S&P Global
Market Intelligence

MSC Industrial Direct Co., Inc. NYSE:MSM

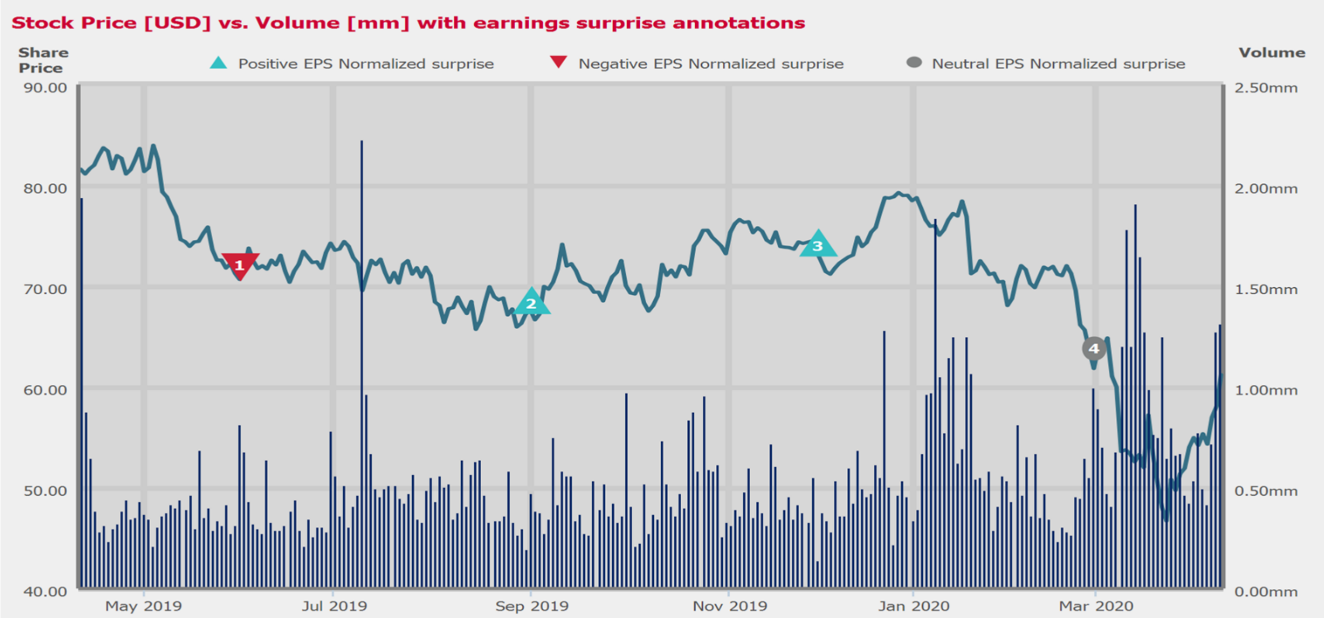
FQ2 2020 Earnings Call Transcripts

Wednesday, April 08, 2020 12:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2020-			-FQ3 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.00	1.00	0.00	0.93	4.12	4.26
Revenue (mm)	792.26	786.09	(0.78 %)	759.29	3144.93	3238.01

Currency: USD
Consensus as of Apr-08-2020 1:15 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2019	1.49	1.45	1 (2.68 %)
FQ4 2019	1.23	1.30	2 5.69 %
FQ1 2020	1.17	1.21	3 3.42 %
FQ2 2020	1.00	1.00	4 0.00 %

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Call Participants

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Erik David Gershwind
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John G. Chironna
VP of Investor Relations & Treasurer

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Presentation

Operator

Good morning, and welcome to the MSC Industrial Supply 2020 Second Quarter Conference Call. [Operator Instructions] Please note, this event is being recorded. I would now like to turn the conference over to John Chironna, Vice President of Investor Relations and Treasurer. Please go ahead.

John G. Chironna
VP of Investor Relations & Treasurer

Thank you, and good morning, everyone. Erik Gershwind, our Chief Executive Officer, is on the call with me. We are remote. So bear with us, if the call drops, we will dial back in, of course. During today's call, we will refer to various financial and management data in the presentation slides that accompany our comments as well as our operational statistics, both of which can be found on the Investor Relations section of our website.

Let me reference our safe harbor statement under the Private Securities Litigation Reform Act of 1995. Our comments on this call as well as the supplemental information we are providing on the website contain forward-looking statements within the meaning of the U.S. securities laws, including guidance about expected future results, expectations regarding our ability to gain market share and expected benefits from our investment and strategic plans, including expected results from acquisitions. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those anticipated by these statements. Information about these risks is noted in our earnings press release and the risk factors in the MD&A sections of our latest annual report on Form 10-K filed with the SEC as well as in our other SEC filings. These risk factors include our comments on the potential impact of COVID-19. These forward-looking statements are based on our current expectations, and the company assumes no obligation to update these statements. Investors are cautioned not to place undue reliance on these forward-looking statements.

I'll now turn the call over to Erik.

Erik David Gershwind
President, CEO & Director

Thank you, John. Good morning, everybody, and thank you for joining us today during these unprecedented times. Let me begin by expressing my best wishes to you and to your families to stay safe and healthy. COVID-19 is no doubt, top of mind for all of us right now. So before we get into the quarter, let me start by sharing with you an overview of how we're dealing with this issue.

We've launched a company-wide business continuity effort to help us navigate the business through this period of uncertainty. As you can imagine, this is getting our leadership team's full attention right now and we are in constant communication with our stakeholders, our associates, our customers, our suppliers, as we contingency plan for what is likely to be an extended disruption to the economy. Our #1 priority is the health and safety of our associates and their families, our customers and our other partners. So those associates who can do so are working from home, particularly in our corporate functions. As we are an essential business, we are continuing to operate our customer fulfillment centers or distribution centers. So those associates continue to be on-premises, serving our customers. This is particularly important because with timely shipping and some creative sourcing, we are helping to keep the nation's front lines running while we all battle this outbreak. We've instituted enhanced safety procedures to safeguard the health and safety of our team, including the use of additional protective equipment and frequent cleanings of our facilities. Given that we're providing essential services to many organizations on the front lines of the response to COVID-19, we do not have any plans at this time to shut down our customer fulfillment centers. However, we will, of course, follow the guidance of health officials, and we're in close contact with them across our operating footprint.

We have eliminated essentially all travel in order to ensure health and safety. We are also reducing spending more broadly across the company, only moving ahead on operating and capital spending that is deemed critical. We have ceased all hiring, cut expenses on items like outside resources, including consulting and more. Looking ahead, we have well-developed contingency plans to reduce costs further if the situation deteriorates from here as it very well may. I am proud of how our associates have stepped up during this time of unprecedented uncertainty.

Our warehouse associates continue getting product out the door every day. Our sales and service teams remain the face of the company on the front lines with our customers. Our category management team is coming up with miracles to find scarce safety and janitorial products that are keeping our customers going. And our IT team has moved in work speed to enable nearly the entire company with remote access. We'll share some more detail on our actions later in the call, but I'll now turn to our fiscal second quarter that we closed at the end of February.

During the quarter, we continue to progress on our journey to reposition MSC as a mission-critical partner on the plant floor of manufacturing and industrial customers. We remain focused on the 3 initiatives that we've discussed over the last couple of calls, to restore operating margin stability and, ultimately, expansion. And those are: Refining the sales effectiveness plan, improving the profitability of our supplier programs and improving productivity by reducing operating expenses. First, we continued refining the sales force and preparing to accelerate growth. Sales headcount was roughly flat during our fiscal second quarter. Importantly, though, we increased headcount in the growth areas, such as business development or the hunter roles that we've talked about into CCSG and a couple of other investment priorities. Our new business wins continued at a strong pace and remained on plan. While encouraging, we realize that the ultimate measure will be our growth gap above market.

Our second initiative is improving the profitability of our supplier programs. Recall that we have negotiated roughly $20 million in annualized profit improvements, split about equally between the back half of our fiscal '20 and our fiscal 2021. The overall program remains on track. We do expect, however, that COVID-19 and the resulting economic ripple could mute some of the benefit in the near-term as purchase levels and hence rebate payouts come down. The third fiscal 2020 initiative is realigning our operating model to reduce expenses and improve productivity. You'll recall that some of this began at the end of our fiscal 2019 with offering voluntary early retirement to some associates and ratcheting our performance management intensity for others. We also selectively eliminated positions where our focus was changing. All of that continued into our fiscal second quarter, and we began selectively hiring in certain customer-facing roles, as I mentioned.

We also continued our assessment of additional opportunities to align our operating model to the new strategy. That exercise confirmed our hypothesis that we see the path to a couple of hundred basis points and improved productivity, as measured by the OpEx to sales ratio. Many of the identified initiatives require travel and team meetings. So as you could imagine, they're on pause until things settle down. However, there are other initiatives such as some contract improvements and indirect procurement savings that are moving forward as we speak. Our transformation effort is being led by Kari Heerdt.

I'll now turn to our fiscal second quarter financial results before providing an update on the environment and then turning it over to John to review the details of the quarter. Greg Clark, our interim CFO, is under the weather right now and out of an abundance of caution, staying home. I would note that he and his team have been doing a great job in finance as expected. We'll then wrap up and open things up for questions.

Our fiscal second quarter results reflected solid execution in an uncertain environment. Both sales and gross margins came within our guidance ranges, with sales falling below the midpoint while gross margin was above it. Operating expenses were also better than the guidance midpoint. And this was despite an extra roughly $1 million of consulting fees related to the acceleration of the review of our operating model that I mentioned earlier. All told, both our operating margin and earnings per share came in at the midpoint of our guidance range.

Turning to the environment. Industrial demand trends overall for the quarter remained relatively soft. We did start to see a couple of encouraging data points with January and February MBI readings improving to

50.2. But this was, of course, quickly erased by what unfolded with the COVID-19 outbreak, and you no doubt saw the March reading of 41.0, which did not surprise us. In terms of end markets, the weakness in industrial demand broadened further with pockets of softness in areas like automotive, heavy truck, oil and gas and agriculture. Aerospace has also weakened due to the Boeing developments and the building concerns around COVID-19.

With regard to the pricing environment, we continue to see list price movements from our suppliers, and we took a midyear price increase at the beginning of our fiscal third quarter or the beginning of March. Realization has been quite good. In fact, as good as anything we've seen over the past several years.

Turning to our performance by customer type. National accounts declined in the low single digits, while core customers declined in the mid-single digits, as this is the portion of our business most heavily levered to metalworking, so no surprise. Government sales growth levels deteriorated to down low teens, which weighed down the overall growth. CCSG remained a bright spot, growing in the low single digits. To be honest, though, all of that feels like ancient history.

I'll now turn to March, our fiscal March, because it is more reflective of what we're seeing since the acceleration of COVID-19. While our fiscal March's sales estimate came in at negative 5.8% overall, there are a few important trends to note under the surface. First, there's a big discrepancy between the first 3 weeks and the last 2. Through 3 weeks, our revenues were up low single digits over prior year. We then saw a big drop-off in the last 2 weeks as customer shutdowns spread rapidly across the nation. This began with the big 3 auto shutdowns and accelerated from there. And I'll just remind you that our last week of March actually runs in given the fiscal calendar runs into April, so included the first 3 days of April.

The second point I'd note is that we saw a big discrepancy in product line performance. Large orders and sales of safety and janitorial products, not surprisingly surged over prior year, particularly with our government customers. At the same time, other product lines saw a substantial drop-through the month with double-digit sales declines in the last 2 weeks. Once again, neither is surprising given the shutdowns and worldwide efforts to control COVID-19.

Third thing I'll note, we saw an unusually big gap between our bookings or orders and what we invoiced. Normally, on these calls, we only discuss revenues, but these are not normal times. Our bookings or orders for March were up high single digits over the prior year. In fact, our bookings were up over prior year even during the last 2 weeks of our fiscal March. This gap in bookings versus revenues actually began in February, where we also saw bookings growth over prior year. The unusually large gap in bookings to revenues is a function of the surge in large safety and janitorial orders, scarcity of some of that product, longer supplier lead times and a larger-than-normal backlog in our own warehouses. We anticipate the majority of these bookings to invoice during the months of April, May and June, which would offer us a growth tailwind to buffer any additional softness that may be yet to come.

I'll now turn things over to John, and I'll then come back with some concluding remarks.

John G. Chironna
VP of Investor Relations & Treasurer

Thank you, Erik. So let me get right into the Q2 numbers. Our total average daily sales were $12.9 million, a decrease of 2.9% on an ADS basis versus the same quarter last year. MSC Mexico contributed approximately 90 basis points of acquisitive growth in the quarter. The decrease in overall ADS was 40 basis points below the negative 2.5% midpoint of our guidance range. Our Q2 reported gross margin was 42.1%, 10 basis points above the midpoint of our guidance range, reflecting higher vendor rebates. Versus prior year, gross margin was down roughly 60 basis points, with Mexico accounting for roughly half of the decline. As expected, the year-over-year gross margin decline continued shrinking as purchase cost escalation continued to wane. March showed nice gross margin performance due to the benefit of strong price realization.

Total operating expenses in Q2 were $253 million, slightly lower-than-expected as a percentage of sales. I'll point out that OpEx included about $2 million of productivity investments related to the review of our operating model that Erik mentioned earlier. $1 million of this expense was in our Q2 guidance, while the other $1 million was due to the acceleration of that work. As Erik mentioned, we are slowing our spend on this type of work right now, but we expect to resume it once COVID-19 is behind us. Therefore, should these expenses become more material going forward, we will break them out of our reported earnings to provide you additional visibility.

Moving on, our operating margin was 9.9% versus guidance of 9.7%. Our tax rate for the first quarter was 25.1%, in line with guidance and the prior year. All of this resulted in earnings per share of $1. Normally, we would take you through the balance sheet at this point in the discussion. However, today, I'd like to focus on where we are as of now and the actions that we are taking to ensure business resilience and continuity during this time of uncertainty. The Q2 balance sheet numbers are in our press release and the 10-Q filing, and we are, of course, happy to answer any questions that you may have about where we stood at the end of Q2.

With the downturn in sales that we saw in the last 2 weeks of March, we are managing our liquidity very closely, and we drew down $300 million from our revolving credit facility to ensure greater liquidity. On the receivables side of the business, we have been managing the credit approval process closely. Most new customers are being pushed toward credit card payments, and we are carefully allocating inventory to existing customers. We have implemented noncancellation policies on most large orders and collections have remained relatively strong. Most of -- many of the large orders are coming from long-standing government customers. When it comes to inventory, we are watching our levels closely, but you have heard us say before that in difficult times, we will use our inventory levels as a competitive differentiator. And remember, booking levels have remained strong through March. Should the environment weaken further, we can and will adjust quickly. In fact, we have already made several adjustments to take down buying levels. And assuming volumes remain suppressed, we'll continue doing so in order to bring inventory levels down.

On the payables side, we continue paying on a timely basis, particularly those suppliers that give us good terms and a preferential position. Those suppliers offering timely delivery and deep discounts will be pushed to the front of the line.

Turning to our ordinary dividend. We have ample liquidity to continue running the business and paying the current level of our dividend in all but the most severe scenarios. We have conducted numerous best and worst-case sensitivity analysis, and revenues would have to decline somewhere in the range of 40% to 50% before our operating cash flow turn negative. At these levels, we would take additional cost down actions and could sustain multiple quarters given our liquidity position.

I'll now turn it back over to Erik.

Erik David Gershwind
President, CEO & Director

Thanks, John. Given the unprecedented uncertainty that we're all facing right now, including the lack of visibility that we have going forward and just how fast things are changing, we do not think that quarterly guidance would provide much value. However, we understand the need for transparency right now for all of our stakeholders, including our investors and analysts. So until we get through this period of heightened uncertainty, we'll be providing monthly updates on average daily sales developments as quickly as possible following our month end close as well as comments on the business trends that we've seen over the course of the month.

I'll offer some closing thoughts. Our focus right now is on navigating the impact of COVID-19. I'm confident that we're doing the right things to protect the health and safety of our associates, to continue serving our customers in this critical time and to play our part in keeping the manufacturing economy running. I thank our entire team for this and I extend this appreciation to our customers and our supply chain partners, who've all come together to address the challenges that all of us face. While the impact of COVID-19 on the industrial economy will likely get worse before it gets better, things will ultimately get better. MSC has been through difficult times before. And we will lean on our time-tested playbook, anchoring ourselves in our mission statement and our values. We will continue supporting our customers and our suppliers through these tough times, while advancing our strategy to become mission-critical on the plant floor.

Finally, our strong balance sheet, our culture and resolve mean that MSC will not only survive, but we will ultimately emerge from this as a stronger company. We'll now open up the line for questions.

Question and Answer

Operator

[Operator Instructions] The first question today comes from Ryan Merkel of William Blair.

Ryan James Merkel
William Blair & Company L.L.C., Research Division

So first off, I want to get a better sense of the sales trend line through March and into early April. You said the first 3 weeks of March were up low single digits, but I'm wondering what happened in the last 2 weeks? And is the trend line getting a whole lot worse? And really, I'm just reaching for any kind of read on how bad April could be.

Erik David Gershwind
President, CEO & Director

Yes. Ryan, sure. So as we mentioned, yes, March first 3 weeks, and what I'll do is split the discussion out into invoicing and then the booked orders, which, as I mentioned, usually, we don't talk about on this call, but these are certainly unusual times. Invoicing first 3 weeks average low single digits. You can do the math, but the last 2 weeks dropped into the double digits. I wouldn't say it was progressively falling through those last 2 weeks. And the other thing I'd note, Ryan, is, for us, April, that last week in March for us included 3 days of April. So you're getting a taste for April. And I wouldn't call out any discernible difference between week 4 and week 5 in March. We are now in the first week of our fiscal April. So we literally have 2 days under our belt. And for the 2 days for what it's worth, I wouldn't call out anything different from the prior 2 weeks of note. That's the invoicing side.

On the bookings side, as we mentioned, Ryan, what's interesting, and I call it out because being in this business forever, it's the thing that I usually look at as my leading indicator for how we're doing. Bookings were -- we said for the month, up high single digit, certainly stronger the first 3 weeks. But even those last 2 weeks of the fiscal month, year-on-year, we're up. Which, obviously, what that would mean as long as those orders come through, and we believe most will, the invoicing will catch up and will provide a buffer. So that would be the color I'd give you through the month.

Ryan James Merkel
William Blair & Company L.L.C., Research Division

Okay. So yes, the bottom line is it's not -- sales aren't falling off dramatically here in the last, call it, 7 to 10 days. I think is what I kind of feel...

Erik David Gershwind
President, CEO & Director

I mean, certainly, relative to the first 3 weeks, a big step down, but I wouldn't say -- between the 2 weeks of week 4 and week 5 of March, which again crept into April, I wouldn't see it as trend line straight down, correct.

Ryan James Merkel
William Blair & Company L.L.C., Research Division

Okay. And then a follow-up there, I probably could do the math, but can you quantify the sales that are on back order as of March? And I assume this has continued into April as well. I mean, how big could the backorder get?

Erik David Gershwind
President, CEO & Director

Hard to give you a number, but I mean just -- you could -- as you said, Ryan, just think about the difference between high single-digit on the order side and then a minus 5.8 on the invoicing side. That's quite a bit of dollars.

Ryan James Merkel
William Blair & Company L.L.C., Research Division

Yes. Okay. And then just lastly...

Erik David Gershwind
President, CEO & Director

And a lot of that -- as I said, a lot of that we expect to build out over the coming 3 months.

Ryan James Merkel
William Blair & Company L.L.C., Research Division

Right. Right, right, right. Okay. And then just lastly, and I'll turn it over, a question on decremental margins. This quarter, decremental margins were about 50%, and sales were down 4%. I'm not sure if this is representative, but any help you could provide on decremental margins for the next 2 quarters, assuming sales are down 10%, maybe 20%?

John G. Chironna
VP of Investor Relations & Treasurer

I'll take that, Ryan. This is John. I think you followed us a long time, right, of course. So we've talked about incremental margins in -- over history being in the 20% to 30% range. Based on the modeling we're doing, I'd say that our decremental margins would be in a similar range on the downside, obviously, let's call it, low 20s to low 30s. And as you can imagine, there's a lot of moving parts there, right? So things like gross margin performance, mix, the size and timing of cost actions and quite a few number of other factors. But I think low 20s to low 30s would put you in the right range.

Operator

Your next question today comes from John Inch of Gordon Haskett.

John George Inch
Gordon Haskett Research Advisors

And hopefully, Greg just has a cold.

Erik David Gershwind
President, CEO & Director

He is doing okay. Just...

John George Inch
Gordon Haskett Research Advisors

I understand, better to be safe than sorry. Can we maybe put a finer point around the magnitude of personal protective equipment, janitorial? What normally do these categories represent, Erik, in terms of the mix? And what are you actually seeing today? And I'm just trying to dovetail that with the fact that government, despite the surge in orders is still only 7% of the total revenues in the fiscal second quarter, kind of flat sequentially. Is there a way you could sort of size these buckets for us proportionally versus kind of what it normally is?

Erik David Gershwind
President, CEO & Director

Yes. Look, John, you're honing right in on a couple of the big changes that we saw. It's almost -- it was funny because I looked back at the numbers and noticed the same thing that if you look at Q2, you don't see much of a difference at all in government. You're right at 7%. [Q2] which ended in February, almost feels like a different world. We are -- if we look ahead, based on the order activity and early invoicing activity for government, we would certainly expect that number to jump up considerably. John, part of the challenge here is the timing of when these orders actually hit. It's tough for me to give you a number, but suffice it to say, I'd be surprised if government as a percentage of sales did not take a meaningful jump in our Q3.

Your other question was a product one and related to, let's say, PPE, the 2 product lines, safety and janitorial. What I would say there is quietly over the years, we've built up a really strong safety business. Metalworking far and away, the biggest category, we've sort of colored that for you. The second biggest being the Class C parts, and we've kind of colored that for you. Behind those two, this would be the next biggest category. It's been growing for years. It has also floated, as you could imagine. So if we look at the sort of the order activity in the past month, 6 weeks versus the prior run rate, multiples bigger than it was. So again, I'd be surprised if moving forward, we didn't see a big jump up as a percentage of revenues.

John George Inch
Gordon Haskett Research Advisors

Right. So it sounds like you're saying those 2 categories combined maybe historically were in the teens. And then if you -- we're probably going to see a big surge on top of that. I think that makes sense.

Erik David Gershwind
President, CEO & Director

It wouldn't be box cars. John, one interesting note, by the way, that I'll call out is, look, it's not surprising that there's demand for products, safety products and janitorial products in this environment. I think the real trick and the secret sauce, and I think where we're having some success is finding sources of supply. Because supply is so limited. And I gave a shout out to our category team, but I do think we've developed a lot of relationships over the years, have a lot of good sourcing capabilities, and it's given us access to tap into sources that maybe others can't. And hopefully, that will give us an opportunity to take advantage and help a lot of people out.

John George Inch
Gordon Haskett Research Advisors

Yes. Maybe you can pass along those skills to the federal government. Wondering about -- so I'm just going to give a specific example. Honeywell issued a letter to its suppliers. This is in its performance materials business, basically imposing a 30% price cut on procured products across the board. Are you seeing -- it's obviously an extreme case. I understand maintenance repair operating supplies are going to be different than their components and other feedstocks that go into that product line. But are you seeing pressure similarly from, say, your national account customers to renegotiate various contracts or whatever, because you had talked about -- it's interesting, you talked about price realization has been pretty good, right, and the acceptance of the price increase seemed to be pretty good. I'm just wondering, though, on the look forward, as a lot of companies get stressed and national accounts are obviously very important for you. What kind of early reads are you getting from your customer base? And how do you think kind of MSC is going to fare through all of this?

Erik David Gershwind
President, CEO & Director

Yes, really good question again. Here's what I'd say, John. So first off, let me just comment briefly on our price realization. I flagged it because it has been better than expected. And that was because -- we actually implemented -- it wasn't a total surprise. I mean, we made a few, I would call it, improvements to our execution on the pricing front between our pricing team and our sales team, and those are paying off. I think those should sustain based on the results I'm seeing and how they're tracking back to actions we took. So I like what I'm seeing there. In terms of the environment, it's an interesting dynamic, John. Because on the one hand, certainly, you're going to have companies who are feeling a lot of financial pressure and are going to look to take cost out. That will be there. No question. The flip side is, this is a bit different, kind of a typical recession in many ways. But one way is scarcity of product and access to key products. So there's certain areas where customers just want to be able to get product in the door to keep their people safe and keep their operations going. So it's a bit different from your typical recession. So those would be kind of competing factors. Net-net, so far, no reason -- I'm not seeing anything that would lead me to believe pricing realization should decline from here.

John George Inch
Gordon Haskett Research Advisors

Got it. Just maybe one last one. In the cash flow, inventory was a large sequential drag, and I guess, payables were a large sequential source. What are you seeing with respect to your working capital? Are customers -- are they slower to pay, in turn, are you sort of -- you mentioned you're actually paying on time. I mean, how are you guys thinking about managing working capital? And what are your expectations in terms of how the resources are used in the coming, in the coming quarters, particularly if sales, obviously, this is going to be the toughest quarter. We hope it's only the toughest quarter for top line, right, in the June quarter -- I mean, second calendar quarter.

John G. Chironna
VP of Investor Relations & Treasurer

Yes. Let me take that, John. As you can imagine, we're watching our working capital and our cash flows extremely closely on every single day. I get reports first thing in the morning. We -- our receivables so far have been remarkably, relatively strong, I would say, as -- in our payables. We've kept up because the world at least, if you look at the numbers, the world is not falling apart yet. But that's why we're watching it very, very closely, right? From an inventory standpoint, as you know, we typically, as a distributor, generate a lot of cash in a downturn because of inventories. You wouldn't have seen that coming into the Q2 because our fiscal Q2, of course, straddled year-end, which is when we typically take advantage of opportunity buys, right? And then that, plus the fact that our bookings were very positive towards the end of February and through March, and combine that as well with our commitment to have product available to our customers, it means we want to keep inventory on the shelf and keep using that as a big differentiator. Lastly, I'll add that safety and janitorial supply is very limited, so we're going to buy all we can of those kind of products. But at the end of the day, if the environment weakens further, we can and we will adjust inventories quickly and draw them down and generate a lot more cash.

Operator

Our next question today comes from Hamzah Mazari of Jefferies.

Hamzah Mazari
Jefferies LLC, Research Division

My first question, and you touched on this, Erik, a little bit in your prepared remarks, but I know it's early, but do you see any permanent changes coming out of this COVID-19 led recession in your business. Just high level operationally, strategy wise, culturally, do you see this as changing your business positively or negatively? Any high level thoughts?

Erik David Gershwind
President, CEO & Director

Hamzah, I mean, another great question. I got to tell you, it's still -- it's something that's beginning to cross my mind, but I would say still -- we are so early in this, Hamzah. And so much is yet to be determined about how long we're in this sort of new normal, what the new normal means and how long before we're back. What I would tell you is it's a bit early to say. The one thing that I would flag is just -- it's been amazing to me to see our culture. So this is sort of more of a right brain thing than a left brain thing, right? But to see our culture in action and to see people rally around the company, rally to support each other, rally to support customers and suppliers, it's been invigorating. And there's been a real sort of surge and renaissance in the culture, if you will, watching our whole team in action and seeing us kind of adhere to the values that we've always adhered to, seeing how we take a long-term perspective. So the one thing I'd call out is a positive from that standpoint that in the face of adversity, I like what I'm seeing from how we're responding. Beyond that, I think a little too early to say.

John G. Chironna
VP of Investor Relations & Treasurer

Erik, and Hamzah, I would add that our model of distributing goods and products directly to the customer really works well in this environment. We -- if they want us there, we can be there with our full-service and solutions. But if they don't, we can ship our goods right to their docks and they can keep operating without us having to come into the premises.

Hamzah Mazari
Jefferies LLC, Research Division

Got it. And just a follow-up. How do you balance sort of liquidity and potentially distressed assets out there where maybe you can do M&A? I know you are excited. Last quarter, the bar on M&A is higher. You're sort of going through a restructuring still but now sort of the world has changed a little bit. Is the M&A sort of bar still pretty high? Or does that change because you may have a lot of distressed companies out there that may fit your book of business?

Erik David Gershwind
President, CEO & Director

So Hamzah, what I would say is, for now, the bar on M&A is still very high, especially in this environment. Look, we feel really good about our liquidity position. And John sort of ran through a framework with you to give you a sense as to why. And then you think about how this business normally performs in a downturn with working capital as we were touching on with John earlier. So we feel good about our liquidity position. There's going to be opportunities that emerge here for sure, and there is going to be opportunities to invest. And whether that's in people or systems or companies, just not yet. And certainly, as it relates to M&A, given where we're at, the answer is for now, certainly, the bar remains high.

Operator

Our next question today comes from Sam Darkatsh of Raymond James.

Samuel John Darkatsh
Raymond James & Associates, Inc., Research Division

Erik, John, I hope both of you and your families are well. Two questions, if I might. One of them is a piggyback on a prior question around your receivables collection. One of the things -- I mean, we're all looking at '08, '09, at least for a guidepost in terms of what might happen. One of the things I found interesting was that your allowance for doubtful accounts never really spiked in '08, '09. It got to about 4% of gross receivables, which is really not all that dissimilar from where you're at now. Erik, help us or remind us as to why allowances don't spike or at least historically don't spike in recessions. Is it something to do with your customer list? Is it something how you tactically go to COD? And how might you look at receivables collectability in a worst-case scenario if this thing does drag on?

Erik David Gershwind
President, CEO & Director

Yes, sure. I mean, I'm happy to give you some historic perspective, and John can weigh in on how we're managing it now. But look, I think Sam, we manage it tightly all the time. We're managing it more tightly now. And what that means is having very proactive, good relationships with customers, long-standing relationships with customers. And so there's dialogue going on all the time. And that, combined with making some sort of common sense moves, as John referenced. So if there's going to be a new customer coming in that we're not familiar with, move that to credit card payment. When it comes to large orders, we're making sure that it's with good, long-standing customers with good payment track records. In some cases, noncancellation policies. So doing some common sense things and then I think leveraging a lot of years of good relationships.

John, I don't know if you have anything to add?

John G. Chironna

VP of Investor Relations & Treasurer

The other thing I would point out, I guess, Sam, is the '08, '09 crisis was pretty sharp and pretty quick. Right now, with COVID, we really don't know. It's building a little momentum, but so far, it's not as bad as it could get. Now we drew down $300 million on our revolver, as I said, to preserve liquidity so that we have that cash. We haven't had to use it really yet. So it was the right thing to do. we feel for our company, but we are -- we'll continue watching receivables very, very closely.

Samuel John Darkatsh
Raymond James & Associates, Inc., Research Division

My last question, and this might be granular, but you've got a very technically proficient sales force that retention is going to be quite critical. I'm guessing you're considering this a fixed cost or at least largely a fixed cost. How are you specifically addressing variable comp with salespeople over the next few months to maintain retention levels?

Erik David Gershwind
President, CEO & Director

Yes, that's a really good question. And look, you're right. I mean, this is a fundamentally -- that's our front lines, our salespeople. You can imagine, Sam, a sensitive one from a competitive standpoint. But suffice it to say, that we are taking environmental factors into account as we look at variable comp and making sure that inside the company, we have a mantra about doing the right thing. And when it comes to our salespeople, we're doing the right thing. I'll kind of leave it at that. But just to say, we are proactively addressing the issue.

Operator

The next question today comes from Adam Uhlman of Cleveland Research.

Adam William Uhlman
Cleveland Research Company

I wanted to -- I had a couple of gross margin questions for you. When we think about safety products and government business, I guess I would have thought that, that would be softer gross margin-type product for the company, maybe not in total. But John, you had mentioned that March gross margin performance was pretty good with the price increase. I'm wondering if you could just mention for us the margin profile of that business as some of those orders start to come through.

Erik David Gershwind
President, CEO & Director

Adam, yes. So what I would say on gross margin is you sort of have different -- there's always -- gross margin is always kind of like a series with some tailwinds and headwinds. What we called out was a tailwind was the price increase we took and the strong realization. So as we look forward, certainly, that's a tailwind. As it relates to -- and it's one of the reasons, by the way, what you're hitting on is one of the reasons why trying to give guidance now would be so fruitless and difficult because one of the other factors that influences gross margin is price, its cost and its mix. And John described how on 2 of the 3 factors, cost is starting to move in the right direction. He talked about it in the prepared remarks. Pricing is moving in the right direction we talked about. Mix is a real wildcard right now. And it just is so hard because to predict, because of the timing and the size of some of these orders. Our approach to pricing a lot of this business has been to do it just as we've always done it, consistent with how we priced it 2 months ago before there was a crisis. So yes, in some cases, some of those orders are going to come in below company average. In some cases, they'll come in at or above. Very difficult, but you are right, what it could make for us is a little choppiness as it relates to mix.

John G. Chironna
VP of Investor Relations & Treasurer

Yes. I would just add in, Adam, I think we've -- over the years, we've at least alluded, if not said directly that government sales are typically lower than the company average gross margin, just like national account sales are as well. So yes, that would be a headwind. I don't know. We haven't -- we certainly haven't broken out various product gross margins. So I won't go there on the janitor and safety stuff.

Adam William Uhlman
Cleveland Research Company

Okay. And then could you dimension the magnitude of the price increase? Remind us what that was?

John G. Chironna
VP of Investor Relations & Treasurer

It was in the neighborhood of 1% to 2%, I'd say. It was definitely smaller than last year's midyear increase.

Adam William Uhlman
Cleveland Research Company

Okay. Got you. And then the supplier programs, Erik, that you had mentioned at the beginning of the call that some of them are potentially at risk with volume-related rebates. I'm just wondering how much of this do we think could stay -- I think I heard you say the majority of it that might have misheard. Any directional sense? And then just for the accounting of that, is that accrued for as we move through the rest of the year or we start accruing for that in the fourth quarter?

Erik David Gershwind
President, CEO & Director

Yes, Adam. And just to be clear on the supplier programs, the programs are all intact. And in fact, I think at a time like this, we need our suppliers and our suppliers need us, we need to lean on each other. Programs are all intact, no change. So the only change I flagged, Adam, is that if you look forward and if a decent portion of the benefits were in the form of guaranteed rebates, let's say, a guaranteed rebate gets paid back to dollar one of purchases. Obviously, if purchases come down, if there's an extended period of economic slowdown and purchases come down, the absolute dollar levels of the program will come down. That's what I was trying to get across. In terms of when you'd start to see that the way the accrual works for the rebate, John, I believe it will begin in our fiscal fourth quarter and move through the rest of the calendar year. And again, it's one of those things, Adam, where it's so hard to predict because it's supplier by supplier, and in some cases, to the extent that they're safety suppliers, you can imagine, purchases are going to be through the roof. If it's somewhere else, it's going to be lower. So it's really tricky to model out. But I flagged it because it likely could be a headwind if there's a protracted downturn.

Operator

The next question today comes from David Manthey of Baird.

David John Manthey
Robert W. Baird & Co. Incorporated, Research Division

First, Erik, you indicated that you increased headcount in the hunter role during the second quarter. And obviously, as a company, you're playing a lot of defense right now. But can you tell us how you'll keep the mission-critical partner strategy moving forward during the crisis and then even potentially several weak quarters thereafter? How do you keep the wheels in motion there?

Erik David Gershwind
President, CEO & Director

Yes, Dave, good question. So what -- yes, I did mention our hunter -- so the BD or the Hunter role was the part of the business where we were really throttling up and we've been seeing good success in capturing new customer relationships or expanding what was a small relationship into a big relationship. In some ways, it sounds crazy, but the whole mission-critical concept that I'm seeing this now in sort of the cultural surge inside the company that I've talked about, becomes more important than ever. Businesses -- many of our customers are considered essential businesses. And they need to keep their operations running in some way, shape or form. So the way we deliver on this promise is -- the idea of being mission-critical means, we're there with you. We're there with you on the plant floor. We're there with you to solve your toughest problems. We've had to adapt a little bit because in some cases, maybe we're not actually inside the customer shop, and we're doing this virtually by phone. But I think it's giving us a chance to bring the value prop and this new strategy alive in a new and exciting way. I mean, we're helping keeping operations going.

David John Manthey
Robert W. Baird & Co. Incorporated, Research Division

Okay. And then in past downturns, MSC has invested aggressively into the decline in some cases. Is it just too early to make that call Erik? Do you wait till we go past the coronavirus and then see what the economy looks like thereafter before you make that call?

Erik David Gershwind
President, CEO & Director

Dave, I think it's a little bit early. I do think that there's going to be some good opportunities that emerge, and we would take a consistent approach in terms of looking and being on our toes and capitalizing on those opportunities, I think, just not yet.

Operator

The next question today comes from Michael McGinn of Wells Fargo.

Michael Lawrence McGinn
Wells Fargo Securities, LLC, Research Division

If I could start off with the SG&A initiatives, the direct savings, the T&E, consulting, discretionary spend and Capex, can you put a -- are you able to put a dollar figure to that, what the first tranche? And then maybe if things get progressively a bit worse, what would a second tranche look like?

Erik David Gershwind
President, CEO & Director

Sure. Sure. So yes, you've hit on. I mean, we've taken pretty much the basic moves out early, I think. We have taken out -- call it stuff, you're looking for a range somewhere in the neighborhood of $500,000 a week run rate wise that we have taken out through the actions that we talked about earlier. Certainly, we're ready if we need to, to take out more cost. There would be significantly more cost out to come. The way we would do that, at some point, depending upon how bad things get, some of the actions begin to involve people, which is we're going to be really careful about. The thing I would say there is we're going to lean on our mission statement, our values, our track record and do things in a way back to the mantra of doing the right thing. That's how we would go about doing it. And I'm going to lean on the playbook that my predecessor, David Sandler years ago, navigated us brilliantly through '08, '09, and it was all about our team sharing in pain collectively and leading from the top, and we would take very much the same approach if we need to go deeper.

Michael Lawrence McGinn
Wells Fargo Securities, LLC, Research Division

Got it. Appreciate the color. And if I could just switch gears to more of a long-term question. If this ends up being -- having some effect down the line towards social distancing. How are you looking to the future for your spec sales? You guys have always done these in-shop studies. You should be using X product instead of Y, you get better turns, you'll get better efficiency and you lower your cost with this product. From a spec sales standpoint, are you able to do that virtual online sharing of CAD documents or whatever it may be? How do you look at that long term?

Erik David Gershwind

President, CEO & Director

That's a great question. So 2 things I'd say. One is that, John mentioned it earlier. If this sort of became the new normal or the new normal for a long period of time, are -- let's start with our logistics model, I think, really lends itself well to this world because it is a centralized model shipping into remote locations, relatively low touch. So I think that works out really well. In terms of the engineered side of the value proposition, the mission-critical part, look, what I would say is we're going to use technology. And we've actually been using technology for quite a while. So we have, in certain locations, a lot of our tech team, believe it or not, actually sits in centralized call center environments and provides just as deep technical expertise and advice and does it over the phone or with FaceTime and with technology. I think what would happen is we would take that model and we would expand upon that for bigger customers. So certainly, it would be different, but not something we're unaccustomed to.

Michael Lawrence McGinn
Wells Fargo Securities, LLC, Research Division

Okay. If I could sneak 1 more in on the discrepancy versus invoices versus orders. Is there a way to disaggregate what has come in from an order standpoint that isn't from that large government customer that may be that smaller shop of 20 employees that is potentially more at risk at shutting down? What has the order flow been for those high demand products thus far?

Erik David Gershwind
President, CEO & Director

Yes. So we do, Mike, we looked at it 10 ways till Sunday by -- for the invoicing and for the orders coming in. What I would say is, look, there's some of everything coming in, but the majority, the concentration of the large orders would be from a product standpoint, safety and janitory related. And then from a customer segment, there are certainly some coming from smaller shops, but the majority would be between government customers and our larger national accounts would be where the bulk of them are coming from.

Operator

The next question today comes from Patrick Baumann of JP Morgan.

Patrick Michael Baumann
JP Morgan Chase & Co, Research Division

Maybe just kind of circling back on some of the earlier discussion. If you could help us understand the -- on decremental margins, the kind of the key variables in that low 20s to low 30s framework? Is it a certain range of sales declines? Is it -- maybe how do you expect gross margins to behave in that kind of a framework? You just went through, I think, operating expenses a little bit. Just kind of curious how to think high level about that framework and what are the variables?

John G. Chironna
VP of Investor Relations & Treasurer

So Pat, we looked at numerous scenarios from 10% to 20% down and further beyond that, obviously, areas where we're nowhere near today. But we -- I think that, that general range of low 20s to low 30s worked pretty much all the way down and even towards the worst scenarios we could -- we modeled, at least, let's say. So I wouldn't get into the details of gross margins and all that. But that's the best we can do, I think, with the modeling that we did so far, unless Erik, do you have anything to add?

Erik David Gershwind
President, CEO & Director

Yes. Maybe just 2 comments, John. So I think that range of low 20s to low 30s. The reason for the broad range is actually one of the biggest factors, Pat, you're hitting on is gross margin. It's hard to predict how it performs. So you can imagine the better gross margin does, the closer we get to the low 20s and the worst to the low 30s. The only other thing I'd call out, and I think Ryan in the initial question asked this, the decrementals actually looked worse over the last year than the range we gave. Obviously, what that range is reflective of is considerable actions being taken by the company. So what you're seeing at the various levels to be able to keep to the low 20s to low 30s is there's significant cost actions being taken beyond what we've done over the past year. And then the gross margin would be the driver behind the size of the range.

Patrick Michael Baumann
JP Morgan Chase & Co, Research Division

Okay. Got it. That's helpful. And I guess, maybe going back to -- I don't know if it was Ryan's question earlier, somebody was asking about March sales, but -- so February was down 4% to 5%, but you saw March improved to low single digits in the first 3 weeks. Just what drove that improvement? Was that all the safety and janitorial stuff? Is that what drove kind of that step-up versus February?

Erik David Gershwind
President, CEO & Director

Actually, the improvement in the step-up was -- because a lot of the safety and janitorial stuff ended up being back ordered or direct ship, and it's why there's this building gap between bookings and invoices. And we actually saw broad-based relative strength. I mean, if you call low single-digit strength. Relative strength from where it was more broad-based. Trying to parse out why, one theory is just in times of uncertainty, customers wanted to, whether it's safety product or not buy up a little bit. We also -- so I would say that's probably the biggest factor, but it was more broad-based.

Patrick Michael Baumann
JP Morgan Chase & Co, Research Division

Okay. And then just last one, back to that question earlier as well. If I run that quick back of the envelope on low single-digit growth in the first 3 weeks and what that implies for the last 2 weeks, I get to something like, I don't know, mid-teens or so declines. Is that in the ballpark of what you saw kind of at the end of the month?

Erik David Gershwind
President, CEO & Director

Somewhere in the ballpark. And the only other color there would be not much of a difference between week 4 and week 5.

Operator

And our last question today comes from Steve Barger of KeyBanc Capital Markets.

Robert Stephen Barger
KeyBanc Capital Markets Inc., Research Division

Just going back to some of the conversations around delivering the value proposition. I wanted to ask how customer attitude towards vending and VMI are changing. Is there more interest given better control and tracking? Or do they want more delivery to dock to limit access to facilities?

Erik David Gershwind
President, CEO & Director

Interesting question, Steve. What I would say is two things. One, it's a little early to say. This is so brand new. Two, we've had competing dynamics. So on the one hand, right now, a good portion of our customers have either shut down, and that's somewhere, by the way, based on our latest data, and the data keeps changing, around 20% or so, a little over 20% of our customers have shut down. And then another chunk of customers are operating but have restricted access to any visitors from the outside.
So when we think about how often we're actually going in and replenishing a vending or VMI installation right now, it's somewhere in the 40% to 50% range. So certainly -- and look, we think that's temporary. Temporary that's down. The flip side has been -- believe it or not, and this surprised us, the number of like

new VMI implementations, for instance, that we did a week or 2 ago, was one of the highest we've ever done, which really surprised us. So it's a little bit of a mixed bag right now. I think temporarily, though, what you're seeing is customers restricting access, which may -- if they're not shutting down, restricting access. So we're enabling them. We're giving them the technology and the tools to be able to replenish on their own if they need to temporarily.

Robert Stephen Barger
KeyBanc Capital Markets Inc., Research Division

Yes. And I'm sure that of that 20% that shuts down, a lot of those are metalworking customers in the automotive supply chain or something. Just any more commentary on how demand for those products progressed in the back half of March? And where do you think inventory levels are with your customers and in your own systems, given we are seeing some decelerating trends in metalworking already.

Erik David Gershwind
President, CEO & Director

So first part of your question, you are correct. In terms of closures everywhere, but acute in the Midwest related to auto, no question. You are correct there. In terms of customer inventory levels, look, they definitely -- they've been building, but it's really hard to say because -- especially when it comes to some of these large orders, it's almost like there's not enough to be had. So we're getting these huge quantities. And even when they're being fulfilled, customers are coming back and saying, we need more. It's really hard to judge. A lot -- just a murky time.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to John Chironna for any closing remarks.

John G. Chironna
VP of Investor Relations & Treasurer

Thank you, Melissa, and thank you, everyone, for joining us today. Our next earnings date is set for July 8, 2020. As Erik mentioned, we will be providing interim monthly updates. We will do this via press release within a week or so of our monthly close. So expect the update for April developments just after the first week in May. I want to thank you for joining us today. And more importantly, please stay healthy and safe. Take care.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.