Aug 10, 2020

W.W. Grainger, Inc. (GWW)

$349.38 (As of 08/07/20)

Price Target (6-12 Months): **$365.00**

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

Summary

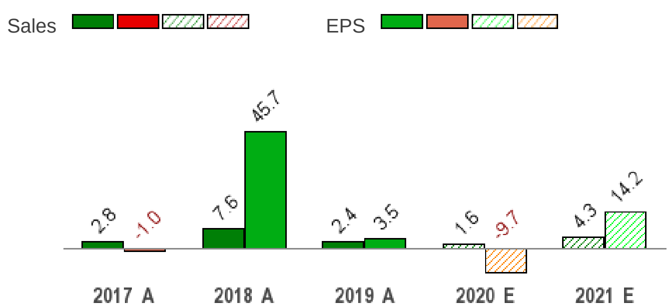
Grainger's second-quarter 2020 earnings and revenues declined year over year but beat the Zacks Consensus Estimate. The company had suspended 2020 guidance citing the uncertainty related to the coronavirus pandemic. It continues to gain from its efforts to strengthen customer relationships in the United States, and increased demand for certain products and higher e-commerce sales triggered by the pandemic. However, these products generally carry lower margins, which is a concern. This along with higher operating costs due to the pandemic may dent margins. While the Canada segment is expected to deliver growth backed by cost control, low oil prices remain a headwind. The Fabory divestiture and the pending sale of distribution business in China will help simplify the company's footprint and focus efforts on its core markets.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$349.51 - $200.61**
20 Day Average Volume (sh)	**378,096**
Market Cap	**$18.7 B**
YTD Price Change	**3.2%**
Beta	**1.01**
Dividend / Div Yld	**$6.12 / 1.6%**
Industry	**Industrial Services**
Zacks Industry Rank	**Bottom 10% (226 out of 252)**
Last EPS Surprise	**7.8%**
Last Sales Surprise	**3.0%**
EPS F1 Est- 4 week change	**5.2%**
Expected Report Date	**NA**
Earnings ESP	**0.0%**
P/E TTM	**21.7**
P/E F1	**22.4**
PEG F1	**2.0**
P/S TTM	**1.6**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	2,979 E	2,961 E	3,059 E	2,984 E	12,171 E
2020	3,001 A	2,837 A	2,974 E	2,886 E	11,673 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	$4.61 E	$4.15 E	$4.68 E	$4.29 E	$17.83 E
2020	$4.24 A	$3.75 A	$4.14 E	$3.76 E	$15.61 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 08/07/2020. The reports text is as of 08/10/2020.

Overview

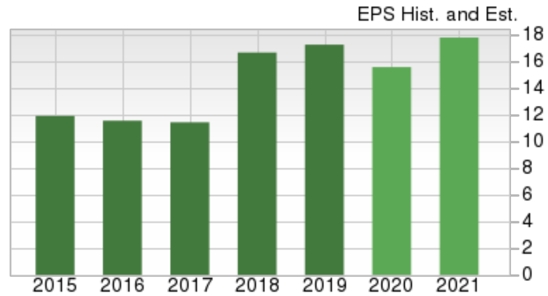
Incorporated in 1928, IL-based W.W. Grainger Inc. is a broad line, business-to-business distributor of maintenance, repair and operating (MRO) products and services. Its operations are primarily in North America, Europe and Japan.

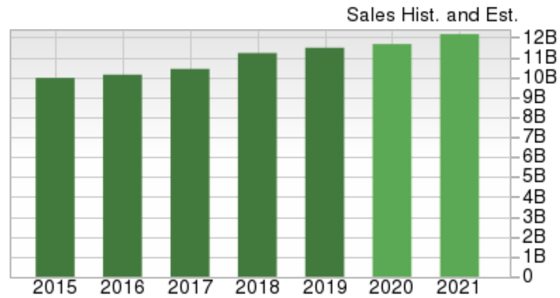
The global MRO market is approximately $608 billion, and the Grainger's estimated market size is $284 billion. Its customers represent a wide array of industries including government, manufacturing, transportation, commercial and contractors.

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.

Other businesses include the endless assortment businesses, Zoro Tools, Inc. (Zoro) and MonotaRO Co., LTD (MonotaRO), and smaller high-touch businesses in the UK and Mexico.

On Jun 30, 2020, Grainger divested the Fabory business in Europe. Also, in June, Grainger announced it has entered into a definitive agreement to sell its distribution business in China — Grainger China LLC.

Reasons To Buy:

> Grainger will gain from momentum in the United States, turnaround in the Canadian business and ongoing strong demand for certain products and e-commerce sales on account of the coronavirus pandemic.

▲ The company accomplished the goal of remerchandising a record $1.2 billion of products in the United States in 2019 and is on track to complete another $1.6 billion in 2020. Grainger outgrew the U.S MRO market by 150-200 basis points in 2019. So far in 2020, the company has consistently outpaced the U.S MRO market. In first-quarter 2020, the U.S. MRO market declined between 1% and 1.5%. Grainger outgrew the U.S MRO market by around 700 basis points. In second-quarter 2020, the U.S. MRO market fared worse, declining between 14% and 15% while Grainger outgrew the U.S MRO market by around 100 basis points, highlighting consistent traction of its growth initiatives. 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.

▲ During second-quarter 2020, Grainger returned $86 million to shareholders through dividends. As of the end of the quarter, the company had $1.9 billion of available liquidity, which includes $1.6 billion in cash. It had cash balance of $360 million at the end of 2019. The company drew down $1 billion from its $1.25 billion credit facility as proactive measure to enhance its cash position and preserve financial flexibility in light of current uncertainty in the global markets owing to the COVID-19 pandemic. Grainger has also suspended share buybacks to preserve cash. Further, Grainger has no debt maturities or material financial obligations due within the next five years. As of Jun 30, 2020, the company's total debt to total capital ratio was at 0.61. Further, its times interest earned ratio is a healthy 10.3. Despite the current unprecedented and challenging market conditions surrounding the COVID-19 pandemic, Grainger has hiked quarterly dividend by 6% — marking its 49th year of consecutive dividend increases.

▲ Grainger experienced a surge of COVID-19 pandemic related product sales such as personal protective equipment (PPE) and safety products due to higher customer demand in response to the global outbreak. The incremental demand came primarily from customers in the front-lines of the pandemic, including hospitals, healthcare providers, governments, first responders and critical manufactures. The company expects increased levels of safety and cleaning product sales to large healthcare, government and critical manufacturing customers in the near term. Further, the pandemic has provided a boost to Grainger's e-commerce sales. 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.

▲ 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 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.

▲ In the wake of the ongoing uncertainty related to the COVID-19, the company has undertaken several cost control measures, which include limiting discretionary spending, temporarily furloughing employees or minimizing work hours, reducing short-term executive pay, delaying salary increases, scaling back advertising spend, eliminating non-essential travel, delaying or reducing hiring activities and deferring certain discretionary capital expenditures.

▲ Grainger remains focused on profitable growth in key geographies. In sync with this, in June, the company announced it has entered into a definitive agreement to sell its distribution business in China, Grainger China LLC (Grainger China). To support this portfolio, the company will maintain its Global Sourcing operations based in China. Grainger's Global Sourcing provides the company with private label products in categories that include safety, cleaning, electrical, motors and tools. Also, in sync with the company's strategic focus on broad-line MRO distribution in key markets, Grainger divested the Fabory business in Europe in June. These actions will help the company simplify its footprint and focus efforts on its core markets.

Reasons To Sell:

> Grainger's results will bear the brunt of shift in demand toward lower-margin products and higher operating costs due to the pandemic. Its Canada business will be hurt by low oil prices.

- The COVID-19 pandemic may cause disruption to Grainger's businesses and operations as well as the operations of its customers and suppliers going forward. The COVID-19 pandemic las led to a shift in demand toward lower-margin products. Further, higher operating costs in response to the COVID-19 pandemic and related activities are also likely to impact operating margins in the upcoming quarters. Given the uncertainty related to the impact and duration of this pandemic, Grainger has suspended guidance for 2020. Further, a pickup in spending related to marketing and travel as business unit activity ramps up, and with the company reinstating the salary hikes, it will lead to higher SG&A expenses in the third quarter.

- Weakness in heavy manufacturing will continue impact Grainger's sales as it contributes around 18% of the company's sales. Grainger's Canada business has a heavy exposure to natural resource customer base. Notably, these customers contributed 32% to the segment's revenues in 2019 and 29% in first-quarter 2020. The low oil prices might impact the segment's results.

- 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. 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.

- 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.

Last Earnings Report

Grainger Q2 Earnings and Revenues Surpass Estimates

Quarter Ending	06/2020
Report Date	Jul 23, 2020
Sales Surprise	3.02%
EPS Surprise	7.76%
Quarterly EPS	3.75
Annual EPS (TTM)	16.13

Grainger reported second-quarter 2020 adjusted earnings per share (EPS) of $3.75, which beat the Zacks Consensus Estimate of $3.48 by 8%. However, the bottom line declined 19% year over year primarily on account of lower operating earnings that were partially offset by lower average shares outstanding.

During the second quarter, Grainger recorded a $109 million pretax loss from the sale of the Fabory business. Including this, earnings came in at $2.10 in the reported quarter. The figure plunged 55% from the year-ago quarter's $4.67.

Grainger's revenues declined 2% to $2.84 billion from the prior-year quarter figure of $2.89 billion. The top line surpassed the Zacks Consensus Estimate of $2.75 billion.

Daily sales for the quarter decreased 1.9% compared with the prior-year quarter. The decline in sales was primarily due to volume decreases including unfavorable product mix from heightened levels of pandemic-related sales, and decreased volume of non-pandemic products. Foreign exchange had an unfavorable impact of 10 basis points.

Operational Update

Adjusted cost of sales increased 3% year over year to $1,821 million. Gross profit was down 9% year over year to $1,016 million. Gross margin contracted to 35.8% in the quarter under review from 38.7% in the prior-year quarter primarily due to pandemic-related impacts, including product mix and increased freight expense, particularly in the U.S. segment. The continued business unit mix impact from faster growth in the lower-margin endless assortment businesses was also instrumental in lower gross margins.

Grainger's adjusted operating income in the second quarter declined 16% to $315 million from the $377 million in the prior-year quarter. Adjusted operating margin contracted 190 bps year over year to 11.1% in the quarter, mainly due to lower gross margins.

Financial Position

The company had cash and cash equivalents of $1,603 million at the end of second-quarter 2020, significantly up from $360 million at 2019 end. Cash provided by operating activities increased to $476 million in the first half of 2020 from the year-ago comparable figure of $450 million.

Long-term debt was $3,301 million as of Jun 30, 2020, compared with $1,914 million as of Dec 31, 2019. The company returned $86 million to shareholders through dividends in the quarter. Earlier, Grainger had announced that it is pausing share repurchases in the wake of the coronavirus pandemic.

Recent News

Grainger Hikes Quarterly Dividend by 6%

On Jul 29, 2020, Grainger announced that its board of directors approved a 6% hike in its quarterly dividend to $1.53 per share. The dividend is payable on Sep 1, 2020, to shareholders of record on Aug 10, 2020. The compnay has delivered 49 consecutive years of increased dividends.

Grainger Announces Agreement to Divest Grainger China

On Jun 22, 2020, Grainger announced it has entered into a definitive agreement to sell its distribution business in China, Grainger China LLC (Grainger China), to a purchaser owned by the Grainger China management team and Sinovation Ventures, a China-based venture capital firm.

This divestiture will better enable Grainger to focus on its key businesses and geographies. To support this portfolio, the company will maintain its Global Sourcing operations based in China. Grainger's Global Sourcing provides the company with private label products in categories that include safety, cleaning, electrical, motors and tools.

While the transaction is not subject to any financing condition, it is subject to the standard regulatory approvals. The deal is expected to close later this year.

Valuation

Grainger's shares are up 3.2% in the year-to-date period and up 32.6% over the trailing 12-month period. Stocks in the Zacks Industrial Services industry are up 2.2% while the Zacks Industrial Products sector are down 3.5% in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are up 14.3% and 12.2%, respectively.

The S&P 500 index is up 3.9% in the year-to-date period and up 16.3% in the past year.

The stock is currently trading at 20.60X forward 12-month earnings, which compares to 16.26X for the Zacks sub-industry, 21.81X for the Zacks sector and 22.77X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.33X and as low as 11.27X, with a 5-year median of 17.60X.

Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $365 price target reflects 21.79X 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	20.6	16.26	21.81	22.77
	5-Year High	25.33	18.68	21.81	22.77
	5-Year Low	11.27	11.94	12.55	15.25
	5-Year Median	17.6	15.44	17.48	17.58
P/S F12M	Current	1.56	1.05	2.9	3.66
	5-Year High	1.77	1.44	2.9	3.66
	5-Year Low	0.84	0.86	1.52	2.53
	5-Year Median	1.34	1.16	2.04	3.05
EV/EBITDA TTM	Current	15.78	11.56	19.49	12.62
	5-Year High	15.78	47.36	19.49	12.84
	5-Year Low	7.9	7.24	10.84	8.24
	5-Year Median	10.87	11.03	14.9	10.9

As of 08/07/2020

Industry Analysis Zacks Industry Rank: Bottom 10% (226 out of 252)

Top Peers

Company (Ticker)	Rec	Rank
ANDRITZ AG **(ADRZY)**	Neutral	3
Ardagh Group S.A. **(ARD)**	Neutral	3
Aggreko PLC **(ARGKF)**	Neutral	4
Ashtead Group PLC **(ASHTY)**	Neutral	3
HD Supply Holdings, Inc. **(HDS)**	Neutral	3
MSC Industrial Direct Company, Inc. **(MSM)**	Neutral	3
ScanSource, Inc. **(SCSC)**	Neutral	5
KION GROUP AG **(KIGRY)**	Underperform	3

Industry Comparison Industry: Industrial Services

	GWW	X Industry	S&P 500	ADRZY	ARD	KIGRY
				Industry Peers		
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Underperform
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	A	B	B
Market Cap	18.72 B	2.29 B	23.30 B	3.92 B	275.79 M	8.46 B
# of Analysts	12	2	14	1	1	1
Dividend Yield	1.65%	0.00%	1.76%	0.96%	4.06%	0.04%
Value Score	B	-	-	B	A	B
Cash/Price	0.09	0.08	0.07	0.41	5.73	0.04
EV/EBITDA	13.46	8.73	13.32	6.33	5.04	5.36
PEG Ratio	1.96	2.50	2.94	NA	NA	NA
Price/Book (P/B)	8.70	3.30	3.19	2.97	NA	2.12
Price/Cash Flow (P/CF)	15.85	8.37	12.51	8.19	0.25	5.58
P/E (F1)	22.38	22.35	22.02	14.78	10.34	33.50
Price/Sales (P/S)	1.61	1.08	2.53	0.53	0.04	0.86
Earnings Yield	4.47%	4.39%	4.37%	6.76%	9.68%	2.99%
Debt/Equity	1.53	0.56	0.77	1.19	-17.91	0.55
Cash Flow ($/share)	22.04	3.42	6.94	0.92	58.12	3.48
Growth Score	A	-	-	B	C	B
Hist. EPS Growth (3-5 yrs)	11.24%	10.40%	10.46%	-20.53%	-1.15%	NA
Proj. EPS Growth (F1/F0)	371.51%	-16.37%	-6.80%	82.14%	197.28%	26.09%
Curr. Cash Flow Growth	-1.82%	1.47%	5.39%	1.75%	8.41%	-1.14%
Hist. Cash Flow Growth (3-5 yrs)	2.17%	8.69%	8.55%	NA	NA	NA
Current Ratio	3.54	1.82	1.33	1.20	1.59	0.78
Debt/Capital	60.53%	40.08%	44.50%	54.33%	NA	35.53%
Net Margin	5.34%	3.40%	10.13%	1.88%	19.41%	5.16%
Return on Equity	42.19%	9.90%	14.39%	10.58%	-66.33%	13.25%
Sales/Assets	1.77	1.03	0.51	0.92	0.75	0.64
Proj. Sales Growth (F1/F0)	1.63%	-3.47%	-1.51%	3.16%	-22.37%	-3.47%
Momentum Score	C	-	-	A	F	D
Daily Price Chg	0.80%	0.00%	0.90%	0.00%	1.37%	-1.02%
1 Week Price Chg	0.04%	0.00%	0.14%	0.00%	-5.42%	-6.53%
4 Week Price Chg	13.07%	13.32%	8.95%	0.00%	17.02%	18.91%
12 Week Price Chg	26.12%	38.86%	18.90%	12.71%	31.96%	69.18%
52 Week Price Chg	26.28%	2.86%	1.18%	4.00%	-15.35%	59.39%
20 Day Average Volume	378,096	77,419	2,057,775	1	66,923	10,592
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	6.25%	0.00%	-3.33%
(F1) EPS Est 4 week change	5.24%	0.00%	1.36%	6.25%	-0.69%	-3.33%
(F1) EPS Est 12 week change	7.14%	-0.69%	1.57%	6.25%	-0.69%	-7.94%
(Q1) EPS Est Mthly Chg	14.85%	0.00%	0.54%	NA	1.15%	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	A
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.

Disclosures

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