W.W. Grainger Inc. (GWW)

Updated November 14th, 2020 by Samuel Smith

Key Metrics

Current Price:	$401	**5 Year CAGR Estimate:**	-0.8%	**Market Cap:**	$21.7B
Fair Value Price:	$245	**5 Year Growth Estimate:**	7.6%	**Ex-Dividend Date:**	2/6/21[1]
% Fair Value:	164%	**5 Year Valuation Multiple Estimate:**	-9.4%	**Dividend Payment Date:**	3/1/21[2]
Dividend Yield:	1.5%	**5 Year Price Target**	$353	**Years Of Dividend Growth:**	49
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	6.3%

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 more than $11.7 billion per year. W.W. Grainger trades with a market capitalization of $21.7 billion and has increased its dividend for 49 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 third quarter earnings results on October 22nd. The company reported that daily sales numbers for the quarter rose by 4.6%. The adjusted gross margin also fell by 170 basis points to 35.6% while adjusted operating margin increased by 90 basis points to 12.4%. Operating cash flow declined from $320 million a year ago to $311 million, primarily attributed to significant required investments in working capital such as inventory. That said, the company still managed to return $82 million to shareholders through dividends.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$6.81	$9.04	$9.52	$11.52	$12.26	$11.94	$11.58	$11.46	$16.70	$17.90	***$16.33***	***$23.50***
DPS	$2.08	$2.52	$3.06	$3.59	$4.17	$4.59	$4.83	$5.06	$5.36	$5.76	***$6.12***	***$7.00***
Shares[1]	69.4	69.9	69.4	68.8	67.4	62.0	58.8	56.3	56.1	55.2	***55.2***	***45.2***

W.W. Grainger grew its earnings-per-share by double digits annually between 2009 and 2019, but this included the impact of the recovery from the financial crisis. Its five-year earnings-per-share growth rate between 2014 and 2019 is about 8%. 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 in the mid- to high-single-digits. 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. We expect current uncertainty and disruption from the coronavirus to suppress earnings-per-share this year, but the company's recession resilience should enable it to avoid significant damage and continue its dividend growth streak.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	16.4	16.8	21.1	21.5	20.3	19.0	19.1	17.7	16.6	18.3	***24.6***	***15.0***
Avg. Yld.	1.9%	1.7%	1.5%	1.4%	1.7%	2.0%	2.2%	2.5%	2.0%	1.8%	***1.5%***	***2.0%***

[1] Estimate

[2] Estimate

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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W.W. Grainger's valuation has declined continuously since the company's price-to-earnings multiple peaked in 2013 until ballooning this year due to expected declines in earnings from the Coronavirus disruption. Our fair value estimate was recently 16 times earnings, but we are reducing it slightly to 15 times earnings to account for expected short term disruptions and uncertainty caused by the coronavirus outbreak. We believe shares of W.W. Grainger are overvalued and are likely to experience significant multiple contraction over the next few years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	31%	28%	32%	31%	34%	38%	42%	44%	32%	32%	***38%***	***30%***

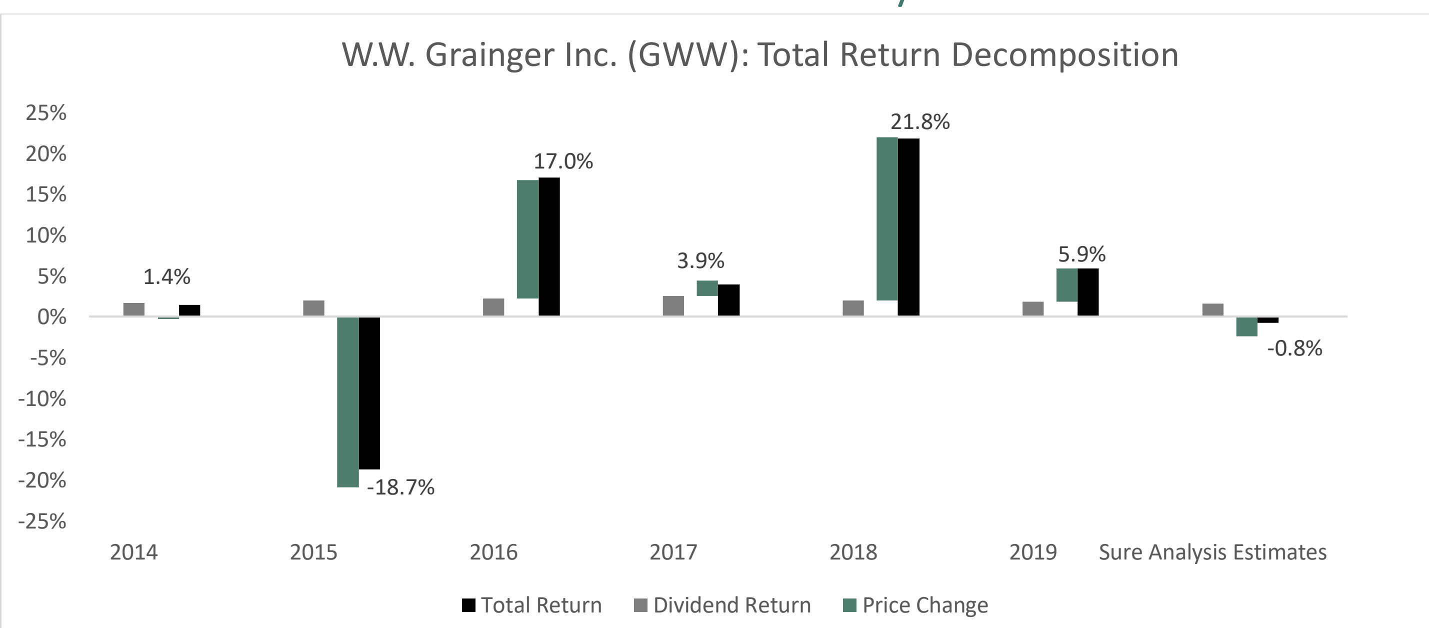
W.W. Grainger has an excellent dividend growth track record. The company has increased its payout annually for several decades in a row. Despite all of these increases, the company's dividend payout ratio has not risen to a high level, as it remained below 50% throughout the last decade. The low dividend payout ratio and a very long dividend growth track record, coupled with a relatively stable performance during the last financial crisis, make 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 lines of many other companies were devastated.

Final Thoughts & Recommendation

W.W. Grainger is a good example of a company 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 annualized returns of -0.8%, which, combined with its low dividend yield, make it a sell. That said, the health and recession resistance of the company, its low payout ratio, and impressive dividend growth streak, could make it worth holding onto through a period of uncertainty for conservative dividend growth investors.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	7,182	8,078	8,950	9,438	9,965	9,973	10137	10425	11221	11486
Gross Profit	3,006	3,511	3,916	4,136	4,314	4,231	4,115	4,098	4,348	4,397
Gross Margin	41.8%	43.5%	43.8%	43.8%	43.3%	42.4%	40.6%	39.3%	38.7%	38.3%
SG&A Expense	2,145	2,458	2,785	2,840	2,967	2,931	3,002	3,063	3,190	3,135
D&A Expense	150	149	159	181	208	228	249	264	257	229
Operating Profit	860	1,052	1,131	1,297	1,347	1,300	1,113	1,035	1,158	1,262
Operating Margin	12.0%	13.0%	12.6%	13.7%	13.5%	13.0%	11.0%	9.9%	10.3%	11.0%
Net Profit	511	658	690	797	802	769	606	586	782	849
Net Margin	7.1%	8.2%	7.7%	8.4%	8.0%	7.7%	6.0%	5.6%	7.0%	7.4%
Free Cash Flow	469	549	566	714	572	662	740	820	818	821
Income Taxes	340	385	419	480	522	466	386	313	258	314

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	3,904	4,716	5,015	5,266	5,283	5,858	5,694	5,804	5,873	6,005
Cash & Equivalents	313	335	452	431	227	290	274	327	538	360
Accounts Receivable	763	889	940	1,102	1,173	1,210	1,223	1,325	1,385	1,425
Inventories	992	1,269	1,302	1,306	1,356	1,414	1,406	1,429	1,541	1,655
Goodwill & Int. Ass.	612	757	786	829	771	1,230	1,113	1,113	884	733
Total Liabilities	1,617	1,992	1,897	1,939	1,999	3,505	3,789	3,976	3,780	3,945
Accounts Payable	344	478	429	511	554	583	650	731	678	719
Long-Term Debt	494	517	565	543	484	1,989	2,247	2,343	2,220	2,215
Shareholders' Equity	2,205	2,629	3,024	3,250	3,210	2,267	1,798	1,690	1,921	1,855
D/E Ratio	0.22	0.20	0.19	0.17	0.15	0.88	1.25	1.39	1.16	1.19

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	13.4%	15.3%	14.2%	15.5%	15.2%	13.8%	10.5%	10.2%	13.4%	14.3%
Return on Equity	23.4%	27.2%	24.4%	25.4%	24.8%	28.1%	29.8%	33.6%	43.3%	45.0%
ROIC	18.5%	21.9%	19.9%	21.1%	21.0%	19.0%	14.3%	14.1%	18.4%	19.8%

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

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