



W.W. Grainger Inc. (GWW)

Updated August 20th, 2019 by Kay Ng

Key Metrics

| | | | | | |
|-----------------------------|-------|--|-------|---------------------------------|-------|
| Current Price: | \$272 | 5 Year CAGR Estimate: | 9.6% | Volatility Percentile: | 85.0% |
| Fair Value Price: | \$322 | 5 Year Growth Estimate: | 7.0% | Momentum Percentile: | 15.2% |
| % Fair Value: | 95% | 5 Year Valuation Multiple Estimate: | 1.0% | Growth Percentile: | 68.8% |
| Dividend Yield: | 2.1% | 5 Year Price Target | \$392 | Valuation Percentile: | 73.8% |
| Dividend Risk Score: | A | Retirement Suitability Score: | B | Total Return Percentile: | 70.1% |

Overview & Current Events

W.W. Grainger is one of the world's largest business-to-business distributors of maintenance, repair, and operations ("MRO") supplies. The company was founded in 1927 and generates sales of approximately \$11 billion per year. W.W. Grainger trades with a market capitalization of \$14.9 billion and has increased its dividend for 47 consecutive years, which makes it a member of the Dividend Aristocrats Index. W.W. Grainger is headquartered in Lake Forest, IL.

W.W. Grainger reported its second-quarter earnings results on July 24. The company generated revenues of \$2.9 billion during the quarter, which represents revenue growth of 1% compared to the prior year's quarter. W.W. Grainger's revenues rose by 2% year over year on a constant currency basis. Through the impact of operating leverage W.W. Grainger was able to grow its adjusted operating earnings by 5% year over year, although the revenue growth rate was small. The company managed to lower its operating expenses compared to the prior year's quarter, which allowed W.W. Grainger to grow its operating margin to 13%, up 50 basis points versus the previous year's comparable quarter on an adjusted basis. W.W. Grainger grew its adjusted earnings-per-share to \$4.64 during the second quarter, which was 6% more than the company's earnings-per-share during Q2 of 2018.

W.W. Grainger revised its guidance for 2019 to net sales growth of 2% to 5% (from 4% to 8.5%) but maintained its estimated earnings-per-share range of \$17.10 to \$18.70. At the midpoint of the guidance range, \$17.90, W.W. Grainger would grow its earnings-per-share by 7.2%.

Growth on a Per-Share Basis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|---------------------------|--------|--------|--------|--------|---------|---------|---------|---------|---------|---------|----------------|----------------|
| EPS | \$5.25 | \$6.81 | \$9.04 | \$9.52 | \$11.52 | \$12.26 | \$11.94 | \$11.58 | \$11.46 | \$16.70 | \$17.90 | \$24.52 |
| DPS | \$1.78 | \$2.08 | \$2.52 | \$3.06 | \$3.59 | \$4.17 | \$4.59 | \$4.83 | \$5.06 | \$5.36 | \$5.76 | \$7.94 |
| Shares¹ | 72.3 | 69.4 | 69.9 | 69.4 | 68.8 | 67.4 | 62.0 | 58.8 | 56.3 | 56.1 | 55.4 | 54.0 |

W.W. Grainger grew its earnings-per-share by 13.7% annually between 2009 and 2018, but this included the impact of the recovery from the financial crisis. Between 2008 and 2018 the earnings-per-share growth rate averaged 10.6%. When we also back out the positive one-time impact of a lower tax rate that led to outsized earnings-per-share growth during 2018, the average growth rate declines further, to 7.3%.

W.W. Grainger's strategic shift of lowering its pricing, thereby creating higher demand and growing its revenues, seems to have worked well during the last few quarters, as operating profits grew at a solid pace. We believe that growth will moderate somewhat, but W.W. Grainger should nevertheless be able to grow its sales as well as its profits further through the next few years. We expect the long-term earnings-per-share growth rate to be about 6.5% a year. Profit growth will not only be driven by rising revenues, but also by a reduction in the company's share count. W.W. Grainger's share repurchases have lowered the company's share count by roughly 25% since 2009. Future share repurchases will be beneficial for W.W. Grainger's earnings-per-share growth rate.

1. Shares in millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Now | 2024 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E | 16.0 | 16.4 | 16.8 | 21.1 | 21.5 | 20.3 | 19.0 | 19.1 | 17.7 | 16.6 | 15.2 | 16.0 |
| Avg. Yld. | 2.1% | 1.9% | 1.7% | 1.5% | 1.4% | 1.7% | 2.0% | 2.2% | 2.5% | 2.0% | 2.1% | 2.0% |

W.W. Grainger’s valuation has declined continuously since the company’s price to earnings multiple peaked in 2013. Shares are currently trading for the lowest P/E in years, but we expect the fair P/E to be lower at 16 based on a lower expected growth rate. We believe shares of W.W. Grainger are close to fairly valued with modest room for multiples expansion.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|--------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Payout | 33.9% | 30.5% | 27.9% | 32.1% | 31.2% | 34.0% | 38.4% | 41.7% | 44.2% | 32.1% | 32.2% | 32.4% |

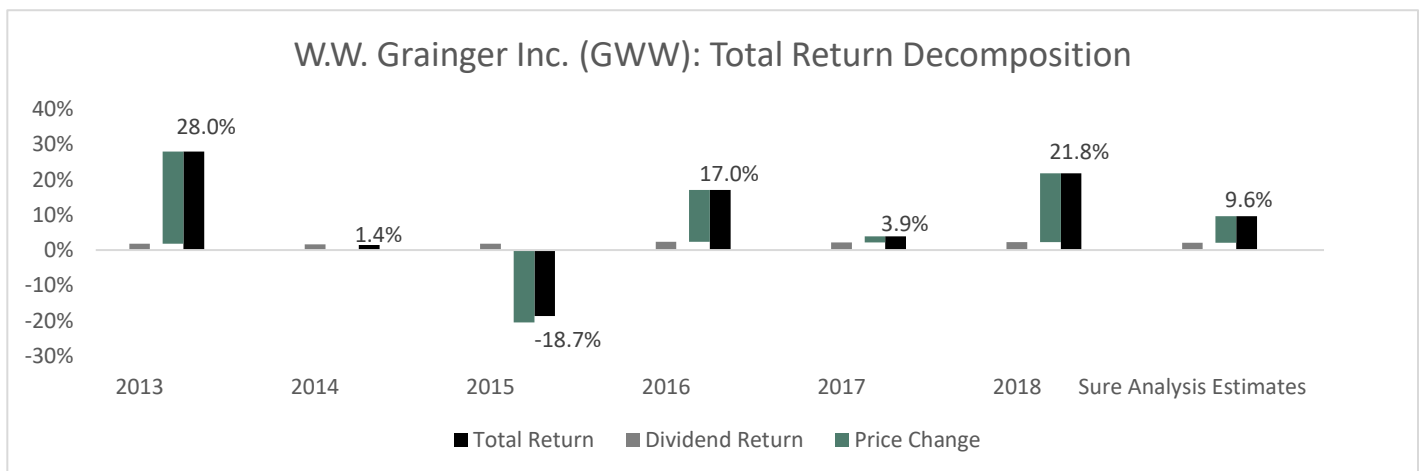
W.W. Grainger has an excellent dividend growth track record. The company has increased its payout annually for several decades in a row. Despite all of these increases, the company’s dividend payout ratio has not risen to a high level, as it remained below 50% throughout the last decade. 2018’s massive earnings growth rate has made the payout ratio decline further. The low dividend payout ratio and a very long dividend growth track record, coupled with a relatively stable performance during the last financial crisis, makes us believe that W.W. Grainger’s dividend is very safe.

W.W. Grainger is not active in a spectacular or high-tech industry, but the services that the company provides are essential for other businesses. This makes W.W. Grainger’s business relatively immune to recessions and economic downturns; its business is not overly cyclical. During the last financial crisis, W.W. Grainger’s earnings-per-share declined by just 15%, whereas the bottom line of many other companies was devastated.

Final Thoughts & Recommendation

W.W. Grainger is a good example of a company that is active in an unspectacular industry, but that has achieved a strong earnings and dividend growth track record nevertheless. Over the next five years, we estimate total returns of 9.6% in the stock, coming from a current yield of 2.1%, earnings growth of 6.5%, and multiple expansion of 1.0%. Its relatively small yield is not appealing. So, interested investors should consider a bigger margin of safety before buying the stock.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 6222 | 7182 | 8078 | 8950 | 9438 | 9965 | 9973 | 10137 | 10425 | 11221 |
| Gross Profit | 2599 | 3006 | 3511 | 3916 | 4136 | 4314 | 4231 | 4115 | 4098 | 4348 |
| Gross Margin | 41.8% | 41.8% | 43.5% | 43.8% | 43.8% | 43.3% | 42.4% | 40.6% | 39.3% | 38.7% |
| SG&A Expense | 1933 | 2145 | 2458 | 2785 | 2840 | 2967 | 2931 | 3002 | 3063 | 3190 |
| D&A Expense | 148 | 150 | 149 | 159 | 181 | 208 | 228 | 249 | 264 | 257 |
| Operating Profit | 665 | 860 | 1052 | 1131 | 1297 | 1347 | 1300 | 1113 | 1035 | 1158 |
| Operating Margin | 10.7% | 12.0% | 13.0% | 12.6% | 13.7% | 13.5% | 13.0% | 11.0% | 9.9% | 10.3% |
| Net Profit | 430 | 511 | 658 | 690 | 797 | 802 | 769 | 606 | 586 | 782 |
| Net Margin | 6.9% | 7.1% | 8.2% | 7.7% | 8.4% | 8.0% | 7.7% | 6.0% | 5.6% | 7.0% |
| Free Cash Flow | 592 | 469 | 549 | 566 | 714 | 572 | 662 | 740 | 820 | 818 |
| Income Taxes | 277 | 340 | 385 | 419 | 480 | 522 | 466 | 386 | 313 | 258 |

Balance Sheet Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---------------------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets | 3726 | 3904 | 4716 | 5015 | 5266 | 5283 | 5858 | 5694 | 5804 | 5873 |
| Cash & Equivalents | 460 | 313 | 335 | 452 | 431 | 227 | 290 | 274 | 327 | 538 |
| Accounts Receivable | 625 | 763 | 889 | 940 | 1102 | 1173 | 1210 | 1223 | 1325 | 1385 |
| Inventories | 890 | 992 | 1269 | 1302 | 1306 | 1356 | 1414 | 1406 | 1429 | 1541 |
| Goodwill & Int. Ass. | 559 | 612 | 757 | 786 | 829 | 771 | 1230 | 1113 | 1113 | 884 |
| Total Liabilities | 1499 | 1617 | 1992 | 1897 | 1939 | 1999 | 3505 | 3789 | 3976 | 3780 |
| Accounts Payable | 301 | 344 | 478 | 429 | 511 | 554 | 583 | 650 | 731 | 678 |
| Long-Term Debt | 525 | 494 | 517 | 565 | 543 | 484 | 1989 | 2247 | 2343 | 2220 |
| Shareholders' Equity | 2164 | 2205 | 2629 | 3024 | 3250 | 3210 | 2267 | 1798 | 1690 | 1921 |
| D/E Ratio | 0.24 | 0.22 | 0.20 | 0.19 | 0.17 | 0.15 | 0.88 | 1.25 | 1.39 | 1.16 |

Profitability Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 11.9% | 13.4% | 15.3% | 14.2% | 15.5% | 15.2% | 13.8% | 10.5% | 10.2% | 13.4% |
| Return on Equity | 20.5% | 23.4% | 27.2% | 24.4% | 25.4% | 24.8% | 28.1% | 29.8% | 33.6% | 43.3% |
| ROIC | 16.2% | 18.5% | 21.9% | 19.9% | 21.1% | 21.0% | 19.0% | 14.3% | 14.1% | 18.4% |

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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