3Q11 Earnings Release Podcast Script
October 18, 2011

Introduction

Hello, this is Laura Brown, Senior Vice President of Communications and Investor Relations. With me is Bill Chapman, Director of Investor Relations. We are pleased to share with you an update regarding Grainger's third quarter 2011 results via this audio web cast. Please also reference our 2011 third quarter earnings release issued October 18th, in addition to other information available on our Investor Relations website, to supplement this web cast.

Before we begin, please remember that certain statements and projections of future results made in the press release and in this web cast constitute forward-looking information. These statements are based on current market conditions and competitive and regulatory expectations and involve risk and uncertainty. Please see our Form 10-K for a discussion of factors that relate to forward-looking statements.

Company Results Summary

We are excited to report that Grainger delivered another record quarter. Strong sales growth and gross margin expansion was the story for the quarter. Thanks to the success of our growth drivers, we continued to gain market share just as we did throughout the downturn. Our growth drivers include expanding our product line, increasing our sales force, enhancing our eCommerce capabilities, growing our inventory management services and investing in our international operations. One of the highlights of the quarter was the acquisition of the Fabory Group. Fabory is a leading European distributor of fasteners and related MRO products. The closing of the acquisition took place on August 31st.

We are also very pleased to announce that we have raised our guidance for the year. As noted in the release, we are now expecting sales for 2011 to grow 11 to 12 percent, with earnings per share of $8.80 to $9.00, excluding unusual items. Please note that our guidance reflects higher growth-related spending for the remainder of the year, which we will discuss later in the podcast.

Let's start with total company results, then dig deeper into our segments. Company sales increased 11 percent versus the 2010 third quarter. We had the same number of selling days this quarter as 2010, so reported sales growth and daily sales growth were the same. Operating earnings and net earnings increased 21 percent. As highlighted in our release, earnings per share of $2.51 is an all-time record and represents a 22 percent increase versus 2010.

As a reminder, the 2010 third quarter included a 7 cent per share benefit from the change in the company's paid time off, or PTO, policy. Excluding the PTO benefit in 2010, third quarter earnings per share increased 26 percent.

In a few moments we'll take an in-depth look at sales results for the quarter; let's now walk down the operating section of the income statement. Gross profit margins increased to 43.2 percent, up 160 basis points versus last year, with higher gross margins in the United States, Canada and in our Other Businesses. Again this quarter, we were able to manage product cost inflation below price increases. We'll provide more detail when we review the business by segment.

Reported company operating earnings for the quarter increased 21 percent. Company operating margins were 14.3 percent, up 110 basis points versus the prior year. If you exclude the $8 million benefit in 2010 from the PTO change, operating earnings were up 25 percent and operating margins increased 150 basis points. This strong performance was primarily driven by the 11 percent sales growth and the 160 basis point improvement in gross profit margins.

Let's now focus on performance drivers during the quarter. In doing so, we'll cover the following topics:

- First, sales by segment in the quarter and the month of September,
- Second, our operating performance by segment,
- Third, cash generation and capital deployment,
- And finally, we'll wrap up with a discussion of other key items of interest.

Quarterly Sales

As mentioned earlier, sales for the company increased 11 percent for the quarter. Of the 11 percent sales growth for the quarter, volume contributed 8 percentage points, price added 3 percentage points, acquisitions contributed 2 percentage points and foreign exchange added 1 percentage point. Sales related to last year's oil spill in the Gulf of Mexico represented a headwind of 3 percentage points. Daily sales growth by month was as follows: 10 percent in July, 10 percent in August, and 14 percent in September. Excluding Fabory, daily sales in September increased 10 percent. It is important to note that despite the uncertainty in the economy, we saw consistent, 10 percent sales growth throughout the quarter.

Let's move on to sales by segment. We report two segments, the United States and Canada. Our remaining operations, Fabory in Europe, Japan, Mexico, Colombia, India, China, Puerto Rico and Panama are reported under a grouping titled Other Businesses.

Sales in the United States, which accounted for 81 percent of total company revenue in the quarter, increased 7 percent. By month, daily sales in the United States increased 5 percent in July, 8 percent in August and 7 percent in September. The 7 percent sales growth for the quarter consisted of 7 percent volume growth and 3 percentage points from price, partially offset by a 3 percentage point drag from the oil spill-related sales in 2010. In August, we put through a modest price increase in the U.S. business tied to commodity inflation.

Now we'll cover our sales performance by customer end-market in the United States. Domestic growth initiatives, including product line expansion, sales force expansion, eCommerce and inventory management services are driving the company to grow faster than the economy and gain additional market share. As a result, sales to all customer end-markets in the United States, except for Reseller, were positive in the quarter as follows:

- Heavy Manufacturing was up in the mid teens;
- Commercial was up in the low double digits;
- Light Manufacturing and Retail were up in the high single digits;
- Contractors and Government were up in the mid single digits; and
- Reseller was down in the low 20s reflecting the strong sales of oil spill-related products in 2010.

Let's turn our attention to the Canadian business, which represented 12 percent of total company revenues in the 2011 third quarter. Sales in Canada increased 23 percent in U.S. dollars and 16 percent in local currency. On a daily basis in Canadian dollars, sales were up 18 percent in July, up 14 percent in August and up 15 percent in September. The 16 percent sales growth in the quarter consisted of 14 percent volume growth and 2 percentage points from acquisitions. From a customer standpoint, sales growth in Canada was driven by strength in the heavy manufacturing, retail/wholesale, transportation, and agriculture and mining customer end-markets.

Let's conclude our review of sales for the quarter by looking at the Other Businesses, which accounted for 7 percent of total company sales in the quarter. Again, this group includes our operations in Europe, Japan, Mexico, Colombia India, China, Puerto Rico and Panama. Sales for this group increased 66 percent, primarily from the incremental sales from Fabory in the month of September, along with strong growth in Japan and Mexico. All businesses contributed to the strong sales growth in the quarter.

September Sales

Earlier in the quarter, we reported sales results for July and August. Let's now take a closer look at September. There were 21 selling days in September of 2011 and 2010. Total company sales increased 14 percent in September, versus September of 2010, consisting of 8 percent volume growth, 5 percentage points from acquisitions, 3 percentage points from price inflation and 1 percentage point from foreign exchange, partially offset by a 3 percentage point headwind from oil spill-related sales in 2010. Excluding sales from Fabory, daily sales in September increased 10 percent.

In the United States, September sales increased 7 percent. This growth consisted of 7 percentage points of volume and 3 percentage points from price, partially offset by 3 percentage points from sales related to last year's oil spill. Daily sales growth in September to each of our U.S. customer end-markets was as follows:

- Heavy Manufacturing was up in the mid teens;
- Commercial and Light Manufacturing were up in the low double digits;
- Retail was up in the high single digits;
- Contractors was up in mid single digits;
- Government was up in the low single digits; and
- Reseller was down in the high teens reflecting the strong sales of oil spill-related products in 2010.

Sales in Canada for September increased 19 percent in U.S. dollars, up 15 percent in local currency. The 15 percent sales growth consisted of 13 percent volume, 1 percent price and 1 percent from acquisitions. Customers in the heavy manufacturing, retail/wholesale, transportation, and agriculture and mining end markets accounted for the largest percentage increases in September.

Sales for our Other Businesses increased 117 percent in September, primarily the result of incremental sales from Fabory, along with strong sales growth in Japan.

<u>October Sales</u>

Company sales growth so far in the month of October is tracking roughly in line with the growth rate posted in September. As a reminder, sales related to the 2010 Gulf of Mexico oil spill clean up contributed 1 percentage point to the 11 percent daily growth in October of last year.

Now I would like to turn the discussion over to Bill Chapman.

<u>Operating Performance:</u>

Thanks Laura. Let's jump right into performance by segment since we have already covered company operating performance.

Reported operating earnings in the United States increased 15 percent versus the 2010 third quarter and operating margin increased 130 basis points to 17.7 percent. If you exclude the benefit from the PTO change in 2010, operating earnings in the United States increased 19 percent and operating margins expanded 180 basis points versus the prior year. This performance was driven by 7 percent sales growth and a higher gross profit margin. Gross profit margins in the United States increased 180 basis points. The gross margin expansion was primarily due to managing product cost inflation below price increases, coupled with favorable selling price mix, strong sales of private label products and lower sales of sourced products related to the clean up of the 2010 oil spill. Operating expenses increased 9 percent, 7 percent excluding the PTO benefit from the prior year. The growth in operating expenses was driven by volume related costs and spending on growth initiatives such as sales force expansion, eCommerce, advertising and the start up of the new distribution center in northern California.

Our business in Canada delivered improved performance in the quarter, a continuation of the strong results seen in the first half of 2011. Third quarter operating earnings increased 72 percent versus the prior year. Strong sales growth, coupled with higher gross margins and effective cost management contributed to a 290 basis point increase in operating margins to 10.1 percent. The gross margin expansion in Canada was driven by the same factors as seen in the United States. Operating expenses increased 12 percent, aided by improved productivity and lower utility costs resulting from milder weather. For the fourth quarter, start up costs for the new distribution center in Saskatchewan will result in sequential operating expense growth. Despite these investments, we expect to generate about 150 to 200 basis points of year-over-year operating expense leverage in the 2011 fourth quarter in Canada.

Operating earnings for our Other Businesses increased 139 percent to $11 million versus $4 million a year ago. This increase was the result of improved operating performance in Japan, Mexico and China. Fabory's September results also contributed to higher operating earnings for the Other Businesses in the quarter. At a total company level, Fabory's earnings were essentially offset by acquisition costs, which are included in unallocated expenses.

<u>Other</u>

Interest expense, net of interest income, was $2.0 million versus $1.6 million in the prior year. The increase was due to €120 million in new debt to finance half of the Fabory acquisition. The effective tax rate for the quarter was 38.7 percent versus 39.4 percent. The lower rate is primarily due to higher earnings in foreign jurisdictions with lower tax rates.

Cash Flow

Lastly, let’s take a look at cash flow for the quarter. Operating cash flow was $251 million, a 22 percent increase versus $206 million in 2010. We used the cash generated during the quarter to invest in the business and return capital to shareholders through dividends and share repurchases. Capital expenditures for the quarter were $47 million versus $43 million in the prior year quarter. Dividends paid to shareholders were $47 million. We also bought back 360,000 shares of stock during the quarter and have approximately 7.3 million shares remaining on our share repurchase authorization.

Other Key Items

As reported in today’s release, we increased our 2011 sales and earnings guidance, reflecting our strong performance to date and the addition of Fabory beginning in September. We now expect 2011 sales growth in the range of 11 to 12 percent and EPS in the range of $8.80 to $9.00. Keep in mind, our EPS guidance excludes unusual items such as the $0.12 cent per share benefit recognized in the 2011 second quarter from the settlement of tax examinations for 2007 and 2008 and the expected $5 million after-tax gain on the sale of our minority ownership position in MRO Korea, announced on October 11, 2011.

So, let’s look at the underlying elements of our expectations:

- First, incremental sales from Fabory, beginning in September, add about 2 percentage points to our expected top line growth for the year. This is the primary driver of our revised guidance of 11 to 12 percent sales growth, versus our previous sales guidance of 9 to 10 percent growth issued on July 19, 2011.
- Second, we expect gross profit margins in the fourth quarter to erode slightly versus the 2011 third quarter on product cost inflation catch-up related to our August price increase.

- Third, our investments in proven growth drivers, such as new sales representatives, eCommerce and advertising will continue to accelerate in the fourth quarter. As previously communicated, we expect to add 150 new sales representatives in the 2011 fourth quarter for a total of 300 new hires for the year. We had expected some of the new sales representatives to be hired in the third quarter, but those incremental expenses will now begin in the fourth quarter. We'll also be investing in some information technology infrastructure to support the development and phased roll out of the company's new eCommerce platform. Our national advertising campaign will also continue in the fourth quarter. Finally, the ramp up of our new 800,000 square foot super regional distribution center in northern California will result in additional operating expense in the 2011 fourth quarter. To recap, we still expect $60 to $70 million in growth-related spending in 2011 spread as follows:
    - $8 million in 1Q
    - $11 million in 2Q
    - $20 million in 3Q
    - $19-$29 million in 4Q

To summarize, 2011 is turning out to be an exceptional year for Grainger. For the first 3 quarters, we have generated 230 basis points of operating margin expansion, excluding unusual items, on 12 percent sales growth. For the full year, we expect normalized operating margins to be 170 to 180 basis points higher than 2010, which is essentially 3 years worth of normal annual margin expansion. Keep in mind, however, that the 2011 fourth quarter will have lower operating margins than the first 3 quarters due to the following factors:

- Organic sales volume is typically lower in the fourth quarter than in the third quarter.
- The 2011 fourth quarter will have 1 less selling day than the 2011 third quarter, 63 versus 64.

- As noted earlier, we expect to see even more growth-related investment spending in the fourth quarter.
- And finally, we will have a full quarter of results from Fabory, which is expected to carry mid-single digit operating margins and be earnings neutral for 2011.

Conclusion

Please mark your calendar for the release of October sales on Friday, November 11th and our Annual Analyst Meeting on November 16th. If you have any questions, please do not hesitate to contact Laura Brown at 847.535.0409 or me at 847.535.0881. Thank you for your interest in Grainger.

GRAINGER
FOR THE ONES WHO GET IT DONE

Exhibit I
2011 Guidance

	July*	October**
Sales	**$7.8 - $7.9**	**$8.0 - $8.1**
V% vs. prior year	9% - 10%	11% - 12%
Operating Margin	**12.9% - 13.2%**	**13.2% - 13.3%**
bps vs. prior year	140 – 170	170 – 180
EPS	**$8.40 - $8.70**	**$8.80 - $9.00**

* Effective 7/19/2011 ** Effective 10/18/2011

Exhibit II
2011 Sales Growth Bridge

	9 Mos Actual	Year Estimate*
Economy/Share Gain	8%	7 -8%
Oil Spill Sales	(1)%	(1)%
Price	2%	2%
Organic Sales (daily)	**9%**	**8 – 9%**
F/X	1%	1%
Acquisitions	1%	2%
Company (reported)	**11%**	**11 – 12%**

* Effective 10/18/2011

Exhibit III

Oil Spill Contribution to Daily Sales in 2010

Month	Percentage point contribution
January	0
February	0
March	0
1Q	**0**
April	0
May	1
June	1
2Q	**1**
July	3
August	3
September	3
3Q	**3**
October	1
November	2
December	3
4Q	**2**
Year	**1**