GRAINGER W W INC
Form 10-K
February 28, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2018
OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to _______

Commission file number 1-5684

W.W. Grainger, Inc.
(Exact name of registrant as specified in its charter)

Illinois	36-1150280
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 Grainger Parkway, Lake Forest, Illinois	60045-5201
(Address of principal executive offices)	(Zip Code)

(847) 535-1000
(Registrant's telephone number including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock $0.50 par value	New York Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [X] No [ ]
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [ ] No [X]
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes [X] No [ ]
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [X]	Accelerated filer [ ]	Non-accelerated filer [ ]	Smaller reporting company [ ]	Emerging growth company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes [ ] No [X]

The aggregate market value of the voting common equity held by nonaffiliates of the registrant was $16,101,319,439 as of the close of trading as reported on the New York Stock Exchange on June 30, 2018. The Company does not have nonvoting common equity.

The registrant had 55,679,223 shares of the Company’s Common Stock outstanding as of January 31, 2019.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be filed in connection with the annual meeting of shareholders to be held on April 24, 2019, are incorporated by reference into Part III hereof of this Form 10-K where indicated the definitive 2018 proxy statement will be filed on or about March 15, 2019.

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PART I

Item 1: Business

The Company

W.W. Grainger, Inc., incorporated in the State of Illinois in 1928, is a broad line, business-to-business distributor of maintenance, repair and operating (MRO) products and services. W.W. Grainger, Inc.'s operations are primarily in North America, Europe and Japan. In this report, the words “Grainger” or “Company” mean W.W. Grainger, Inc. and its subsidiaries, except where the context makes it clear that the reference is only to W.W. Grainger, Inc. itself and not its subsidiaries.

Strategy

In the large and fragmented MRO industry, Grainger holds an advantaged position with its supply chain infrastructure, broad in-stock product offering and deep customer relationships. Grainger's purpose is to help businesses keep their operations running and their people safe.

The Company competes with two models: the high-touch, high-service model and the endless assortment (single-channel) model. Competing with these two models allows Grainger to leverage its scale and advantaged supply chain to meet the changing needs of its customers. Grainger’s high-touch, high-service model serves customers with complex needs in North America and Europe. The endless assortment model is focused on customers with less-complex needs and includes the Zoro Tools, Inc. (Zoro) brand in the U.S. and MonotaRO Co., Ltd. (MonotaRO) in Japan.

MRO Industry

The global MRO market is approximately $608 billion, and the estimated market size where Grainger has operations is $284 billion. The most attractive geographies for Grainger are those with high GDP per capita and a developed infrastructure. Grainger’s strategy is concentrated in North America, Europe and Japan. Each of these core markets is large and the competition is highly fragmented. In total, Grainger has about 4 percent share within its addressable market with ample opportunity for growth.

Grainger’s two reportable segments are the U.S. and Canada, and they are described further below. Other businesses include the endless assortment businesses, Zoro in the U.S. and MonotaRO in Japan, and smaller businesses in Europe, Asia and Mexico. For further segment and financial information, see “Item 7: Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Note 17 to the Consolidated Financial Statements (Financial Statements).

The table below shows Grainger's estimated share of the MRO market and the summary of its operations by reporting segments and other businesses as of December 31, 2018:

	Approximate MRO Market Size (billions)[1]	Approximate Market Share	Branches[2]	Distribution Centers (DCs)[2]	Approximate Number of Customers Served (thousands)[4]
United States	$93	7%	283	16	1,100
Canada	12	5%	54	5	50
Other businesses					
Endless assortment businesses	82	2%	—	4	2,200
High-touch, high-service businesses[3]	97	1%	120	6	320
TOTAL	$284	4%	457	31	3,700

[1] Estimated MRO market size where Grainger has operations.
[2] See Item 2, "Properties" for more information.
[3] Includes businesses in Europe, Asia and Mexico.
[4] Customers served in the United States may include overlap with Zoro in Endless assortment business.

Customers and Products

Grainger serves more than 3.5 million customers worldwide through its DCs, eCommerce platform, contact centers, branches and sales and service representatives. These customers represent a broad collection of industries including government, manufacturing, transportation, commercial and contractors (see Note 2 to the Financial Statements).
Grainger offers a broad selection of products to its customers including 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. Products are regularly added and deleted from Grainger's product lines on the basis of customer demand, market research, suppliers' recommendations, sales volumes and other factors. No one product category comprises more than 18% of global sales.

United States

The U.S. business offers a broad selection of MRO products and services through its eCommerce 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.
The U.S. business purchases products for sale from approximately 3,000 suppliers, most of which are manufacturers. No single supplier comprised more than 5% of total purchases and no significant barriers thus far exist with respect to sources of supply. The majority of products sold by the U.S. business are nationally branded products. In addition, approximately 21% of 2018 sales were private label MRO items bearing Grainger’s registered trademarks, including DAYTON®, SPEEDAIRE®, AIR HANDLER®, TOUGH GUY®, WESTWARD®, CONDOR® and LUMAPRO®. Grainger has taken steps to protect these trademarks against infringement and believes that they will remain available for future use in its business.
The U.S. business operates and fulfills orders nationally through a network of DCs, branches and contact centers. Customers range from small and mid-sized businesses to large corporations, government entities and other institutions within many industries (see Note 2 to the Financial Statements). Sales in 2018 were made to more than 1 million customers and no single end customer accounted for more than 1% of total sales. The U.S. business also exports to various countries.

Macro trends and technology drive the way Grainger's U.S. customers behave. Customers want highly tailored solutions with real-time access to information and just-in-time delivery of products and services. Demands for transparency are also increasing as access to information expands. These changes are reflected in how customers do business in the U.S. as demonstrated in the following tables for the 2018 line mix:

Order Origination			Order Fulfillment		
Website	31	%	Ship to Customer	70	%
EDI/ePro	23	%	Pick up at Branch	13	%
KeepStock®	17	%	KeepStock®	17	%
Counter	9	%		100	%
Phone	20	%			
	100	%			

U.S. customers continue to migrate to web and electronic platforms such as EDI, eProcurement and KeepStock®. Through Grainger.com and other branded websites, customers have access to more than 2.9 million products. Grainger.com provides real-time price and product availability, detailed product information and features such as product search and compare capabilities. For customers with sophisticated electronic purchasing platforms, the U.S. business utilizes technology that allows these systems to communicate directly with Grainger.com.

The U.S. business has an outside and inside sales force to help customers select the right products for their needs and reduce costs by utilizing Grainger as a consistent source of supply.

Inventory management is another area where the U.S. business helps customers be more productive. KeepStock® is a comprehensive program that includes vendor-managed inventory, customer-managed inventory and onsite vending machines.

DCs in the U.S. business range in size from approximately 45,000 square feet to 1.3 million square feet, the largest of which can accommodate more than 500,000 in-stock products. Automation in the DCs allows Grainger to ship most orders complete with next-day delivery and replenish branches that provide same-day availability.

Branches in the U.S. business serve the immediate needs of customers in their local markets by allowing them to directly pick up items. Branches also support local KeepStock® operations and allow customers to leverage branch staff for their technical product expertise and search-and-select support.

Grainger's contact center network in the U.S. business on average handles about 73,000 customer interactions per day including approximately 20,000 orders via phone, e-mail and chat.

Canada

Acklands – Grainger Inc. 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. Customers have access to more than 194,000 stocked products through a comprehensive catalog and website.

Other businesses

Other businesses is comprised of the endless assortment businesses, Zoro in the U.S. and MonotaRO in Japan, and smaller high-touch, high-service businesses in Europe, Asia and Mexico.

Zoro

Zoro is an online MRO distributor, primarily serving U.S. customers through its website, Zoro.com. Zoro, with sales of more than $500 million in 2018, offers a broad selection of more than 2 million products to its customers. Zoro has no branches or sales force, and customer orders are fulfilled through the U.S. business supply chain and third parties.

MonotaRO

Grainger operates in Japan and other Asian countries primarily through its majority interest in MonotaRO. MonotaRO had nearly $1 billion in revenue in 2018 and provides customers with access to approximately 20 million MRO products primarily through its websites and catalogs. A majority of orders are conducted through MonotaRO.com and fulfilled from its DCs and third parties.

Seasonality
Grainger’s business in general is not seasonal, however, there are some products that typically sell more often during the winter or summer seasons. In any given month, unusual weather patterns, that is, unusually hot or cold weather, could positively or negatively impact the sales volumes of these products.

Competition
Grainger faces competition in each market from manufacturers (including some of its own suppliers) that sell directly to certain segments of the market, to wholesale distributors, catalog houses, retail enterprises and internet-based businesses. Grainger differentiates itself by providing local product availability, a broad product line, sales and service representatives, competitive pricing, catalogs (which include product descriptions and, in certain cases, extensive technical and application data) and electronic and eCommerce technology. Grainger also offers other services, such as inventory management. Grainger has several large competitors and continues to be highly competitive against the predominant number of small local and regional competitors.

Employees
As of December 31, 2018, Grainger had approximately 24,600 employees, of whom approximately 23,100 were full-time and 1,500 were part-time or temporary. Grainger has never had a major work stoppage and considers employee relations to be good.

Website Access to Company Reports
Grainger makes available free of charge, through its website, www.grainger.com/investor, its Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and amendments to those reports if any, as soon as reasonably practicable after these materials are electronically filed with, or furnished to, the U.S. Securities and Exchange Commission (SEC).
The SEC maintains a website that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC and the address of that site is http://www.sec.gov.

Item 1A: Risk Factors

The following is a discussion of significant risk factors relevant to Grainger's business that could adversely affect its financial condition, results of operations and cash flows. The risk factors discussed in this section should be considered together with information included elsewhere in this Annual Report on Form 10-K and should not be considered the only risks to which the Company is exposed.

Weakness in the economy, market trends and other conditions affecting the profitability and financial stability of Grainger's customers could negatively impact Grainger's sales growth and results of operations.

Economic, political, and industry trends affect Grainger's business environments. Grainger serves several industries and markets in which the demand for its products and services is sensitive to the production activity, capital spending and demand for products and services of Grainger's customers. Many of these customers operate in markets that are subject to cyclical fluctuations resulting from market uncertainty, trade and tariff policies, costs of goods sold, currency exchange rates, central bank interest rate changes, foreign competition, offshoring of production, oil and natural gas prices, geopolitical developments, labor shortages, inflation, deflation, and a variety of other factors beyond Grainger's control. Any of these factors could cause customers to idle or close facilities, delay purchases, reduce production levels, or experience reductions in the demand for their own products or services.

Any of these events could also reduce the volume of products and services these customers purchase from Grainger or impair the ability of Grainger's customers to make full and timely payments, and could cause increased pressure on Grainger's selling prices and terms of sale. Accordingly, a significant or prolonged slowdown in activity in the U.S., Canada or any other major world economy, or a segment of any such economy, could negatively impact Grainger's sales growth and results of operations.

The facilities maintenance industry is highly competitive, and changes in competition could result in decreased demand for Grainger's products and services.

Grainger competes in a variety of ways, including product assortment and availability, services offered to customers, pricing, purchasing convenience, and the overall experience Grainger offers. This includes the ease of use of Grainger's high-touch high-service operations (branches and digital platforms) and delivery of products.

There are several large competitors in the industry, although most of the market is served by small local and regional competitors. Grainger faces competition in all markets it serves, from manufacturers (including some of its own suppliers) that sell directly to certain segments of the market, wholesale distributors, catalog houses, retail enterprises and online businesses that compete with price transparency.

To remain competitive, the Company must be willing and able to respond to market pressures. These pressures, and the implementation, timing and results of Grainger's strategic pricing and other responses, could have a material effect on Grainger's sales and profitability. If the Company is unable to grow sales or reduce costs, among other actions, to wholly or partially offset the effect on profitability of its pricing actions, the Company's results of operations and financial condition may be adversely affected.

Moreover, Grainger expects technological advancements and the increased use of eCommerce solutions within the industry to continue to evolve at a rapid pace. As a result, Grainger's ability to effectively compete requires Grainger to respond and adapt to new industry trends and developments, and implement new technology and innovations that may result in unexpected costs or may take longer than expected.

Volatility in commodity prices may adversely affect gross margins.

Some of Grainger's products contain significant amounts of commodity-priced materials, such as steel, copper, petroleum derivatives, or rare earth minerals, and are subject to price changes based upon fluctuations in the commodities market. Fluctuations in the price of fuel could affect transportation costs. Grainger's ability to pass on such increases in costs in a timely manner depends on market conditions. The inability to pass along cost increases could result in lower gross margins. In addition, higher prices could impact demand for these products, resulting in lower sales volumes.

Unexpected product shortages, tariffs, and risks associated with Grainger's suppliers could negatively impact customer relationships or result in an adverse impact on results of operations.

Grainger's competitive strengths include product selection and availability. Products are purchased from approximately 5,000 suppliers located in various countries around the world, not one of which accounted for more than 5% of total purchases.

Historically, no significant difficulty has been encountered with respect to sources of supply; however, disruptions could occur due to factors beyond Grainger's control, including economic downturns, geopolitical unrest, new tariffs or tariff increases, trade issues and policies, labor problems experienced by Grainger's suppliers, transportation availability and cost, inflation and other factors, any of which could adversely affect a supplier's ability to manufacture or deliver products or could result in an increase in Grainger's product costs.

Further, Grainger sources products from Asia and other areas of the world. This increases the risk of supply disruption due to the additional lead time required and distances involved.

If Grainger was to experience difficulty in obtaining products, there could be a short-term adverse effect on results of operations and a longer-term adverse effect on customer relationships and Grainger's reputation. In addition, Grainger has strategic relationships with a number of vendors. In the event Grainger was unable to maintain those relations, there might be a loss of competitive pricing advantages which could, in turn, adversely affect results of operations.

Changes in customer base or product mix could cause changes in Grainger's gross margin or affect Grainger's competitive position.

From time to time, Grainger experiences changes in customer base and product mix that affect gross margin. Changes in customer base and product mix result primarily from business acquisitions, changes in customer demand, customer acquisitions, selling and marketing activities and competition. There can be no assurance that Grainger will be able to maintain historical gross margins in the future.

Additionally, as customer base and product mix change over time, Grainger must identify new products, product lines and services that respond to industry trends and customer needs. The inability to introduce new products and effectively integrate them into Grainger's existing product mix could have a negative impact on future sales growth and Grainger's competitive position.

Disruptions in Grainger's supply chain could result in an adverse impact on results of operations.

The occurrence of one or more natural disasters such as earthquakes, storms, hurricanes, floods, fires, droughts, tornados and other extreme weather; geopolitical events, such as war, civil unrest or terrorist attacks in a country in which Grainger operates or in which its suppliers are located; and the imposition of measures that create barriers to or increase the costs associated with international trade could result in disruption of Grainger's logistics or supply chain network. Any such disruption could cause one or more of Grainger's distribution centers or branches to become non-operational, adversely affect Grainger's ability to obtain or deliver inventory in a timely manner, impair Grainger's ability to meet customer demand for products, result in lost sales, additional costs, or penalties, or damage Grainger's reputation. Grainger's ability to provide same-day shipping and next-day delivery is an integral component of Grainger's business strategy and any such disruption could adversely impact results of operations and financial performance.

Interruptions in the proper functioning of information systems could disrupt operations and cause unanticipated increases in costs and/or decreases in revenues.

The proper functioning of Grainger's information systems is critical to the successful operation of its business. Grainger continues to invest in software, hardware and network infrastructures in order to effectively manage its information systems. Although Grainger's information systems are protected with robust backup and security systems, including physical and software safeguards and remote processing capabilities, information systems are still vulnerable to damage or interruption from natural disasters, power losses, telecommunication failures, user error, third party actions such as malicious computer programs, denial-of-service attacks and cybersecurity breaches, and other problems.

If Grainger's systems are damaged, breached or cease to function properly Grainger may have to make a significant investment to repair or replace them and may suffer interruptions in its business operations in the interim. If critical information systems fail or otherwise become unavailable, among other things, Grainger's ability to process orders, maintain proper levels of inventories, collect accounts receivable, and disburse funds could be adversely affected. Any such interruption of Grainger's information systems could have a material adverse effect on its business or results of operations.

Cybersecurity incidents, including breaches of information systems security, could damage Grainger's reputation, disrupt operations, increase costs and/or decrease revenues.

Through Grainger's sales and eCommerce channels, Grainger collects and stores personally identifiable, confidential, proprietary and other information from customers so that they may, among other things, purchase products or services, enroll in promotional programs, register on Grainger's websites or otherwise communicate or interact with the Company. Moreover, Grainger's operations routinely involve receiving, storing, processing and transmitting sensitive information pertaining to its business, customers, suppliers and employees, and other sensitive matters.

Cyber threats are rapidly evolving and those threats and the means for obtaining access to information in digital and other storage media are becoming increasingly sophisticated. Each year, cyber-attackers make numerous attempts to access the information stored in our information systems.

Moreover, from time to time, Grainger may share information with vendors and other third parties that assist with certain aspects of the business. While Grainger requires assurances that these vendors and other parties will protect confidential information, there is a risk that the confidentiality of data held or accessed by them may be compromised. If successful, those attempting to penetrate Grainger's or its vendors' information systems may misappropriate personally identifiable, credit card, confidential, proprietary or other sensitive customer, supplier, employee or business information, or cause systems disruption.

In addition, a Grainger employee, contractor or other third party with whom Grainger does business may attempt to circumvent security measures in order to obtain such information or inadvertently cause a breach involving such information. Further, Grainger's systems are integrated with customer systems in certain cases, and a breach of the Company's information systems could be used to gain illicit access to customer systems and information.

While Grainger has instituted safeguards for the protection of such information, because techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until they are launched against a target, Grainger may be unable to anticipate these techniques or implement adequate preventative measures. Any breach of Grainger's security measures or any breach, error or malfeasance of those of its third party service providers could cause Grainger to incur significant costs to protect any customers, suppliers, employees, and other parties whose personal data is compromised and to make changes to its information systems and administrative processes to address security issues. Loss of customer, supplier, employee or other business information could disrupt operations, damage Grainger's reputation and expose Grainger to claims from customers, suppliers, financial institutions, regulators, payment card associations, employees and others, any of which could have a material adverse effect on Grainger, its financial condition and results of operations.

In the past, Grainger has experienced certain cybersecurity incidents. In each instance, Grainger provided notifications and adopted remedial measures. While these incidents have not been deemed to be material to Grainger, there can be no assurance that a future breach or incident would not be material to Grainger's operations and financial condition.

Grainger's ability to adequately protect its intellectual property or successfully defend against infringement claims by others may have an adverse impact on operations.

Grainger's business relies on the use, validity and continued protection of certain proprietary information and intellectual property, which includes current and future patents, trade secrets, trademarks, service marks, copyrights and confidentiality agreements as well as license and sublicense agreements to use intellectual property owned by affiliated entities or third parties. Unauthorized use of Grainger's intellectual property by others could result in harm to various aspects of the business and may result in costly and protracted litigation in order to protect its rights. In addition, Grainger may be subject to claims that it has infringed on the intellectual property rights of others, which could subject Grainger to liability, require Grainger to obtain licenses to use those rights at significant cost or otherwise cause Grainger to modify its operations.

Fluctuations in foreign currency could have an effect on reported results of operations.

Grainger’s exposure to fluctuations in foreign currency rates results primarily from the translation exposure associated with the preparation of the Consolidated Financial Statements, as well as from transaction exposure associated with transactions in currencies other than an entity’s functional currency. While the Consolidated Financial Statements are reported in U.S. dollars, the financial statements of Grainger’s subsidiaries outside the U.S. are prepared using the local currency as the functional currency and translated into U.S. dollars. In addition, Grainger is exposed to foreign currency exchange rate risk with respect to the U.S. dollar relative to the local currencies of Grainger’s international subsidiaries, primarily the Canadian dollar, euro, pound sterling, Mexican peso, renminbi and yen, arising from transactions in the normal course of business, such as sales and loans to wholly owned subsidiaries, sales to customers, purchases from suppliers, and bank loans and lines of credit denominated in foreign currencies. Grainger also has foreign currency exposure to the extent receipts and expenditures are not denominated in the subsidiary’s functional currency and that could have an impact on sales, costs and cash flows. These fluctuations in foreign currency exchange rates could affect Grainger’s results of operations and impact reported net sales and net earnings.

Acquisitions, partnerships, joint ventures and other business combination transactions involve a number of inherent risks, any of which could result in the benefits anticipated not being realized and could have an adverse effect on results of operations.

Acquisitions, partnerships, joint ventures and other business combination transactions, both foreign and domestic, involve various inherent risks, such as uncertainties in assessing value, strengths, weaknesses, liabilities and potential profitability. There is also risk relating to Grainger’s ability to achieve identified operating and financial synergies anticipated to result from the transactions. Additionally, problems could arise from the integration of acquired businesses, including unanticipated changes in the business or industry or general economic or political conditions that affect the assumptions underlying the acquisition. Any one or more of these factors could cause Grainger to not realize the benefits anticipated or have a negative impact on the fair value of the reporting units. Accordingly, goodwill and intangible assets recorded as a result of acquisitions could, and have in the past, become impaired.

In order to compete, Grainger must attract, retain and motivate key employees, and the failure to do so could have an adverse effect on results of operations.

In order to compete and have continued growth, Grainger must attract, retain and motivate executives and other key employees, including those in managerial, technical, sales, marketing and support positions. Grainger competes to hire employees and then must train them and develop their skills and competencies. Grainger’s results of operations could be adversely affected by increased costs due to increased competition for employees, higher employee turnover or increased employee benefit costs.