090	84,661	23,339	25,179	26,477	26,066	101,061	121,766	145,199
SG&A	142,561	195,856	257,389	360,133	102,799	108,126	113,895	129,973	454,793	128,880	140,393	143,989	152,937	566,199	696,679	835,082
Adjusted EBIT	27,650	37,664	50,574	79,629	22,672	34,102	28,596	32,401	117,771	36,506	37,245	34,237	25,394	133,382	158,045	198,633
Adj. Pro Forma EBIT as Public Co.	25,361	35,375	48,285	77,340	22,672	34,102	28,596	32,401	117,771	36,506	37,245	34,237	25,394	133,382	158,045	198,633
Interest Expense	7,684	8,949	9,204	12,804	5,414	3,353	2,610	2,400	13,777	1,784	2,145	2,171	2,200	8,300	8,600	8,700
Loss on Early Extinguishment of Debt	1,638	0	0	1,813	0	5,442	0	0	5,442	0	0	0	0	0	0	0
Pre-Tax Income	17,940	24,732.0	41,075	54,513	17,258	25,307	25,986	30,001	98,552	34,722	35,100	32,066	23,194	125,082	149,445	189,933
Adjusted Pre-Tax Income	19,966	28,716	41,370	66,825	17,258	30,749	25,986	30,001	103,994	34,722	35,100	32,066	23,194	125,082	149,445	189,933
Adj. Pro Forma EBT as Public Co.	17,677	26,426	39,081	64,536	17,258	30,749	25,986	30,001	103,994	34,722	35,100	32,066	23,194	125,082	149,445	189,933
Taxes	6,857	9,635	15,463	11,474	6,130	4,878	2,731	-17,975	-4,236	2,851	-4,746	5,498	5,437	9,040	34,970	44,444
Net Income	11,083	15,097	25,612	43,039	11,128	20,429	23,255	47,976	102,788	31,871	39,846	26,568	17,757	116,042	114,475	145,489
Adjusted Taxes	12,335	17,529	25,796	50,846	11,128	25,871	23,255	47,976	108,230	31,871	39,846	26,568	17,757	116,042	114,475	145,489
Adjusted Net Income	12,335	17,529	25,796	50,846	11,128	25,871	23,255	47,976	108,230	31,871	39,846	26,568	17,757	116,042	114,475	145,489
Adj Pro Forma Net Income as Public Co.	6,835	12,867	21,877	40,791	13,157	20,735	17,341	19,911	71,144	26,731	28,373	25,533	18,257	98,894	114,475	145,489
Diluted EPS	\$0.11	\$0.15	\$0.26	\$0.43	\$0.11	\$0.20	\$0.22	\$0.46	\$1.00	\$0.30	\$0.38	\$0.25	\$0.17	\$1.11	\$1.09	\$1.37
Adj. Pro Forma EPS as Public Co.	\$0.07	\$0.13	\$0.22	\$0.41	\$0.13	\$0.20	\$0.17	\$0.19	\$0.69	\$0.26	\$0.27	\$0.24	\$0.17	\$0.94	\$1.09	\$1.37
Diluted shares outstanding	100,375	100,375	100,375	100,375	98,792	102,930	103,900	104,238	102,949	104,665	104,937	104,565	104,800	104,742	105,146	106,197
EBITDA Reconciliation																
EBITDA	33,864	44,754	67,072	94,280	30,440	42,128	37,121	41,628	151,317	46,734	47,928	46,224	39,730	180,616	216,806	269,959
Adjusted EBITDA (incl Pre-Open Costs)	36,776	51,208	70,704	108,460	31,897	43,681	39,709	43,494	158,781	47,827	50,683	48,918	42,602	190,030	225,200	280,149
Adjusted Pro forma EBITDA (Incl. Pre-Open)	34,487	48,919	68,415	106,170	31,897	43,681	39,709	43,494	158,781	47,827	50,683	48,918	42,602	190,030	225,200	280,149
Ratios																
Gross Profit	38.2%	39.3%	39.8%	40.9%	40.8%	41.3%	41.4%	41.7%	41.3%	41.0%	40.9%	40.9%	41.1%	41.0%	40.7%	40.6%
Store Operating Expenses	24.1%	25.1%	26.0%	25.9%	26.3%	24.9%	24.7%	26.2%	25.5%	25.5%	25.0%	25.0%	27.5%	25.8%	25.8%	25.5%
Pre-Opening Expenses	1.2%	1.3%	1.0%	1.3%	1.4%	0.9%	1.9%	0.7%	1.2%	0.7%	1.5%	1.9%	1.7%	1.5%	1.6%	1.6%
Store Level Costs Sub-Total	25.2%	26.3%	26.9%	27.2%	27.6%	25.8%	26.7%	26.9%	26.7%	26.2%	26.5%	27.0%	29.2%	27.2%	27.4%	27.1%
Store EBIT	13.0%	12.9%	12.9%	13.7%	13.2%	15.6%	14.8%	14.8%	14.6%	14.9%	14.4%	13.9%	11.8%	13.7%	13.3%	13.5%
G&A Expenses (incl Public Co Costs)	7.4%	7.6%	6.7%	6.3%	5.8%	5.7%	6.4%	6.4%	6.1%	5.8%	5.8%	6.1%	6.0%	5.9%	5.8%	5.7%
SG&A, Adj.	32.5%	33.2%	33.6%	33.5%	33.5%	31.4%	33.1%	33.4%	32.8%	32.0%	32.3%	33.0%	35.2%	33.2%	33.2%	32.8%
Adjusted pro forma EBIT incl Public Co Costs	5.7%	6.1%	6.3%	7.4%	7.4%	9.9%	8.3%	8.3%	8.5%	9.1%	8.6%	7.9%	5.8%	7.8%	7.5%	7.8%
D&A	1.5%	1.9%	2.2%	2.4%	2.5%	2.3%	2.5%	2.4%	2.4%	2.5%	2.5%	2.8%	3.3%	2.8%	2.8%	2.8%
Stock Option Expense	0.4%	0.4%	0.4%	0.3%	0.29%	0.36%	0.41%	0.36%	0.4%	0.4%	0.4%	0.4%	0.5%	0.4%	0.4%	0.4%
Adjusted Pro forma EBITDA incl Public Co Costs	7.8%	8.4%	8.9%	10.1%	10.4%	12.7%	11.5%	11.2%	11.5%	11.9%	11.7%	11.2%	9.8%	11.1%	10.7%	11.0%
Interest Expense	1.7%	1.5%	1.2%	1.2%	1.8%	1.0%	0.8%	0.6%	1.0%	0.4%	0.5%	0.5%	0.5%	0.5%	0.4%	0.3%
Adj. Pre-Tax Income	4.0%	4.5%	5.1%	6.1%	5.6%	8.9%	7.6%	7.7%	7.5%	8.6%	8.1%	7.4%	5.3%	7.3%	7.1%	7.5%
Effective Tax Rate	38.2%	39.0%	37.6%	21.0%	35.5%	19.3%	10.5%	-59.9%	-4.3%	8.2%	-13.5%	17.1%	23.4%	7.2%	23.4%	23.4%
Adj. Pro Forma Net Income incl Public Co Costs	1.5%	2.2%	2.8%	3.9%	4.3%	6.0%	5.0%	5.1%	5.1%	6.6%	6.5%	5.9%	4.2%	5.8%	5.5%	5.7%

Source: Company data, Credit Suisse estimates

Companies Mentioned (Price as of 01-Nov-2018)

Floor & Decor Holdings, Inc. (FND.N, \$31.73, OUTPERFORM, TP \$37.0)

Disclosure Appendix

Analyst Certification

Seth Sigman, Kieran McGrath and Lavesh Hemnani each certify, with respect to the companies or securities that the individual analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

3-Year Price and Rating History for Floor & Decor Holdings, Inc. (FND.N)

FND.N	Closing Price	Target Price	
Date	(US\$)	(US\$)	Rating
22-May-17	36.28	43.00	O *
17-Jul-17	39.47		R
25-Jul-17	37.88	43.00	O
03-Nov-17	41.29	47.00	
13-Nov-17	39.07		R
20-Nov-17	38.45	47.00	O
10-Jan-18	46.25	50.00	
03-May-18	46.56	55.00	
02-Aug-18	39.53	50.00	
17-Oct-18	26.99	33.00	



* Asterisk signifies initiation or assumption of coverage.

As of December 10, 2012 Analysts' stock rating are defined as follows:

Outperform (O) : The stock's total return is expected to outperform the relevant benchmark* over the next 12 months.

Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.

Underperform (U) : The stock's total return is expected to underperform the relevant benchmark* over the next 12 months.

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Target Price and Rating

Valuation Methodology and Risks: (12 months) for Floor & Decor Holdings, Inc. (FND.N)

Method: Our \$37 target price is based on ~35x our 2019 EPS of \$1.09 (18x EBITDA). Our Outperform rating is based on total return relative to the rest of our coverage.

Risk: Risks to our \$37 target price and Outperform rating include: 1) macro risks, including rising interest rates, deteriorating consumer confidence, and tighter credit availability; 2) store growth execution risk, and 3) risks around increased regulation in the hard surface flooring industry.

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