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Apr 08, 2020

W.W. Grainger, Inc. (GWW)

$257.93 (As of 04/07/20)

Price Target (6-12 Months): **$273.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 04/24/19) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**4-Sell**
	Zacks Style Scores:	VGM:C
	Value: C | Growth: C | Momentum: C	

Summary

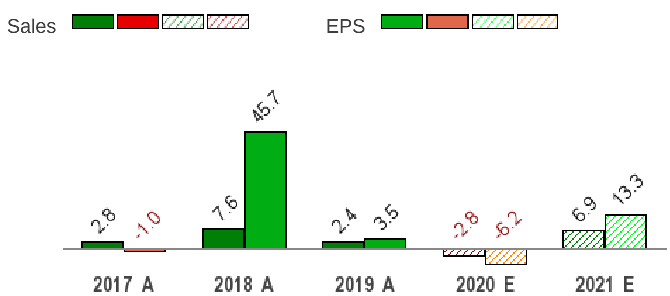
Grainger expects earnings per share of $17.75-$19.25 for 2020. The mid-point of the guided range indicates growth of 7% from that reported in 2019. Revenue growth is projected between 3.5% and 6.5%, driven by the ongoing momentum in U.S segment, and continued expansion of the endless assortment business. The company will benefit from efforts to strengthen relationships with customers in the United States. The Canada segment is expected to deliver growth aided by focus on reducing costs. However, input cost inflation and unfavorable foreign exchange remain headwinds. Grainger is likely to benefit from investments in e-commerce over the long haul. However, Grainger's operating expenses will likely be higher as the company invests in digital marketing capabilities. Its results will also bear the brunt of foreign exchange headwind.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	$346.60 - $200.61
20 Day Average Volume (sh)	489,880
Market Cap	$13.8 B
YTD Price Change	-23.8%
Beta	0.97
Dividend / Div Yld	$5.76 / 2.2%
Industry	Industrial Services
Zacks Industry Rank	Bottom 17% (210 out of 253)
Last EPS Surprise	-3.7%
Last Sales Surprise	0.1%
EPS F1 Est- 4 week change	-12.6%
Expected Report Date	04/23/2020
Earnings ESP	-0.8%
P/E TTM	14.9
P/E F1	15.9
PEG F1	1.4
P/S TTM	1.2

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	3,025 E	3,092 E	3,161 E	3,050 E	11,935 E
2020	2,881 E	2,659 E	2,788 E	2,877 E	11,168 E
2019	2,799 A	2,893 A	2,947 A	2,847 A	11,486 A

EPS Estimates

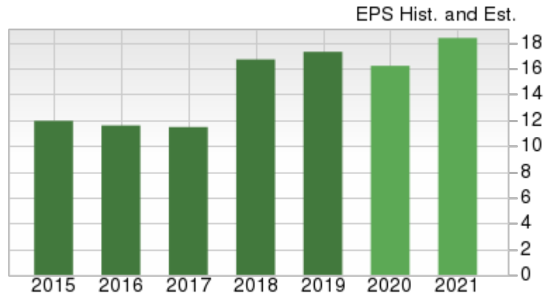
	Q1	Q2	Q3	Q4	Annual*
2021	$4.80 E	$4.59 E	$4.63 E	$4.15 E	$18.36 E
2020	$4.53 E	$3.56 E	$3.71 E	$3.81 E	$16.21 E
2019	$4.51 A	$4.64 A	$4.26 A	$3.88 A	$17.29 A

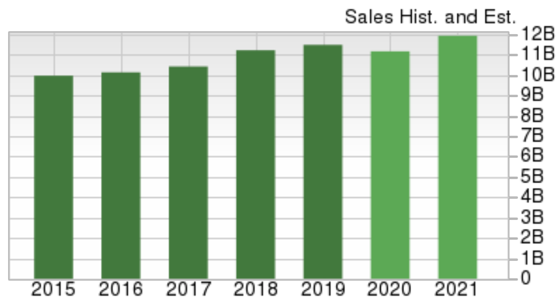
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/07/2020. The reports text is as of 04/08/2020.

Overview

Incorporated in 1928, IL-based W.W. Grainger Inc. is a broad line, business-to-business distributor of maintenance, repair and operating (MRO) products and services. Its operations are primarily in North America, Europe and Japan. The global MRO market is approximately $608 billion, and the Grainger's estimated market size is $284 billion. Its customers represent a wide array of industries including government, manufacturing, transportation, commercial and contractors.





Its products include material-handling equipment, safety and security supplies, lighting and electrical products, power and hand tools, pumps and plumbing supplies, cleaning and maintenance supplies, and metalworking tools.

The company reports revenues under two business segments — the **United States**, which contributes around 74% to revenues, and **Canada**, which generates around 5%. The **Other Businesses** accounts for nearly 21% of revenues.

The U.S. business offers a broad selection of MRO products and services through its e-commerce platform, catalogs, branches and sales and service representatives. A combination of product breadth, local availability, speed of delivery, detailed product information and competitively priced products and services is provided by this business. Customers range from small and mid-sized businesses to large corporations, government entities and other institutions within various industries.

Acklands – Grainger and its subsidiaries (the Canada business) provide a combination of product breadth, local availability, speed of delivery, detailed product information and competitively priced products and services. The Canada business serves customers through branches, DCs and sales and service representatives.

The businesses from the operating units in Japan, Mexico, India, Puerto Rico, China, Panama and Columbia and Fabory Group are all combined and included in Other Businesses.

Reasons To Buy:

> Grainger will gain from momentum in the United States, turnaround in the Canadian business and investments in digital capabilities. Focus on strengthening customer base will also drive growth.

▲ Grainger initiated guidance for full-year 2020. Operating margin is projected in the band of 11.7-12.5%. The company expects EPS of $17.75-$19.25. The mid-point of the guidance range indicates year-over-year growth of 7% from 2019. Gross margin is estimated between 37.2% and 37.8%. Revenue growth is projected between 3.5% and 6.5% driven by outperformance to the market in the United States, and continued expansion of endless assortment business. Grainger expects its endless assortment business to grow around 20% in 2020.

▲ The company accomplished the goal of remerchandising a record $1.2 billion of products in the United States and is on track to complete another $1.6 billion in 2020. Aided by its ongoing investments in growth initiatives, Grainger outgrew the U.S MRO market by 150-200 basis points in 2019. The company gained momentum through the year and exited the fourth quarter growing about 300 basis points faster than the market. In the fourth quarter, the U.S. large customer business grew 3% or 350 basis points faster than the market while the U.S. midsize customer business grew 5% or approximately 550 basis points faster than the market. Growth in these two customer groups remained stable despite slower market conditions in the quarter. The company expects the segment to outpace the MRO market, which includes a target of 300-400 basis points annual outgrowth in the United States. Grainger will continue its efforts to strengthen relationships with both large and mid-sized customers to improve sales force effectiveness. Grainger continues to re-engage lapsed customers and acquire new ones.

▲ Grainger's Canada business is an attractive market and is expected to deliver double-digit operating margin growth over the next five years. The company has been focused on reducing its cost structure in the Canada operations to drive profitable growth. Grainger has been managing inventory effectively to drive profitability, and is focused on making incremental investments in marketing and merchandising. Through 2019, revenues have stabilized and customer feedback has improved significantly. Grainger expects to return to growth in the business in the back half of 2020 and anticipates the business to be sustainable and profitable in the future.

▲ Grainger continues to expect strong cash flow generation for the current year. The company plans to utilize the cash in invest in its distribution network, digital platform, and IT infrastructure. The company will also continue to return cash to shareholders through share repurchase and dividends. Grainger returned $1 billion to shareholders through $328 million in dividends and $700 million to buy back around 2.4 million shares in 2019. In April, the company's board declared and authorized the repurchase of up to 5 million shares of the company's outstanding common stock, replacing the company's existing repurchase program. As of Dec 31, 2019, the company had approximately 53.7 million shares of common stock outstanding. For 2020, the company plans to make $600 million to $700 million of share repurchases. For 2020, the company anticipates operating cash flow between $1.1 billion and $1.2 billion. Capital expenditures are projected at about $250 million. The major portion of the investment will be on the U.S. segment and endless assortment business in order to drive growth in these areas.

▲ Grainger's e-commerce sales continue to grow. The company is focused on improving the end-to-end customer experience by making investments in its e-commerce and digital capabilities, and executing improvement initiatives within its supply chain. Notably, it intends to continue to reduce the cost base. The company's single-channel businesses, primarily MonotaRO and Zoro, continued to drive profitable growth. The company expects to drive growth with endless assortment model through the strength of the MonotaRO and the incremental investments in Zoro.

Reasons To Sell:

- Given the success of the Zoro business, the company has decided to invest in Zoro to accelerate its product expansion efforts. The company is also leveraging its knowledge of MonotaRO to improve marketing and analytics capability in the Zoro U.S. operation. These changes call for some incremental investment, which in turn will lower margins in the Zoro business in the near term.

- The implementation of tariffs has led to input cost inflation. The company is working with suppliers to minimize the cost impact, including identifying alternative supply and evaluating pricing actions. Moreover, the company is also facing higher freight costs.

Grainger's results will bear the brunt of input cost inflation, higher freight charges and foreign exchange headwind. Operating expenses will be higher as it invests in digital marketing.

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Last Earnings Report

Grainger Q4 Earnings Lag Estimates, Revenues Beat

Quarter Ending	12/2019
Report Date	Jan 30, 2020
Sales Surprise	0.07%
EPS Surprise	-3.72%
Quarterly EPS	3.88
Annual EPS (TTM)	17.29

Grainger reported fourth-quarter 2019 adjusted earnings per share (EPS) of $3.88, down 2% year over year primarily owing to a higher tax rate in the reported quarter. The bottom line also missed the Zacks Consensus Estimate of $4.03, resulting in a negative surprise of 4%.

Including one-time items, such as restructuring and other charges, earnings came in at $1.88 in the reported quarter. The figure plunged 49% from the year-ago quarter's $3.68.

Grainger's revenues jumped 3% to $2,847 million from the prior-year quarter figure of $2,763 million. This upside was driven by an increase of 3.5 percentage point (pp) in volume and unfavorable price impact of 0.5%. The top line surpassed the Zacks Consensus Estimate of $2,845 million.

Operational Update

Adjusted cost of sales increased 4% year over year to $1,766 million. Gross profit was up 1.5% year over year to $1,081 million. Gross margin contracted 38.0% in the quarter from 38.5% in the year-ago quarter.

Grainger's adjusted operating income in the fourth quarter dipped 1% to $307 million from the $310 million in the prior-year quarter. Adjusted operating margin contracted 40 bps year over year to 10.8% in the quarter.

Financial Position

The company had cash and cash equivalents of $360 million at the end of 2019, down from $538 million at 2018 end. Cash provided by operating activities decreased to $1,042 million in the fourth quarter from the year-ago quarter figure of $1,057 million.

Long-term debt was $1,914 million as of Dec 31, 2019, compared with $2,090 million as of Dec 31, 2018. The company returned $1,028 million to shareholders through $328 million in dividends and $700 million to buy back around 2.4 million shares in 2019.

2019 Results

Grainger reported adjusted earnings per share of $17.29 in 2019, up 4% from the prior-year reported figure of $16.70. However, earnings missed the Zacks Consensus Estimate of $17.46. Including one-time items, the bottom line came in at $15.32, up 12% from $13.73 reported in 2018.
Sales rose 2.4% year over year to around $11.5 billion from the prior-year figure of $11.2 billion. The top line came in line with the Zacks Consensus Estimate.

Outlook

Grainger initiated guidance for full-year 2020. Operating margin is forecasted in the band of 11.7-12.5%. The company expects EPS of $17.75-$19.25. The mid-point of the guidance range indicates year-over-year growth of 7% from 2018. Gross margin is estimated between 37.2% and 37.8%, and revenue growth is projected between 3.5% and 6.5%.

Valuation

Grainger's shares have moved down 15.5% over the trailing 12-month period. Stocks in the Zacks Industrial Services industry and the Zacks Industrial Products sector are down 27.2% and 22.3%, over the past year.

The S&P 500 index has declined 7.7% in the past year.

The stock is currently trading at 13.62X forward 12-month earnings, which compares to 13.40X for the Zacks sub-industry, 15.38X for the Zacks sector and 16.91X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.33X and as low as 12.18X, with a 5-year median of 17.67X.

Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $273 price target reflects 14.42X Forward 12-month earnings.

The table below shows summary valuation data for GWW:

Valuation Multiples - GWW

		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	13.62	13.4	15.38	16.91
	5-Year High	25.33	18.68	19.93	19.34
	5-Year Low	12.18	11.94	12.55	15.19
	5-Year Median	17.67	15.44	16.47	17.44
P/S F12M	Current	1.14	0.9	2.11	2.92
	5-Year High	1.77	1.44	2.72	3.44
	5-Year Low	0.84	0.86	1.52	2.54
	5-Year Median	1.34	1.16	1.99	3
EV/EBITDA TTM	Current	10.09	8.22	13.23	9.75
	5-Year High	15.31	47.36	17.37	12.87
	5-Year Low	7.9	7.24	10.71	8.27
	5-Year Median	10.09	11.37	14.75	10.78

As of 04/07/2020

Industry Analysis **Zacks Industry Rank:** Bottom 17% (210 out of 253)

Top Peers

ANDRITZ AG **(ADRZY)**	Neutral
Ardagh Group S.A. **(ARD)**	Neutral
Aggreko PLC **(ARGKF)**	Neutral
Ashtead Group PLC **(ASHTY)**	Neutral
HD Supply Holdings, Inc. **(HDS)**	Neutral
KION GROUP AG **(KIGRY)**	Neutral
MSC Industrial Direct Company, Inc. **(MSM)**	Neutral
ScanSource, Inc. **(SCSC)**	Neutral

Industry Comparison Industry: Industrial Services

Industry Peers

	GWW Neutral	X Industry	S&P 500	ADRZY Neutral	ARD Neutral	KIGRY Neutral
VGM Score	C	-	-	B	A	B
Market Cap	13.84 B	2.44 B	18.38 B	3.41 B	213.47 M	5.00 B
# of Analysts	11	2	13	1	1	1
Dividend Yield	2.23%	0.00%	2.31%	0.00%	0.00%	1.84%
Value Score	C	-	-	B	A	A
Cash/Price	0.03	0.06	0.06	0.42	3.07	0.06
EV/EBITDA	10.15	7.42	11.23	5.79	5.05	3.60
PEG Ratio	1.43	1.15	1.91	NA	NA	NA
Price/Book (P/B)	6.74	2.44	2.45	2.71	NA	1.32
Price/Cash Flow (P/CF)	11.70	7.03	9.63	7.25	0.20	3.26
P/E (F1)	16.25	12.79	15.92	9.94	7.29	9.33
Price/Sales (P/S)	1.21	0.79	1.94	0.45	0.03	0.51
Earnings Yield	6.28%	7.82%	6.15%	10.06%	13.72%	10.71%
Debt/Equity	0.93	0.59	0.70	1.29	-27.05	0.59
Cash Flow ($/share)	22.04	3.44	7.01	0.90	58.12	3.52
Growth Score	C	-	-	C	C	D
Hist. EPS Growth (3-5 yrs)	9.58%	20.14%	10.92%	NA	NA	20.14%
Proj. EPS Growth (F1/F0)	-6.28%	-3.23%	-0.12%	37.50%	-13.74%	13.89%
Curr. Cash Flow Growth	-1.82%	1.71%	5.93%	2.74%	8.41%	27.81%
Hist. Cash Flow Growth (3-5 yrs)	2.17%	8.25%	8.55%	NA	NA	NA
Current Ratio	2.12	1.61	1.24	1.18	1.27	0.78
Debt/Capital	48.16%	39.06%	42.36%	56.35%	NA	37.27%
Net Margin	7.39%	5.16%	11.64%	1.73%	17.26%	5.16%
Return on Equity	45.63%	10.56%	16.74%	9.38%	-34.54%	13.42%
Sales/Assets	1.92	1.30	0.54	0.91	0.83	0.65
Proj. Sales Growth (F1/F0)	-2.77%	-0.01%	0.85%	4.24%	-21.34%	-0.02%
Momentum Score	C	-	-	A	A	C
Daily Price Chg	2.69%	2.69%	0.69%	0.00%	-7.67%	6.30%
1 Week Price Chg	-3.39%	-4.05%	-4.40%	0.00%	-9.04%	0.10%
4 Week Price Chg	-7.76%	-10.41%	-10.67%	-20.10%	-26.48%	-11.17%
12 Week Price Chg	-24.20%	-28.88%	-23.70%	-24.16%	-44.22%	-33.64%
52 Week Price Chg	-15.51%	-29.15%	-15.92%	-29.15%	-16.80%	-23.97%
20 Day Average Volume	489,880	124,540	4,068,329	5	124,540	12,070
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-12.56%	-9.89%	-5.24%	0.00%	0.00%	0.00%
(F1) EPS Est 12 week change	-14.23%	-15.01%	-6.86%	0.00%	1.29%	-0.81%
(Q1) EPS Est Mthly Chg	-27.04%	-22.56%	-8.25%	NA	0.00%	NA

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	C
Momentum Score	C
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.