

MSC INDUSTRIAL DIRECT CO INC  
Form 10-Q  
April 11, 2013

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR  
15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 2, 2013**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For transition period from            to**

**Commission File No.: 1-14130**

**MSC INDUSTRIAL DIRECT CO., INC.**

(Exact name of registrant as specified in its charter)

New York  
(State or Other Jurisdiction of  
Incorporation or Organization)

11-3289165  
(I.R.S. Employer  
Identification No.)

75 Maxess Road, Melville, New York  
(Address of principal executive offices)

11747  
(Zip Code)

**(516) 812-2000**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of April 4, 2013, 48,492,634 shares of Class A common stock and 14,800,294 shares of Class B common stock of the registrant were outstanding.

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## SAFE HARBOR STATEMENT

This Quarterly Report on Form 10-Q (the Report ) contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Discussions containing such forward-looking statements may be found in Items 2 and 3 of Part I and Item 1 of Part II of this Report, as well as within this Report generally. The words believes, anticipates, thinks, expects, estimates, plans, intends, and similar expressions are intended to forward-looking statements. In addition, any statements which refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. We undertake no obligation to publicly disclose any revisions to these forward-looking statements to reflect events or circumstances occurring subsequent to filing this Report with the Securities and Exchange Commission (the SEC ). These forward-looking statements are subject to risks and uncertainties, including, without limitation, those discussed in this section and Items 2 and 3 of Part I, as well as in Part II, Item 1A, Risk Factors of this Report, and in Part I, Item 1A, Risk Factors and in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended September 1, 2012. In addition, new risks emerge from time to time and it is not possible for management to predict all such risk factors or to assess the impact of such risk factors on our business. Accordingly, future results may differ materially from historical results or from those discussed or implied by these forward-looking statements. Given these risks and uncertainties, the reader should not place undue reliance on these forward-looking statements. These risks and uncertainties include, but are not limited to:

- current economic, political, and social conditions;
- general economic conditions in the markets in which the Company operates;
- changing customer and product mixes;
- risks associated with acquisitions, including difficulties with integrating acquired businesses;
- competition;
- industry consolidation and other changes in the industrial distribution sector;
- volatility in commodity and energy prices;
- the outcome of potential government or regulatory proceedings or future litigation;
- credit risk of our customers;
- risk of cancellation or rescheduling of customer orders;
- work stoppages or other business interruptions (including those due to extreme weather conditions) at transportation centers or shipping ports;
- risk of loss of key suppliers, key brands or supply chain disruptions;
- dependence on our information systems;
- retention of key personnel; and
- risk of delays in opening or expanding our customer fulfillment centers or customer service centers.

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(In thousands, except share data)**

	March 2, 2013 (Unaudited)	September 1, 2012
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$243,949	\$168,453
Accounts receivable, net of allowance for doubtful accounts of \$7,196 and \$6,934, respectively	304,712	297,215
Inventories	364,726	393,412
Prepaid expenses and other current assets	38,791	29,313
Deferred income taxes	31,718	31,718
Total current assets	983,896	920,111
Property, plant and equipment, net	201,628	174,597
Goodwill	289,124	289,124
Identifiable intangibles, net	45,876	51,212
Other assets	6,131	9,832
Total assets	\$1,526,655	\$1,444,876
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities:		
Current maturities of capital lease and financing obligations	\$1,265	\$1,007
Accounts payable	86,599	96,640
Accrued liabilities	57,179	72,868
Total current liabilities	145,043	170,515
Capital lease obligations, net of current maturities	1,986	2,189
Deferred income taxes and tax uncertainties	85,061	85,061
Total liabilities	232,090	257,765
Commitments and Contingencies		
Shareholders' Equity:		
Preferred stock; \$0.001 par value; 5,000,000 shares authorized; none issued and outstanding		
Class A common stock (one vote per share); \$0.001 par value; 100,000,000 shares authorized; 53,856,013 and 52,581,838 shares issued, respectively	54	53
	15	16

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Class B common stock (ten votes per share); \$0.001 par value;  
50,000,000 shares authorized; 14,800,294 and 15,560,294 shares issued and  
outstanding, respectively

Additional paid-in capital	513,101	483,682
Retained earnings	1,052,261	970,965
Accumulated other comprehensive loss	(3,220 )	(2,443 )
Class A treasury stock, at cost, 5,362,290 and 5,342,091 shares, respectively	(267,646 )	(265,162 )
Total shareholders equity	1,294,565	1,187,111
Total liabilities and shareholders equity	\$1,526,655	\$1,444,876

See accompanying notes to condensed consolidated financial statements.

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**Condensed Consolidated Statements of Income**  
**(In thousands, except per share data)**  
**(Unaudited)**

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	March 2, 2013	February 25, 2012	March 2, 2013	February 25, 2012
Net sales	\$569,462	\$562,974	\$1,146,953	\$1,108,677
Cost of goods sold	313,093	303,514	625,495	597,084
Gross profit	256,369	259,460	521,458	511,593
Operating expenses	165,793	162,933	328,530	318,242
Income from operations	90,576	96,527	192,928	193,351
Other Income (Expense):				
Interest expense	(73 )	(70 )	(125 )	(116 )
Interest income	39	68	82	118
Other income (expense), net	87	(16 )	71	(20 )
Total other income (expense)	53	(18 )	28	(18 )
Income before provision for income taxes	90,629	96,509	192,956	193,333
Provision for income taxes	34,550	36,441	73,690	73,428
Net income	\$56,079	\$60,068	\$119,266	\$119,905
Per Share Information:				
Net income per common share:				
Basic	\$0.89	\$0.95	\$1.89	\$1.90
Diluted	\$0.88	\$0.95	\$1.88	\$1.89
Weighted average shares used in computing net income per common share:				
Basic	62,699	62,616	62,538	62,451
Diluted	63,008	63,008	62,854	62,818
Cash dividend declared per common share	\$0.30	\$0.25	\$0.60	\$0.50

See accompanying notes to condensed consolidated financial statements.

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**MSC INDUSTRIAL DIRECT CO., INC.**  
**Condensed Consolidated Statements of**  
**Comprehensive Income**  
**(In thousands)**  
**(Unaudited)**

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	March 2, 2013	February 25, 2012	March 2, 2013	February 25, 2012
Net income, as reported	\$ 56,079	\$ 60,068	\$ 119,266	\$ 119,905
Cumulative foreign currency translation adjustment	(1,046 )	319	(777 )	(373 )
Comprehensive income	\$ 55,033	\$ 60,387	\$ 118,489	\$ 119,532

See accompanying notes to condensed consolidated financial statements.

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**MSC INDUSTRIAL DIRECT CO., INC.**

**Condensed Consolidated Statement of Shareholders  
Equity  
Twenty-Six Weeks Ended March 2, 2013  
(In thousands)  
(Unaudited)**

See accompanying notes to condensed consolidated financial statements.

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**MSC INDUSTRIAL DIRECT CO., INC.**  
**Condensed Consolidated Statements of Cash Flows**  
**(In thousands)**  
**(Unaudited)**

	Twenty-Six Weeks Ended	
	March 2, 2013	February 25, 2012
Cash Flows from Operating Activities:		
Net income	\$119,266	\$119,905
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	21,069	16,369
Stock-based compensation	8,104	7,571
Loss on disposal of property, plant, and equipment.	645	2
Provision for doubtful accounts	1,591	2,370
Deferred income taxes		(1,984 )
Excess tax benefits from stock-based compensation	(4,735 )	(4,203 )
Changes in operating assets and liabilities, net of amounts associated with business acquired:		
Accounts receivable	(9,573 )	(23,783 )
Inventories	28,246	(29,814 )
Prepaid expenses and other current assets	(9,494 )	(9,196 )
Other assets	2,390	3,434
Accounts payable and accrued liabilities	(22,482 )	(6,608 )
Total adjustments	15,761	(45,842 )
Net cash provided by operating activities	135,027	74,063
Cash Flows from Investing Activities:		
Expenditures for property, plant and equipment	(40,306 )	(17,322 )
Cash used in business acquisitions, net of cash received		(32,396 )
Net cash used in investing activities	(40,306 )	(49,718 )
Cash Flows from Financing Activities:		
Purchases of treasury stock	(3,629 )	(3,439 )
Payments of cash dividends	(37,855 )	(31,522 )
Payments on capital lease and financing obligations	(610 )	(275 )
Excess tax benefits from stock-based compensation	4,735	4,203
Proceeds from sale of Class A common stock in connection with associate stock purchase plan	2,094	1,781
Proceeds from exercise of Class A common stock options	15,901	16,811
Borrowings under financing obligations	257	1,050

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Net cash used in financing activities	(19,107 )	(11,391 )
Effect of foreign exchange rate changes on cash and cash equivalents	(118 )	(32 )
Net increase in cash and cash equivalents	75,496	12,922
Cash and cash equivalents beginning of period	168,453	95,959
Cash and cash equivalents end of period	\$243,949	\$108,881
Supplemental Disclosure of Cash Flow Information:		
Cash paid for income taxes	\$77,552	\$78,839
Cash paid for interest	\$31	\$

See accompanying notes to condensed consolidated financial statements.

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**MSC INDUSTRIAL DIRECT CO., INC.**

**Notes to Condensed Consolidated Financial Statements**

**(Dollar amounts and shares in thousands, except per share data)  
(Unaudited)**

**Note 1. Basis of Presentation**

The accompanying condensed consolidated financial statements include MSC Industrial Direct Co., Inc. ( MSC ) and all of its subsidiaries (hereinafter referred to collectively as the Company ). All intercompany balances and transactions have been eliminated in consolidation.

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation (consisting of normal recurring adjustments) have been included. Operating results for the thirteen week and twenty-six week periods ended March 2, 2013 are not necessarily indicative of the results that may be expected for the fiscal year ending August 31, 2013. For further information, refer to the financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended September 1, 2012.

The Company s fiscal year ends on the Saturday closest to August 31 of each year. Unless the context requires otherwise, references to years contained herein pertain to the Company s fiscal year. The Company s 2013 fiscal year will be a 52-week accounting period that will end on August 31, 2013 and the 2012 fiscal year was a 53-week accounting period that ended on September 1, 2012.

**Note 2. Net Income per Share**

The following table sets forth the computation of basic and diluted net income per common share under the two-class method in accordance with Accounting Standards Codification™ ( ASC ) Topic 260, Earnings Per Share :

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	March 2, 2013	February 25, 2012	March 2, 2013	February 25, 2012
Net income as reported	\$56,079	\$60,068	\$119,266	\$119,905
	(123 )	(40 )	(240 )	(157 )

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Less: Distributed net income available to participating securities				
Less: Undistributed net income available to participating securities	(300 )	(394 )	(644 )	(812 )
Numerator for basic net income per share:				
Undistributed and distributed net income available to common shareholders	\$55,656	\$59,634	\$118,382	\$118,936
Add: Undistributed net income allocated to participating securities	300	394	644	812
Less: Undistributed net income reallocated to participating securities	(299 )	(391 )	(641 )	(808 )
Numerator for diluted net income per share:				
Undistributed and distributed net income available to common shareholders	\$55,657	\$59,637	\$118,385	\$118,940
Denominator:				
Weighted average shares outstanding for basic net income per share	62,699	62,616	62,538	62,451
Effect of dilutive securities	309	392	316	367
Weighted average shares outstanding for diluted net income per share	63,008	63,008	62,854	62,818

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(Unaudited)****Note 2. Net Income per Share (continued)**

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	March 2, 2013	February 25, 2012	March 2, 2013	February 25, 2012
Net income per share Two-class method:				
Basic	\$ 0.89	\$ 0.95	\$ 1.89	\$ 1.90
Diluted	\$ 0.88	\$ 0.95	\$ 1.88	\$ 1.89

There were no antidilutive stock options included in the computation of diluted earnings per share for the thirteen and twenty-six week periods ended March 2, 2013 and February 25, 2012.

**Note 3. Stock-Based Compensation**

The Company accounts for all share-based payments in accordance with ASC Topic 718, Compensation - Stock Compensation (ASC 718). The stock-based compensation expense related to the stock option plans and the Associate Stock Purchase Plan included in operating expenses was \$1,329 and \$1,475 for the thirteen week periods ended March 2, 2013 and February 25, 2012, respectively and \$2,768 and \$2,919 for the twenty-six week periods ended March 2, 2013 and February 25, 2012, respectively. Tax benefits related to these expenses for the thirteen week periods ended March 2, 2013 and February 25, 2012 were \$480 and \$542, respectively, and for the twenty-six week periods ended March 2, 2013 and February 25, 2012 were \$1,004 and \$1,068, respectively.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Twenty-Six Weeks Ended	
	March 2, 2013	February 25, 2012
Expected life (in years)	3.8	4.8
Risk-free interest rate	0.55 %	1.01 %
Expected volatility	32.86 %	35.20 %

Expected dividend yield 1.70 % 1.70 %

A summary of the Company's stock option activity for the twenty-six weeks ended March 2, 2013 is as follows:

	Options	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding on September 1, 2012	1,377	\$ 49.79		
Granted	359	69.52		
Exercised	(384 )	41.37		
Canceled	(4 )	62.43		
Outstanding on March 2, 2013	1,348	\$ 57.41	4.84	\$ 37,753
Exercisable on March 2, 2013	505	\$ 48.62	3.55	\$ 18,575

The weighted-average grant-date fair values of the stock options granted for the twenty-six week periods ended March 2, 2013 and February 25, 2012 were \$15.33 and \$17.67, respectively. The unrecognized share-based compensation cost related to stock option expense at March 2, 2013 was \$10,524 and will be recognized over a weighted average period of 1.8 years. The total intrinsic value of options exercised, which represents the difference between the exercise price and market value of common stock measured at each

TABLE OF CONTENTS**MSC INDUSTRIAL DIRECT CO., INC.****Notes to Condensed Consolidated Financial Statements****(Dollar amounts and shares in thousands, except per share data)  
(Unaudited)****Note 3. Stock-Based Compensation (continued)**

individual exercise date, during the twenty-six week periods ended March 2, 2013 and February 25, 2012 were \$12,356 and \$12,143, respectively.

A summary of the non-vested restricted share award activity under the Company's 2005 Omnibus Incentive Plan (the Plan) for the twenty-six weeks ended March 2, 2013 is as follows:

	Shares	Weighted-Average Grant-Date Fair Value
Non-vested restricted share awards at September 1, 2012	535	\$ 52.37
Granted	136	70.11
Vested	(157 )	45.12
Canceled/Forfeited	(6 )	55.92
Non-vested restricted share awards at March 2, 2013	508	\$ 59.31

Stock-based compensation expense recognized for the restricted share awards was \$1,992 and \$1,738 for the thirteen week periods ended March 2, 2013 and February 25, 2012, respectively, and \$4,277 and \$3,593 for the twenty-six week periods ended March 2, 2013 and February 25, 2012, respectively. The unrecognized compensation cost related to restricted share awards granted under the Plan at March 2, 2013 was \$19,696 and will be recognized over a weighted average period of 2.4 years.

In October 2010, the Compensation Committee of the Board of Directors of the Company approved the grant of a Restricted Stock Unit Award (RSU Award) to the Company's former Chief Executive Officer in connection with an overall approach to succession planning. The RSU Award covers 183 restricted share units that accrue dividend equivalent units, and provides for vesting in two installments, contingent on both performance and service conditions of the RSU Award. The performance condition was satisfied based on fiscal year 2011 performance. The value of each restricted stock unit is equal to the fair market value of one share of the Company's Class A Common Stock on the date of the grant. All restricted stock units that vest, including dividend equivalent units on the vested portion of the grant, will be settled in shares of the Company. For the twenty-six week period ended March 2, 2013, dividend equivalents covering 2 shares were earned with a weighted average grant date fair value of \$72.26. As of March 2,

2013, there were 194 unvested restricted stock units outstanding, with a weighted-average grant date fair value of \$55.05 per underlying share.

Stock-based compensation expense recognized for the restricted stock units was \$529 and \$530 for the thirteen week periods ended March 2, 2013 and February 25, 2012, respectively, and \$1,059 for the twenty-six week periods ended March 2, 2013 and February 25, 2012. The unrecognized compensation cost related to the restricted stock units at March 2, 2013 was \$4,968 and is expected to be recognized over a period of 2.7 years.

## **Note 4. Fair Value**

Fair value accounting standards define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following fair value hierarchy prioritizes the inputs used to measure fair value into three levels, with Level 1 being of the highest priority. The three levels of inputs used to measure fair value are as follows:

**Level 1** Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

**Level 2** Include other inputs that are directly or indirectly observable in the marketplace.

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**MSC INDUSTRIAL DIRECT CO., INC.**

**Notes to Condensed Consolidated Financial  
Statements**

**(Dollar amounts and shares in thousands, except per  
share data)  
(Unaudited)**

**Note 4. Fair Value (continued)**

**Level 3** Unobservable inputs which are supported by little or no market activity.

As of March 2, 2013 and September 1, 2012, the Company measured cash equivalents consisting of money market funds at fair value on a recurring basis for which market prices are readily available (Level 1) and that invest primarily in United States government and government agency securities and municipal bond securities, which aggregated \$159,462 and \$104,529, respectively.

The Company's financial instruments, other than those presented in the disclosure above, include cash, receivables, accounts payable, and accrued liabilities. Management believes the carrying amount of the aforementioned financial instruments is a reasonable estimate of fair value as of March 2, 2013 and September 1, 2012 due to the short-term maturity of these items. In addition, based on borrowing rates currently available to the Company for borrowings with similar terms, the carrying values of the Company's capital lease obligations also approximate fair value.

During the twenty-six weeks ended March 2, 2013 and February 25, 2012, the Company had no measurements of non-financial assets or liabilities at fair value on a non-recurring basis subsequent to their initial recognition.

**Note 5. Business Combinations**

**Pending acquisition**

On February 22, 2013, the Company entered into an Asset Purchase Agreement (the "Asset Purchase Agreement") with Barnes Group Inc. ("Barnes"), to acquire substantially all of the assets and assume certain liabilities of the North American distribution business ("BDNA") of Barnes for a purchase price of \$550,000. The purchase price is subject to a customary working capital adjustment. In addition, the purchase price is subject to a downward adjustment if the adjusted EBITDA (as defined in the Asset Purchase Agreement) derived from the audited financial statements of BDNA for the year ended December 31, 2012 and delivered prior to the closing of the acquisition is less than \$36,000. The acquisition is expected to close during the Company's fiscal third quarter and will be financed using available cash and borrowings under an anticipated new credit facility and term loan structure.

## Note 6. Debt and Capital Lease Obligations

### Credit Facility

In June 2011, the Company entered into a \$200,000 unsecured credit facility (the Credit Facility ). The Company has the right to request to increase the aggregate amount available to be borrowed under the Credit Facility by an additional \$250,000, in \$50,000 increments, subject to lending group approval. This Credit Facility will mature on June 8, 2016.

Borrowings under the Credit Facility bear interest, at the Company's option either at (i) the LIBOR rate plus the applicable margin for LIBOR loans ranging from 1.00% to 1.25%, based on the Company's consolidated leverage ratio; or (ii) the greatest of (a) the Administrative Agent's prime rate in effect on such day, (b) the federal funds effective rate in effect on such day, plus 0.50% and (c) the LIBOR rate that would be calculated as of such day in respect of a proposed LIBOR loan with a one-month interest period, plus 1.0%, plus, in the case of each of clauses (a) through (c), an applicable margin ranging from 0% to 0.25%, based on the Company's consolidated leverage ratio. The applicable borrowing rate for the Company for any borrowings outstanding under the Credit Facility at March 2, 2013 was 1.2%, which represents LIBOR plus 1.0%.

The Company is required to pay a quarterly undrawn fee ranging from 0.15% to 0.20% per annum on the unutilized portion of the Credit Facility, a quarterly letter of credit usage fee ranging between 1.00% to 1.25%

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**MSC INDUSTRIAL DIRECT CO., INC.**

**Notes to Condensed Consolidated Financial  
Statements**

**(Dollar amounts and shares in thousands, except per  
share data)  
(Unaudited)**

**Note 6. Debt and Capital Lease Obligations (continued)**

on the amount of the daily average outstanding letters of credit, and a quarterly fronting fee of 0.125% per annum on the undrawn and unexpired amount of each letter of credit.

The Credit Facility contains customary restrictions on the ability of the Company and its subsidiaries to incur debt, make investments, and engage in sales of assets and in fundamental corporate changes, among other restrictions. The Credit Facility also requires that the Company maintain a maximum consolidated leverage ratio of total indebtedness to EBITDA and a minimum consolidated interest coverage ratio of EBITDA to total interest expense during the term of the Credit Facility. Borrowings under the Credit Facility are guaranteed by certain of the Company's subsidiaries.

As of March 2, 2013 and September 1, 2012, there were no borrowings outstanding under the Credit Facility other than letters of credit, which were immaterial. At those dates, the Company was in compliance with the operating and financial covenants of the Credit Facility.

**Capital Lease and Financing Obligations**

From time to time, the Company enters into capital leases and financing arrangements to purchase certain equipment. The equipment acquired from these vendors is paid over a specified period of time based on the terms agreed upon.

During the twenty-six week period ended March 2, 2013, the Company entered into capital lease and financing arrangements for certain information technology equipment totaling \$665. During the fiscal year ended September 1, 2012, the Company entered into various capital leases and financing obligations for certain information technology equipment totaling \$4,582.

The amount due under all capital leases and financing arrangements at March 2, 2013 was approximately \$3,251, of which \$1,265 represents current maturities. The net book value of the property and equipment acquired under these capital leases and financing agreements at March 2, 2013 and September 1, 2012 was approximately \$4,724 and \$3,751, respectively.

**Note 7. Shareholders Equity**

The Company paid cash dividends of \$37,855 for the twenty-six weeks ended March 2, 2013. For the twenty-six weeks ended February 25, 2012, the Company paid cash dividends of \$31,522. On December 6, 2012, the Board of

Directors declared an accelerated quarterly cash dividend of \$0.30 per share payable on December 27, 2012 to shareholders of record at the close of business on December 17, 2012. This accelerated quarterly dividend was intended to be in lieu of the quarterly dividend which would have been payable in January 2013. This dividend resulted in a payout of \$18,948.

On April 4, 2013, the Board of Directors declared a dividend of \$0.30 per share payable on April 30, 2013 to shareholders of record at the close of business on April 16, 2013. The dividend will result in a payout of approximately \$18,988, based on the number of shares outstanding at April 4, 2013.

The Board of Directors established the MSC Stock Repurchase Plan (the Repurchase Plan ), which allows the Company to repurchase shares at any time and in any increments it deems appropriate in accordance with Rule 10b-18 under the Securities Exchange Act of 1934, as amended. As of March 2, 2013 the maximum number of shares that may yet be repurchased under the Repurchase Plan was 4,384 shares. In addition, during the twenty-six week period ending March 2, 2013, the Company repurchased 50 shares of its Class A common stock for \$3,629, which is reflected at cost as treasury stock in the accompanying condensed consolidated financial statements. These shares were repurchased by the Company to satisfy the Company's associates' tax withholding liability associated with its share-based compensation program.

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**MSC INDUSTRIAL DIRECT CO., INC.**

**Notes to Condensed Consolidated Financial  
Statements**

**(Dollar amounts and shares in thousands, except per  
share data)  
(Unaudited)**

**Note 8. Product Warranties**

The Company generally offers a maximum one-year warranty, including parts and labor, for some of its machinery products. The specific terms and conditions of those warranties vary depending upon the product sold. The Company may be able to recoup some of these costs through product warranties it holds with its original equipment manufacturers, which typically range from thirty to ninety days. In general, many of the Company's general merchandise products are covered by third party original equipment manufacturers' warranties. The Company's warranty expense for the twenty-six week periods ended March 2, 2013 and February 25, 2012 was minimal.

**Note 9. Income Taxes**

During the thirteen and twenty-six week periods ended March 2, 2013, there were no material changes in unrecognized tax benefits.

**Note 10. Legal Proceedings**

There are various claims, lawsuits, and pending actions against the Company incidental to the operation of its business. Although the outcome of these matters is currently not determinable, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company's consolidated financial position, results of operations, or liquidity.

**Note 11. Recently Issued Accounting Standards**

**Reclassification Adjustments out of Accumulated Other Comprehensive Income**

In February 2013, the Financial Accounting Standards Board ( FASB ) issued an accounting standard which requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required

under U.S. GAAP that provide additional detail about those amounts. This guidance is effective for periods beginning after December 15, 2012. The Company does not expect the adoption of this new guidance to have any impact on its financial position, results of operations or cash flows.

### **Testing Indefinite-lived Intangible Assets for Impairment**

In July 2012, the FASB issued an accounting standard update that allows an entity the option to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is not more likely than not that the indefinite-lived intangible asset is impaired. An entity no longer will be required to perform the quantitative impairment test of indefinite-lived intangible assets if, after it assesses that the totality of events and circumstances, the entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired. The guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company does not anticipate that the adoption of the guidance will have any impact on its financial position, results of operations or cash flows.

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## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is intended to update the information contained in the Company's Annual Report on Form 10-K for the fiscal year ended September 1, 2012 and presumes that readers have access to, and will have read, Management's Discussion and Analysis of Financial Condition and Results of Operations contained in such Annual Report on Form 10-K.

### Overview

MSC Industrial Direct Co., Inc. (together with its subsidiaries, MSC, the Company, we, our, or us) is one of the largest direct marketers and distributors of a broad range of metalworking and maintenance, repair, and operations (MRO) products to customers throughout the United States.

We offer approximately 600,000 stock-keeping units (SKUs) through our master catalogs; weekly, monthly and quarterly specialty and promotional catalogs; newspapers; brochures; and the Internet, including our websites, MSCDirect.com, MSCMetalworking.com and Use-Enco.com (the MSC Websites). We service our customers from five customer fulfillment centers and 106 branch offices. We employ one of the industry's largest sales forces. Most of our products are carried in stock, and orders for these in-stock products are typically fulfilled the day on which the order is received. We also offer a nationwide cutoff time of 8:00 PM Eastern time on qualifying orders for customers in the contiguous United States, which will be delivered to the customers the next day at no additional cost over standard MSC ground delivery charges.

Net sales increased by 1.2% and 3.5% for the thirteen and twenty-six week periods ended March 2, 2013, as compared to the same periods in the prior fiscal year. We have experienced a slower sales growth rate for the thirteen and twenty-six week periods ended March 2, 2013, as compared to the same periods in the prior fiscal year. The manufacturing measurements, such as the Institute for Supply Management (ISM) index, began to decline during our fiscal fourth quarter of 2012 into a contracting manufacturing sector environment. However, the trend has recently stabilized into a range above 50.0%, which is indicative of future growth. Historically, our sales growth rates have tended to lag the ISM by 4 to 5 months. Despite the improvements in recent ISM measurements, our sales growth rates for the thirteen and twenty-six week periods ended March 2, 2013, as compared to the same periods in the prior fiscal year, have slowed primarily due to continued weakness in the core metalworking manufacturing sector. We will continue to invest in our business by increasing our sales force, increasing our investment in vending solutions, making technology investments to improve our electronic procurement tools, and making productivity investments. These investments, combined with our strong balance sheet, extensive product assortment, high in-stock levels, same day shipping, and high levels of execution, have increased our competitive advantage over smaller distributors. See the discussion below describing recent fluctuations in economic indicators and the possible impact on our future sales.

Our gross profit margin was 45.0% and 45.5% for the thirteen and twenty-six week periods ended March 2, 2013, as compared to 46.1% for the same periods in the prior fiscal year. The decrease in gross margin was primarily driven by increases in product costs, changes in customer and product mix and lower gross margins from acquired businesses and our vending program.

Operating expenses increased 1.8% and 3.2% for the thirteen and twenty-six week periods ended March 2, 2013 as compared to the same periods in the prior fiscal year, as a result of increased payroll costs, costs associated with our investment programs, and costs related to the establishment of our new co-located headquarters in Davidson, North

Carolina. The increase in payroll is primarily a result of the additional sales associate headcount. For the thirteen and twenty-six week periods ended March 2, 2013, our operating margin was 15.9% and 16.8%, as compared to 17.1% and 17.4% for the same periods in the prior fiscal year.

We expect operating costs to continue to increase throughout fiscal 2013, as compared to the same periods in fiscal 2012, due to increased compensation expenses and fringe benefits costs, in addition to costs associated with executing on our vending and other investment programs. We also expect to continue to incur operating costs associated with the establishment of our new co-located headquarters in Davidson, North Carolina. In connection with the new co-location, we have estimated non-recurring costs ranging between \$7.0 million to \$10.0 million, to be incurred primarily in fiscal years 2013 and 2014. For the thirteen and twenty-six week periods ended March 2, 2013, we have incurred approximately \$0.1 million and \$1.5 million, respectively, in non-recurring costs associated with the establishment of our new co-located headquarters.

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However, we will continue to work proactively to manage and control discretionary spending as we closely monitor current economic conditions. We will also continue to seek opportunities to help position us for future expansion and any such expansion would increase our operating expenses. We believe that cash flows from operations, available cash and funds available under the current revolving credit facility or an anticipated new revolving credit facility, which is discussed below, will be adequate to support our operations and growth plans for the next twelve months.

The ISM index, which measures the economic activity of the U.S. manufacturing sector, is important to our planning because it historically has been an indicator of our manufacturing customers' activity. A substantial portion of our revenues came from sales in the manufacturing sector during the twenty-six week period ended March 2, 2013, including certain national account customers. An ISM index reading below 50.0% generally indicates that the manufacturing sector is contracting. Conversely, an ISM index reading above 50.0% generally indicates that the manufacturing sector is expanding. The ISM index dropped below 50.0% in June 2012 for the first time since July 2009. However, the trend has recently stabilized into a range above 50.0%, which is indicative of future growth. The ISM index was 51.3% for the month of March 2013. Details released with the most recent index indicate that economic activity in the manufacturing sector related to new orders, production, and employment are growing while inventories are contracting from the previous month. Although the most recent measurement trend indicates that the manufacturing sector is expanding, there remains uncertainty relating to the current economic environment. Continued concerns relating to macroeconomic factors may continue to influence our customers and cause them to be more cautious in their purchases of MSC's products. In addition, sales to governmental agencies have generally been constrained by the government spending environment. Sales to our government accounts represented approximately 9.0% of our total sales during the twenty-six week period ended March 2, 2013.

We are continuing to take advantage of our strong balance sheet, which enables us to maintain or extend credit to our credit worthy customers and maintain optimal inventory and service levels to meet customer demands during these challenging economic conditions, while many of our smaller competitors in our fragmented industry continue to have difficulties in offering competitive service levels. We also believe that customers will continue to seek cost reductions and shorter cycle times from their suppliers. Our business model focuses on providing overall procurement cost reduction and just-in-time delivery to meet our customers' needs. We will seek to continue to drive cost reduction throughout our business through cost saving strategies and increased leverage from our existing infrastructure, and continue to provide additional procurement cost savings solutions to our customers through technology such as our Customer Managed Inventory ( CMI ), Vendor Managed Inventory ( VMI ), and vending programs.

On February 22, 2013, we signed an Asset Purchase Agreement (the "Asset Purchase Agreement") to acquire substantially all the assets and assume certain liabilities of the North American distribution business ( BDNA ) of Barnes Group Inc., subject to the terms and conditions of the Asset Purchase Agreement, for a purchase price of \$550.0 million. The purchase price is subject to a customary working capital adjustment. In addition, the purchase price is subject to a downward adjustment if the adjusted EBITDA (as defined in the Asset Purchase Agreement) derived from the audited financial statements of BDNA for the year ended December 31, 2012 and delivered prior to the closing of the acquisition is less than \$36.0 million. The acquisition is expected to close during our fiscal third quarter, subject to regulatory approvals and customary closing conditions and will be financed using available cash and borrowings under an anticipated new credit facility and term loan structure. BDNA is a leading distributor of fasteners and other high margin, low cost consumables with a broad distribution footprint throughout the U.S. and Canada. BDNA has a strong presence with customers across manufacturing, government, transportation and natural resources end-markets. BDNA specializes in lowering the total cost of their customers' inventory management through storeroom organization and vendor managed inventory. With this acquisition, we will add a highly complementary provider of fasteners and other high margin consumable products and services (often referred to as "Class C" items) with an industry leading field sales force and VMI solution. With the integration of the two businesses, we will have the opportunity to bring our MRO offering to BDNA's customers, and BDNA's Class C offering and VMI system to

our customers.

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TABLE OF CONTENTS**Results of Operations****Net Sales**

	Thirteen Weeks Ended			Twenty-Six Weeks Ended		
	March 2, 2013	February 25, 2012	Percentage Change	March 2, 2013	February 25, 2012	Percentage Change
	(Dollars in thousands)					
Net Sales	\$ 569,462	\$ 562,974	1.2 %	\$ 1,146,953	\$ 1,108,677	3.5 %

Net sales increased 1.2%, or approximately \$6.5 million for the thirteen week period ended March 2, 2013, as compared to the same period in the prior fiscal year. This increase resulted from an increase of approximately \$8.8 million from improved price realization, which includes the effects of price increases, discounting, changes in sales and product mix, and other items, offset by a volume-related decrease of approximately \$2.3 million (after giving effect to volume-related increases of approximately \$5.5 million from the acquisition of ATS Industrial Supply, Inc. in January 2012). Of the above \$6.5 million increase in net sales, our government and national account programs ( Large Account Customer ) increased by approximately \$4.3 million and there was an increase in our remaining business of approximately \$2.2 million.

Net sales increased 3.5%, or approximately \$38.3 million for the twenty-six week period ended March 2, 2013, as compared to the same period in the prior fiscal year. We estimate that of this \$38.3 million increase in net sales, an increase of approximately \$13.0 million is volume-related, after giving effect to volume-related increases of approximately \$13.5 million from the acquisition of ATS Industrial Supply, Inc. in January 2012, and the remaining \$25.3 million reflects improved price realization, which includes the effects of price increases, discounting, changes in sales and product mix, and other items. Of the above \$38.3 million increase in net sales, our Large Account Customers increased by approximately \$15.6 million and there was an increase in our remaining business of approximately \$22.7 million.

The table below shows the pattern to the change in our fiscal quarterly average daily sales from the same period in the prior fiscal year:

Average Daily Sales Percentage Change Total Company

(unaudited)

Fiscal Periods	Thirteen Week Period Ended Fiscal Q2	Thirteen Week Period Ended Fiscal Q1	Twenty-Six Week Period Ended Fiscal Q2 YTD
2013 vs. 2012	1.2 %	5.8 %	3.5 %
2012 vs. 2011	16.5 %	15.4 %	15.9 %

The trends noted above can be further analyzed by customer type. Our manufacturing customers currently represent approximately 76% of our business and our non-manufacturing customers currently represent approximately 24% of our business. The table below shows the pattern to the change in our fiscal quarterly average daily sales by customer

type from the same periods in the prior fiscal year.

TABLE OF CONTENTSAverage Daily Sales Percentage Change Manufacturing Customers

(unaudited)

Fiscal Periods	Thirteen Week Period Ended Fiscal Q2	Thirteen Week Period Ended Fiscal Q1	Twenty-Six Week Period Ended Fiscal Q2 YTD
2013 vs. 2012	1.3 %	6.2 %	3.7 %
2012 vs. 2011	19.4 %	19.8 %	19.6 %

Average Daily Sales Percentage Change Non-Manufacturing Customers

(unaudited)

Fiscal Periods	Thirteen Week Period Ended Fiscal Q2	Thirteen Week Period Ended Fiscal Q1	Twenty-Six Week Period Ended Fiscal Q2 YTD
2013 vs. 2012	0.4 %	4.9 %	2.7 %
2012 vs. 2011	9.2 %	4.1 %	6.6 %

Exclusive of the UK, average order size increased to approximately \$398 for the second quarter of fiscal 2013 as compared to \$385 in the second quarter of fiscal 2012. We believe that our ability to transact business with our customers through various electronic portals and directly through the MSC Websites, gives us a competitive advantage over smaller suppliers. Historically, we have reported our business through electronic portals by disclosing sales made through the MSC Websites. During the fourth quarter of fiscal 2012, we adopted a new measurement of sales through all eCommerce platforms. The new measurement, which measures all sales made through our eCommerce platforms, includes sales made through Electronic Data Interchange systems, VMI systems, Extensible Markup Language ordering based systems, vending machine systems, hosted systems and other electronic portals. Sales made through all of our eCommerce platforms were \$494.7 million, representing 43.1% of consolidated net sales for the twenty-six week period ended March 2, 2013, compared to \$447.2 million, representing 40.3% of consolidated net sales for the same period in the prior fiscal year.

We grew our field sales associate headcount to 1,103 at March 2, 2013, an increase of approximately 2.0% from field sales associates of 1,081 at February 25, 2012, in order to support our strategy to acquire new accounts and expand existing accounts across all customer types. Our field sales associate headcount is expected to be approximately 1,125 associates by the end of the 2013 fiscal year and we will continue to manage the timing of our sales force expansion based on economic conditions and our selected mix of growth investments.

In the fiscal 2013 MSC catalog, distributed in September 2012, we added approximately 19,500 new SKUs and removed approximately 17,400 SKUs. Approximately 25% of the new SKUs are MSC proprietary brands. SKUs are primarily removed at the end of their lifecycle or when demand can be shifted to other items we believe provide our customers equal or higher value and are consistent with our margin expansion initiatives. In fiscal 2013, we are enhancing our SKU expansion plans through our eCommerce channels in order to bring additional value to our key stakeholders. Our suppliers can broaden their product portfolio available through MSC, and shorten time to market for

new items outside our annual catalog cycle. Customers can find and buy from an expanded SKU selection and our associates realize improved productivity as fewer transactions are carried out as special orders . We expect to introduce approximately 70,000 additional SKUs through our eCommerce channels during fiscal 2013.

TABLE OF CONTENTS**Gross Profit**

	Thirteen Weeks Ended			Twenty-Six Weeks Ended		
	March 2, 2013	February 25, 2012	Percentage Change	March 2, 2013	February 25, 2012	Percentage Change
	(Dollars in thousands)					
Gross Profit	\$256,369	\$259,460	(1.2 )%	\$521,458	\$511,593	1.9 %
Gross Profit Margin	45.0 %	46.1 %		45.5 %	46.1 %	

Gross profit margin for the thirteen and twenty-six week periods ended March 2, 2013 decreased from the comparable periods in the prior fiscal year as a result of increased costs of our products, changes in customer and product mix, and the temporary impact of lower gross profit margins from acquired businesses and our vending programs.

**Operating Expenses**

	Thirteen Weeks Ended			Twenty-Six Weeks Ended		
	March 2, 2013	February 25, 2012	Percentage Change	March 2, 2013	February 25, 2012	Percentage Change
	(Dollars in thousands)					
Operating Expenses	\$165,793	\$162,933	1.8 %	\$328,530	\$318,242	3.2 %
Percentage of Net Sales	29.1 %	28.9 %		28.6 %	28.7 %	

The increase in operating expenses as a percentage of net sales for the thirteen week period ended March 2, 2013, as compared to the same period in the prior fiscal year, was primarily a result of increases in payroll costs and costs associated with our investment programs.

The decrease in operating expenses as a percentage of net sales for the twenty-six week period ended March 2, 2013, as compared to the same period in the prior fiscal year, was primarily a result of productivity gains, cost containment initiatives, including the reduction in the annual bonus expense accrual as the fiscal 2013 bonus payout is expected to be at lower levels than fiscal 2012 due to the Company's expected fiscal 2013 performance relating to the current economic conditions, and the allocation of fixed expenses over a larger revenue base.

The increase in operating expenses in dollars for the thirteen week period ended March 2, 2013, as compared to the same period in the prior fiscal year, was primarily a result increases in payroll costs and costs associated with our investment programs. Also included in operating expenses for the thirteen week period ended March 2, 2013 are approximately \$1.6 million of expenses related to non-recurring transaction costs associated with the BDNA acquisition.

The increase in operating expenses in dollars for the twenty-six week period ended March 2, 2013, as compared to the same period in the prior fiscal year, was primarily a result of increases in payroll costs as well as costs associated with our investment programs which included non-recurring operating costs associated with the establishment of our new co-located headquarters in Davidson, North Carolina of approximately \$1.5 million. Also included in operating expenses for the twenty-six week period ended March 2, 2013 are approximately \$1.6 million of expenses related to non-recurring transaction costs associated with the BDNA acquisition.

Payroll and payroll related costs represented approximately 54.5% of total operating expenses for each of the thirteen and twenty-six week periods ended March 2, 2013, as compared to approximately 55.8% and 55.1% for the thirteen and twenty-six week periods ended February 25, 2012, respectively. Included in these costs are salary, incentive

compensation, and sales commission. Payroll and payroll related costs decreased as a percentage of operating expenses for the thirteen and twenty-six week periods ended March 2, 2013, as compared to the same periods in the prior fiscal year primarily as a result of the reduction in the annual bonus expense accrual as the fiscal 2013 bonus payout is expected to be at lower levels than fiscal 2012 due to the Company's expected fiscal 2013 performance relating to the current economic conditions and as a result of increased operating expenses due to the other factors discussed above.

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Freight costs represented approximately 15.0% of total operating expenses for each of the thirteen and twenty-six week periods ended March 2, 2013, as compared to 15.0% and 15.4% for the thirteen and twenty-six week periods ended February 25, 2012, respectively. These costs decreased as a percentage of operating expenses for the twenty-six week period ended March 2, 2013, primarily as a result of increased rebate incentives relating to overall higher expenditures as compared to the same period in the prior fiscal year. In addition, a decrease in the overall number of packages shipped and an increase in the number of direct shipments from our suppliers compared to the same period in the prior fiscal year contributed to the decrease in freight costs.

**Income from Operations**

	Thirteen Weeks Ended			Twenty-Six Weeks Ended		
	March 2, 2013	February 25, 2012	Percentage Change	March 2, 2013	February 25, 2012	Percentage Change
	(Dollars in thousands)					
Income from Operations	\$90,576	\$96,527	(6.2 )%	\$192,928	\$193,351	(0.2 )%
Percentage of Net Sales	15.9 %	17.1 %		16.8 %	17.4 %	

The decrease in income from operations for the thirteen and twenty-six week periods ended March 2, 2013, as compared to the same periods in the prior fiscal year, was primarily attributable to decreases in our gross profit margins and increases in operating expenses as described above. Income from operations as a percentage of net sales also decreased for the thirteen and twenty-six week periods ended March 2, 2013, as compared to the same periods in the prior fiscal year due to those same factors.

**Provision for Income Taxes**