

W.W. Grainger, Inc. (GWW)

\$341.41 (As of 01/08/20)

Price Target (6-12 Months): **\$362.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/24/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:B

Value: B

Growth: B

Momentum: C

Summary

Grainger's earnings per share guidance for 2019 is at \$17.10-\$18.70, reflecting year-over-year growth of 2-12%. Earnings growth will be driven by operating performance and favorable tax rates. Operating margin is projected at 12.2-13.0%, a 20-100-basis point expansion from 2018. 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 will likely benefit from investments in e-commerce over the long haul. Nevertheless, this will lead to higher operating expenses in the near term and dent the company's margins. Moreover, Grainger's earnings estimates for the fourth quarter of 2019 have been stable lately.

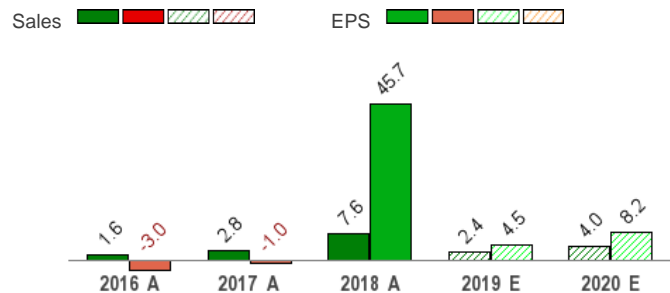
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$344.71 - \$255.09
20 Day Average Volume (sh)	305,178
Market Cap	\$18.4 B
YTD Price Change	0.9%
Beta	0.98
Dividend / Div Yld	\$5.76 / 1.7%
Industry	Industrial Services
Zacks Industry Rank	Bottom 16% (214 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-4.1%
Last Sales Surprise	-0.1%
EPS F1 Est- 4 week change	0.2%
Expected Report Date	01/30/2020
Earnings ESP	-1.3%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	2,893 E	2,982 E	3,060 E	2,965 E	11,948 E
2019	2,799 A	2,893 A	2,947 A	2,848 E	11,492 E
2018	2,766 A	2,860 A	2,831 A	2,763 A	11,221 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$4.76 E	\$4.93 E	\$4.66 E	\$4.47 E	\$18.89 E
2019	\$4.51 A	\$4.64 A	\$4.26 A	\$4.03 E	\$17.46 E
2018	\$4.18 A	\$4.37 A	\$4.19 A	\$3.96 A	\$16.70 A

*Quarterly figures may not add up to annual.

P/E TTM	19.7
P/E F1	18.1
PEG F1	1.6
P/S TTM	1.6

The data in the charts and tables, except sales and EPS estimates, is as of 01/08/2020. The reports text and the analyst-provided sales and EPS estimates are as of 01/09/2020.

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.

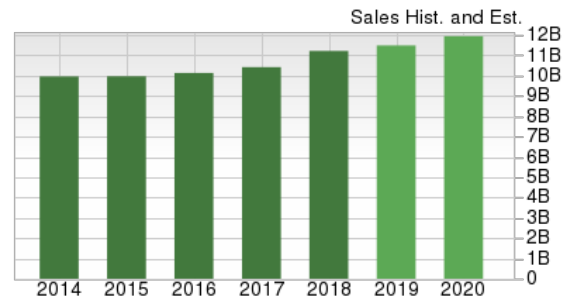
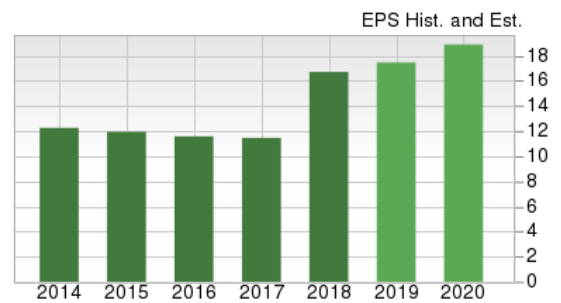
Its products include material-handling equipment, safety and security supplies, lighting and electrical products, power and hand tools, pumps and plumbing supplies, cleaning and maintenance supplies, and metalworking tools.

The company reports revenues under two business segments — the **United States**, which contributed around 74% to total revenues in 2018, and **Canada**, which added 5%. The **Other Businesses** contributed nearly 21% to revenues during the time period.

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 has reaffirmed its guidance for 2019. Earnings per share in the band of \$17.10-\$18.70, reflecting year-over-year growth of 2-12%. Gross margin is estimated between 38.1% and 38.7%. Operating margin is projected at 12.2-13.0%, a 20-100 basis point expansion from 2018. For the Other Business segment, the operating margin guidance is at 4-6%. Earnings growth will be driven by operating performance and favorable tax rates. In the United States, business investment is likely to remain solid in 2019, supported by expanding global markets, lower capital costs and an improving regulatory environment. Moreover, Grainger is poised to deliver strongest SG&A leverage and continued operating margin improvement resulting from incremental margin of 20% to 25%.

Grainger will gain from momentum in the United States, strong Canadian business and investments in digital capabilities. Focus on strengthening its customer base will also drive growth.
 - ▲ The company expects revenues in the United States segment to grow 300-400 basis points faster than the market. 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.
 - ▲ 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 \$279 million to shareholders through \$79 million in dividends and \$200 million to buy back around 725,000 shares in the third quarter of 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 Sep 30, 2019, the company had approximately 53.8 million shares of common stock outstanding.
 - ▲ 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. Daily sales grew 23% for the single-channel model in 2018 and 19.5% in third-quarter 2019. The company expects to drive growth with endless assortment model through the strength of the MonotaRO and the incremental investments in Zoro.
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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 will require some incremental investment in 2019, which in turn will lower margins in the Zoro business.
- ▼ 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 operating expenses will be higher as the company invests in digital marketing capabilities. Its results will also bear the brunt of foreign exchange headwind.

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.

Last Earnings Report

Grainger Q3 Earnings & Revenues Miss Estimates, Up Y/Y

Grainger posted third-quarter 2019 adjusted earnings per share (EPS) of \$4.26, up 2% year over year. Earnings, however, missed the Zacks Consensus Estimate of \$4.44, resulting in a negative surprise of 4%. Growth in operating earnings and lower average shares outstanding drove Grainger's quarterly performance.

Including one-time items, such as restructuring and other charges, earnings came in at \$4.25 in the reported quarter. The figure soared 134% from the year-ago quarter's \$1.82.

Grainger's revenues jumped 4% to \$2,947 million from the prior-year quarter's \$2,831 million.

This upside was driven by an increase of 2.5 percentage point (pp) in volume. However, the revenue figure missed the Zacks Consensus Estimate of \$2,950 million.

Quarter Ending **09/2019**

Report Date	Oct 23, 2019
Sales Surprise	-0.09%
EPS Surprise	-4.05%
Quarterly EPS	4.26
Annual EPS (TTM)	17.37

Operational Update

Cost of sales increased 5.5% year over year to \$1,848 million. Gross profit was up 1.8% year over year to \$1,099 million. Gross margin shrunk to 37.3% in the quarter from the 38.1% reported in the year-ago quarter.

Grainger's adjusted operating income in the July-September quarter increased 2% to \$339 million from the \$332 million witnessed in the prior-year quarter. Adjusted operating margin contracted 20 bps year on year to 11.5% in the quarter.

Financial Position

The company had cash and cash equivalents of \$286 million at the end of the third quarter, down from \$517 million at the prior-year quarter end. Cash provided by operating activities decreased to \$320 million for the quarter from the year-ago quarter's \$348 million.

Long-term debt was \$1,918 million as of Sep 30, 2019, compared with \$2,090 million as of Dec 31, 2018. The company returned \$279 million to shareholders through \$79 million in dividends and \$200 million to buy back around 725,000 shares in the reported quarter.

Outlook

Grainger has maintained its guidance for full-year 2019. Operating margin is forecasted in the band of 12.2-13.0%. The company expects EPS of \$17.10-\$18.70. Gross margin is estimated between 38.1% and 38.7%, and revenue growth is projected between 2% and 5%.

Valuation

Grainger's shares have moved up 20% over the trailing 12-month period. Stocks in the Zacks Industrial Services industry and the Zacks Industrial Products sector are up 6.2% and 16.9% respectively, over the past year.

The S&P 500 index has gained 24.3% in the past year.

The stock is currently trading at 18.04X forward 12-month earnings, which compares to 15.72X for the Zacks sub-industry, 18.04X for the Zacks sector and 18.74X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.33X and as low as 13.75X, with a 5-year median of 17.74X.

Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$362 price target reflects 19.12X 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	18.04	15.72	18.04	18.74
	5-Year High	25.33	18.93	19.9	19.34
	5-Year Low	13.75	12.21	12.59	15.17
	5-Year Median	17.74	15.91	16.54	17.44
P/S F12M	Current	1.54	1.18	2.74	3.47
	5-Year High	1.77	1.43	2.74	3.47
	5-Year Low	0.84	0.92	1.51	2.54
	5-Year Median	1.35	1.13	1.96	3
EV/EBITDA TTM	Current	12.77	10.03	17	11.99
	5-Year High	15.41	37.37	17.43	12.86
	5-Year Low	8.05	9.14	10.89	8.48
	5-Year Median	10.51	11.21	14.71	10.67

As of 01/08/2019

Industry Analysis Zacks Industry Rank: Bottom 16% (214 out of 254)



Top Peers

Fastenal Company (FAST)	Neutral
HD Supply Holdings, Inc. (HDS)	Neutral
Hudson Technologies, Inc. (HDSN)	Neutral
Harsco Corporation (HSC)	Neutral
MSC Industrial Direct Company, Inc. (MSM)	Neutral
ScanSource, Inc. (SCSC)	Neutral
Snap-On Incorporated (SNA)	Neutral
DMC Global Inc. (BOOM)	Underperform

Industry Comparison Industry: Industrial Services				Industry Peers		
	GWG Neutral	X Industry	S&P 500	FAST Neutral	HDS Neutral	HSC Neutral
VGM Score	B	-	-	B	A	B
Market Cap	18.39 B	2.66 B	23.84 B	20.76 B	6.48 B	1.73 B
# of Analysts	12	2	13	11	8	1
Dividend Yield	1.69%	0.00%	1.79%	2.43%	0.00%	0.00%
Value Score	B	-	-	D	A	A
Cash/Price	0.02	0.03	0.04	0.01	0.01	0.04
EV/EBITDA	14.04	9.66	13.88	18.59	11.69	7.45
PEG Ratio	1.59	1.45	2.02	1.77	0.57	NA
Price/Book (P/B)	8.88	3.23	3.33	8.03	4.99	2.30
Price/Cash Flow (P/CF)	15.90	11.51	13.76	23.18	9.82	7.31
P/E (F1)	18.07	13.59	18.76	24.84	11.49	14.17
Price/Sales (P/S)	1.61	1.09	2.63	3.93	1.04	1.04
Earnings Yield	5.53%	7.21%	5.32%	4.03%	8.71%	7.06%
Debt/Equity	0.93	0.57	0.72	0.23	1.85	1.06
Cash Flow (\$/share)	21.47	3.00	6.94	1.56	4.07	3.00
Growth Score	B	-	-	B	A	F
Hist. EPS Growth (3-5 yrs)	8.24%	8.94%	10.56%	11.69%	21.88%	30.09%
Proj. EPS Growth (F1/F0)	8.20%	9.26%	7.46%	5.74%	2.28%	9.93%
Curr. Cash Flow Growth	29.50%	4.91%	14.83%	30.99%	33.27%	25.98%
Hist. Cash Flow Growth (3-5 yrs)	3.77%	6.54%	9.00%	11.73%	16.01%	-5.45%
Current Ratio	2.16	1.43	1.23	4.51	1.98	1.21
Debt/Capital	48.07%	37.37%	42.99%	18.50%	64.95%	51.48%
Net Margin	8.38%	4.62%	11.08%	14.77%	7.51%	30.79%
Return on Equity	46.07%	11.91%	17.16%	32.03%	45.42%	22.29%
Sales/Assets	1.92	1.15	0.55	1.45	1.34	0.78
Proj. Sales Growth (F1/F0)	3.96%	3.96%	4.16%	5.25%	1.60%	5.66%
Momentum Score	C	-	-	A	D	A
Daily Price Chg	1.06%	0.00%	0.39%	0.75%	-0.15%	-0.63%
1 Week Price Chg	0.95%	0.54%	-0.30%	-1.11%	-0.52%	-1.18%
4 Week Price Chg	3.61%	1.33%	2.38%	-0.10%	1.22%	0.87%
12 Week Price Chg	10.90%	10.32%	6.40%	1.66%	2.04%	17.94%
52 Week Price Chg	21.93%	8.92%	22.97%	34.35%	4.74%	1.06%
20 Day Average Volume	305,178	105,827	1,610,101	2,913,214	949,317	485,058
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.18%	0.00%	0.00%	0.12%	-0.67%	0.00%
(F1) EPS Est 12 week change	-1.30%	-1.10%	-0.50%	0.62%	-1.10%	0.00%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	-4.96%	NA

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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	B
Growth Score	B
Momentum Score	C
VGM Score	B

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.

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