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Snap-on (SNA) Update- 9/20 Qtr.
Cancel SELL, Initiate EQ Coverage

Current EQ Rating*	Previous EQ Rating
4+	na

6- "Exceptionally Strong"
5- "Strong"
4- "Acceptable"
3- "Minor Concern"
2- "Weak"
1- "Strong Concerns"

Note that a "+" sign indicates the earnings quality improved in the most recent quarter while a "–" sign indicates deterioration

*For an explanation of the EQ Review Rating scale, please refer to the end of this report

We are canceling our SELL rating on SNA and initiating earnings quality coverage with a rating of 4+ (Acceptable)

Our initial warning on SNA focused on the company driving sales growth with the extension of credit to its franchisees and their customers. In addition, the company has faced secular headwinds from new cars requiring less maintenance, the industry shift away from "mom-and-pop" shops, and the budding move towards electric vehicles. COVID has resulted in a change (likely temporary) to the outlook for driving. People are working from home more, are taking driving vacations closer to home rather than flying, and are considering a move to the suburbs. These trends are boosting miles driven and could boost business at auto shops. However, investors should remember that the SNA value proposition remains tied to the extension of credit to both franchisees and their customers. The average yield on finance receivables is north of 17%, indicating that many of these customers would not be able to get credit anywhere else.

Going forward, we will focus on SNA's earnings quality which will include special attention paid to credit trends.

- Contract and finance receivable days of sales both fell YOY, ending a long string of material YOY increases. Originations were down slightly despite an almost 10% increase in Tool Group and Repair System revenues indicating sales growth was not driven by credit extension. The increase in cash sales could be an indication of a quick recovery in repair business but the impact of stimulus payments should not be ruled out.

- Delinquency rates for contract and finance receivables both improved versus the year-ago period despite payment support returning to a normal level and payments from deferred payment plans offered through June likely coming due. Recall that delinquency rates received an artificial benefit from both items in the June quarter.

Extension of Credit Slowed

SNA's originations were $252.8 million in the quarter, down slightly from the year-ago levels despite a 9.5% increase in Tool Group and Repair Systems revenue. This ended a long string of significant increases in contract receivable days and finance receivable days of sales as shown below:

Contract Receivable Days of Sales	9/26/2020	6/27/2020	3/28/2020	12/28/2019
Tool Group + Repair Systems Sales	$705.9	$519.8	$625.2	$686.5
Total Contract Receivables	$480.5	$464.6	$447.6	$460.8
Total Contract Receivables Days	62.1	81.6	65.3	61.2

	9/28/2019	6/29/2019	3/30/2019	12/29/2018
Tool Group + Repair Systems Sales	$644.8	$688.3	$672.2	$682.5
Total Contract Receivables	$451.3	$439.0	$438.0	$443.2
Total Contract Receivables Days	63.9	58.2	59.5	59.3

Finance Receivable Days of Sales	9/26/2020	6/27/2020	3/28/2020	12/28/2019
Tool Group + Repair Systems Sales	$705.9	$519.8	$625.2	$686.5
Total Finance Receivables	$1,654.4	$1,648.8	$1,616.2	$1,633.6
Total Finance Receivables Days	213.9	289.4	235.9	217.1

	9/28/2019	6/29/2019	3/30/2019	12/29/2018
Tool Group + Repair Systems Sales	$644.8	$688.3	$672.2	$682.5
Total Finance Receivables	$1,618.2	$1,618.0	$1,603.0	$1,592.9
Total Finance Receivables Days	229.0	214.5	217.6	213.0

We view this as a positive indication that the company has not pushed sales to customers and franchisees through aggressive credit extension. This could be an indication of a quick recovery in business at auto shops, but it can't be ruled out that the increase in cash sales was impacted by stimulus payments and could prove to be short-lived.

Credit Metrics Improved Noticeably Even Without Payment Relief

We noted in our last review that credit metrics improved artificially due to the company extending short-term payment relief with forbearance at 2.5% of the portfolio compared to a historical norm of 1%. In addition, SNA offered 60-day deferred payments plans that ran through June to support revenue in the second quarter. However, we also noted it was possible that increasing miles driven could support repair businesses enough for them to service their loans. This appears to have been the case as delinquency rates for contract and finances receivables fell YOY in the 9/20 quarter:

Contract Receivables	9/26/2020	6/27/2020	3/28/2020	12/28/2019
30-59 days past due	0.27%	0.25%	0.39%	0.32%
60-90 days past due	0.10%	0.15%	0.20%	0.19%
>90 days past due	0.27%	0.36%	0.31%	0.32%
Total past due	0.63%	0.76%	0.90%	0.84%
>90 Days and Still Accruing	0.06%	0.06%	0.09%	0.11%

Contract Receivables	9/28/2019	6/29/2019	3/30/2019	12/29/2018
30-59 days past due	0.33%	0.29%	0.29%	0.38%
60-90 days past due	0.22%	0.23%	0.20%	0.27%
>90 days past due	0.35%	0.32%	0.32%	1.16%
Total past due	0.90%	0.83%	0.81%	1.81%
>90 Days and Still Accruing	0.04%	0.07%	0.09%	0.04%

Finance Receivables	9/26/2020	6/27/2020	3/28/2020	12/28/2019
30-59 days past due	1.03%	0.55%	1.07%	1.16%
60-90 days past due	0.65%	0.29%	0.68%	0.71%
>90 days past due	0.97%	0.90%	1.23%	1.26%
Total past due	2.65%	1.74%	2.98%	3.13%
>90 Days and Still Accruing	0.80%	0.70%	0.97%	1.01%

Finance Receivables	09/28/2019	06/29/2019	03/30/2019	12/29/2018
30-59 days past due	1.07%	0.95%	0.85%	1.17%
60-90 days past due	0.67%	0.61%	0.58%	0.73%
>90 days past due	1.19%	0.97%	1.17%	1.23%
Total past due	2.92%	2.53%	2.60%	3.13%
>90 Days and Still Accruing	0.93%	0.75%	0.90%	0.96%

Despite the removal of payment support and payments on the deferred payment plans kicking in, total delinquency rates for both contract receivables and finance receivables were lower than they were in the comparable year-ago (pre-COVID) quarter.

We will continue to monitor the credit portfolio for signs of aggressive credit extension or deterioration in outstanding loans.

Explanation of EQ Rating Scale

6- "Exceptionally Strong"	Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises
5- "Strong"	Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.
4- "Acceptable"	Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement
3- "Minor Concern"	Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.
2- "Weak"	Indicates the company's recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.
1- "Strong Concerns"	Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely.

In addition to the numerical rating, the EQ Review Rating may also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into the next quarter. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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