CAIRN INVESTMENT GROUP

COMPANY SPOTLIGHT:

W.W. Grainger, Inc.

COMPANY DESCRIPTION

KEY POINTS

- Global leader in MRO distribution and services.
- Strong technology platform allows Grainger to create economies of scale to gain business from smaller competition.
- Diversified revenue stream as no customer is greater than 3% of revenues.
- Excellent financial health with low leverage and strong cash flow generation.
- Compelling upside as valuations and growth remain attractive.

Headquartered in Lake Forest, Illinois, W.W. Grainger is a global distributor of maintenance, repair and operating (MRO) equipment, supplies, and services. As a major supplier to the industrial sector, the company sells everything from gloves, safety equipment, AC units, to plumbing supplies. Its extensive product selection combined with its inventory management services has contributed to being a leader in the MRO market. Grainger serves roughly 3 million businesses and institutions worldwide via their network of distribution centers, websites, and branches.

Donald Macpherson was appointed CEO in October 2016 and has been with Grainger since 2008.

COMPANY HIGHLIGHTS AND FINANCIALS

The MRO market is highly fragmented but Grainger has separated itself from competitors by offering customized services and enhanced e-commerce platforms that cater to large customers. Approximately five thousand suppliers provide Grainger with more than 1.6 million products. Grainger maintains strong relationships with its active customers via enhanced inventory management solutions. It is estimated that Grainger controls 6% of the US market share in this space with its $10 billion in annual revenue. Through continued investments in e-commerce, Grainger has become the 11th largest website (by sales) in the US, which accounts for close to 50% of their revenues and 65% of their orders. Of the 250 branches that Grainger operates, the majority are company owned without mortgages, increasing balance sheet strength, and allowing for increased flexibility in their continued transition to digital platforms.

The company's operating performance has been very strong over time. The firm generates consistent operating margins, averaging 10% over the previous 10 years. They also generate much higher returns on capital than other logistics firms due to their low asset base and strong balance sheet (ROIC has averaged 18% over the last 10 years). This, combined with Grainger's focus of returning cash to shareholders via dividends (45 consecutive years of dividend increases), and strategic buybacks, shows how focused and shareholder friendly the management team has been over time. With low debt and strong cash flow generation, this should allow Grainger to continue to grow over time and allow it to do so without excess leverage.

6/28/2017 :: Ticker: GWW :: Div. Yield: 2.9% :: Closing Price: $176.96

VALUATION AND RISKS

Grainger is trading at a discount compared with historical valuations and below fair value based on scenario analysis of free cash flow growth. Grainger has a dividend yield of 2.90% and generates significant free cash flow, creating the flexibility to continue to raise their dividend over time. We expect the company to grow free cash flow on average at 4.5% over the next decade, below its historical average, due to increased competition and pricing pressure from clients. Modeling our conservative assumption places a price of $200.00 on shares which is almost a 12% premium based on current price. If our conservative assumptions turn out to be overly optimistic, we still feel there is a margin of safety built into the current price based on the company's high returns on capital, strong cash flow generation, and strong balance sheet.

The largest risks we view is an overall cyclical downturn in the global economy and increased competition from larger more diversified firms. Though we believe that Grainger's strong customer relationships, technology platform, and diversified revenue stream would allow the company to continue to earn high returns on capital, it could put short term pressure on operating performance.

—Patrick Mason, Investment Analyst, Cairn Investment Group

ABOUT CAIRN INVESTMENT GROUP Cairn Investment Group is an independent fee only Registered Investment Advisor based in Portland, Oregon. Cairn staff has the experience and capabilities to serve our investors with a level of personal attention that only a smaller, independent company can provide. We pride ourselves on working in close contact with our investors.

503.241.4901 :: 877.241.4901 :: cairninvestment.com

121 SW Morrison, Suite 1060 :: Portland, Oregon 97204