2Q12 Earnings Release Podcast Script
July 18, 2012

Introduction

Hello, this is Laura Brown, Senior Vice President of Communications and Investor Relations. With me today is Bill Chapman, Senior Director of Investor Relations. We are pleased to share with you some information regarding Grainger's second quarter 2012 results via this audio web cast. Please also reference our 2012 second quarter earnings release issued today, July 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

Healthy sales growth, consistent execution and impressive margin expansion was the story line for the quarter. This performance was largely driven by continued enhancements to the foundation of our business and aggressive investment in our growth programs. As a result, we reiterated our 2012 sales growth guidance of 12 to 14 percent and raised the bottom end of our earnings per share guidance as referenced in today's earnings release. We now expect EPS of $10.50 to $10.80 for the full year 2012. At the end of this recording we'll talk more about our guidance and related assumptions.

We'll start with total company results, and then take a closer look at our segments. Company sales increased 12 percent versus the 2011 second quarter. We had 64 selling days in both quarters. Operating earnings increased 18 percent, while net earnings increased 12 percent. As highlighted in the earnings release, earnings per share of $2.63 for the quarter represents an all-time company record and represents a 12 percent increase versus 2011. The 2011 quarter included a $0.12 per share benefit from the settlement of tax examinations. Excluding this benefit, the earnings per share increased 18 percent versus 2011.

In a few moments we'll analyze our sales results for the quarter. Let's now walk down the operating section of the income statement. Gross profit margins increased 40 basis points to 43.5 percent. Our purchasing scale enables us to manage price changes in line with the market and ahead of product cost inflation. We'll provide more detail when we review the business by segment.

It is important to note that our gross profit margin follows a fairly consistent annual pattern, with generally the highest gross margins in the first quarter of each year. This is primarily driven by supplier funding for our annual customer trade shows early in the year, which is accounted for as a credit to Cost of Goods Sold. So the sequential decline in our gross profit margin from 44.4 percent in the 2012 first quarter to 43.5 percent in the 2012 second quarter is normal and expected.

Our company operating margin increased 80 basis points to 14 percent. This improvement was driven by solid sales growth, gross margin expansion and positive expense leverage. Operating expenses grew 11 percent, including $24 million in incremental growth-related spending in the quarter and the operating expenses from the businesses in Europe and Brazil, which we acquired during the last 12 months.

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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 June,
- Second, operating performance by segment,
- Third, cash generation and capital deployment,
- And finally, we'll wrap up with a discussion of our 2012 guidance.

Quarterly Sales

As mentioned earlier, company sales increased 12 percent for the quarter. Daily sales growth by month was as follows: 12 percent in April, 13 percent in May, and 12 percent in June. The 12 percent sales growth for the quarter included 5 percentage points from acquisitions and a 2 percentage point decline from unfavorable foreign exchange. As a point of reference, foreign exchange represented a 1 percentage point headwind in the 2012 first quarter. On an organic basis, sales for the quarter increased 9 percent including 6 percentage points from volume and 3 percentage points from price.

Let's move on to sales by segment. We report two segments, the United States and Canada. Our remaining operations in Asia, Europe and Latin America are reported under a grouping titled Other Businesses.

Sales in the United States, which accounts for 77 percent of total company revenue, increased 7 percent in the quarter, consisting of 4 percent volume growth and 3 percent from price. Despite the hot weather in late June, sales of seasonal products were not a factor in the quarter or the month of June. Daily sales in the United States increased 7 percent in April, 8 percent in May and 7 percent in June.

Let’s review sales performance by customer end market in the United States. Our growth drivers, which include increasing our product line, expanding customer sales coverage, enhancing our eCommerce capabilities and increasing our inventory management solutions, are enabling Grainger to grow faster than the economy and gain additional market share. This is evident when you look at the variety of customer end markets we serve in the United States and performance for each:

- Heavy Manufacturing was up in the low-double digits;
- Light Manufacturing, Commercial, Reseller, Retail and Natural Resources were up in the high-single digits;
- Government was up in the mid-single digits, and
- Contractor was flat.

Now let’s turn our attention to the Canadian business. Sales in Canada represent 12 percent of total company revenues. For the quarter, sales in Canada increased 9 percent in U.S. dollars and 14 percent in local currency. The 14 percent local currency sales growth in the quarter consisted of 12 percent volume growth and 2 percentage points from price. From a customer standpoint, sales performance in Canada was driven by strong growth in the Commercial, Oil & Gas, Utilities and Contractor end markets. On a daily basis in Canadian dollars, sales increased 13 percent in April, 14 percent in May and 14 percent in June.

Let's conclude our discussion of sales for the quarter by looking at the Other Businesses. Again, this group includes our operations in Asia, Europe and Latin America and currently represents about 11 percent of total company sales. Sales for this group increased 84 percent, which consisted of a 75 percentage point contribution from the acquired businesses in Europe and Brazil, 21 percentage points from volume led by strong growth in Japan, partially offset by a 12 percentage point decline from unfavorable foreign exchange.

June Sales

Earlier in the quarter, we reported sales results for April and May and shared some information regarding performance in those months. Let's now take a look at June. There were 21 selling days in June of 2012, one less than in 2011. Total company sales were up 12 percent on a daily basis in June of 2012 versus June of 2011. The daily sales growth in June included 5 percentage points from acquisitions and a 2 percentage point decline from unfavorable foreign exchange. Organic sales increased 9 percent on a daily basis consisting of 6 percent volume growth and 3 percentage points from price inflation.

In the United States, June daily sales were up 7 percent. This growth consisted of 4 percentage points of volume and 3 percentage points from price. We saw positive daily sales growth in all but 1 of our U.S. customer end markets as follows:

- Heavy and Light Manufacturing increased in the low-double digits;
- Government, Commercial, Reseller, Retail and Natural Resources increased in the mid-single digits; and
- Contractor was essentially flat.

The mid-single digit sales growth to our Government customers is worth noting. As we shared with our May sales release, the fiscal year-end for many state and local governments end in June. Thanks to our strong relationships with these government agencies, coupled with the value of the service we provide, we enjoyed a strong finish to the month. This level of growth to the Government was achieved despite a 25 percent decline in sales to the U.S. Postal Service related to their aggressive restructuring program.

Daily sales in Canada for June increased 8 percent in U.S. dollars, up 14 percent in local currency. The 14 percent local currency daily sales growth consisted of 12 percentage points from volume and 2 percentage points from price. Similar to the quarter, sales growth in Canada was driven by strong performance in the Commercial, Oil & Gas, Utilities and Contractor end markets.

Daily sales for our Other Businesses increased 86 percent in June, consisting of 75 percentage points from acquisitions, 25 percentage points from volume, partially offset by a negative 14 percentage points from unfavorable foreign exchange.

July Sales

Sales in the month of July are off to a good start. Despite the challenges of having the Fourth of July on a Wednesday, daily sales growth to date is trending in line with the 12 percent growth in June.

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

Operating Performance:

Thanks Laura.

Since we have already analyzed company operating performance, let's jump right into performance by reporting segment. Operating earnings in the United States increased 15 percent versus the 2011 second quarter and the U.S. operating margin increased 120 basis points to 17.8 percent. This impressive performance was driven by 7 percent sales growth, higher gross margins and positive expense leverage. Gross profit margins for the quarter increased 20 basis points driven by price increases exceeding cost inflation, partially offset by unfavorable customer and product mix. Expense leverage in the United States was positive despite $24 million in incremental growth-related spending on areas such as new sales representatives, eCommerce and advertising.

Let's move on to our business in Canada. Operating earnings increased 15 percent versus the prior year, up 20 percent in local currency. Strong sales growth, coupled with higher gross profit margins and positive expense leverage contributed to operating margins increasing 60 basis points to 12 percent. Gross margins increased 10 basis points, primarily driven by improved customer mix.

Operating performance for our Other Businesses improved versus a year ago, the result of our focus on enhancing growth and operating performance. This group posted operating earnings of $11 million for the quarter versus $9 million a year ago. Strong operating performance in Japan and Mexico was responsible for this improvement. In addition, approximately $1 million in operating earnings from Fabory in the quarter were offset by losses from the acquired business in Brazil. Consistent with our expectations, investments in expanding the sales force and product offering are creating some near-term headwinds for our business in Brazil.

Other

Below the operating line, interest expense, net of interest income, was $2.3 million in the 2012 second quarter versus $1.5 million in the 2011 second quarter. This increase was primarily attributable to interest on the debt of €120 million incurred in 2011 to finance a portion of the Fabory acquisition.

The effective tax rate for the 2012 second quarter was 37.9 percent versus 38.3 percent in 2011, adjusted for the $0.12 per share tax benefit noted earlier. The lower rate was primarily due to higher earnings in foreign jurisdictions with lower tax rates and a lower blended state tax rate.

Cash Flow

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $132 million versus $191 million in 2011. The year-over-year reduction in cash flow was driven by higher investments in receivables and inventory tied to sales growth along with a reduction in current liabilities tied to higher payments for income taxes. We used the cash generated during the quarter, along with cash on hand, to invest in the business and return cash to shareholders through share repurchase and dividends. Capital expenditures for the quarter were $56 million versus $52 million in 2011. We paid dividends of $58 million in the quarter, reflecting the 21 percent increase in the quarterly dividend announced in April of this year. In addition, we bought back 760,000 shares of stock and ended the quarter with about 6 million shares remaining on our share repurchase authorization. In total, we returned $207 million to shareholders in the quarter.

2012 Guidance

As reported in our 2012 second quarter earnings release, we reiterated our 2012 sales guidance of 12 to 14 percent and raised the low end of our 2012 earnings per share guidance by $0.10. We now expect earnings per share of $10.50 to $10.80. Keep in mind, if economic growth slows and the dollar continues to strengthen, the lower end of our sales range is more probable than the higher end. If that happens, we plan to reassess and adjust spending levels.

Let's look more closely at the underlying elements of our current expectations:

- First, sales in the back half of the year are expected to grow in the 10 to 13 percent range. As a reminder, we reach the anniversary of the Fabory acquisition at the end of August. In addition, we will lose a selling day in the 2012 third quarter and gain it back in the fourth quarter versus 2011.
- Second, we continue to forecast operating margin expansion, over prior year, in the two remaining quarters of 2012. Gross profit margins for the remaining quarters should remain relatively consistent with the 43.5 percent reported for the 2012 second quarter. Incremental growth related spending in the 2012 third quarter should be in line with the $24 million incremental spend in the 2012 second quarter. Better expense and earnings leverage should come in the 2012 fourth quarter as we lap some of the aggressive growth investments in 2011, such as new sales representatives and eCommerce, and benefit from having a full quarter of Fabory in the base. Although comparisons will be easier in the 2012 fourth quarter, we plan to continue to invest in our growth drivers given the opportunity to gain share in this large, fragmented market.

- Third, our Other Businesses have posted improved performance, which should continue to be driven by our business in Japan. As for our newest businesses, we continue to expect AnFreixo to be slightly dilutive in 2012, while Fabory may post a small loss if the economy and currency in Europe weaken further.
- Fourth, we now expect foreign exchange to be a headwind on both the top and bottom lines for the full year. Given the relative strength of the U.S. dollar, foreign exchange could represent as much as a 1 percentage point drag on sales and $0.04 to $0.06 per share in earnings dilution for the year.
- Finally, our 2012 guidance assumes an effective tax rate of 37.4 to 37.7 percent.

Conclusion

Thank you for your interest in Grainger. Please mark your calendar for the release of July sales on Friday, August 10th. If you have any questions, please do not hesitate to contact Laura Brown at 847.535.0409 or me at 847.535.0881.

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Exhibit 1

2012 Guidance

	July 18, 2012			April 17, 2012			2011 Actual
Sales ($B)	**$ 9.1**	**-**	**$9.2**	**$ 9.1**	**-**	**$9.2**	**$8.1**
V% vs. prior yr.	**12%**	**-**	**14%**	**12%**	**-**	**14%**	**12%**
Op Margin	**13.8%**	**-**	**13.9%**	**13.7%**	**-**	**13.9%**	**13.3%**
bps vs. prior yr.	50	**-**	65	40	**-**	65	175
EPS	**$10.50**	**-**	**$10.80**	**$10.40**	**-**	**$10.80**	**$9.04**
	1.3x	**-**	**1.4x**	**1.2x**	**-**	**1.4x**	**2.6x**

Note: 2011 Actual excludes tax gain $ 0.12, gain of $0.07 for sale of Korea & negative -$0.16 branch closures (adj. = -$.03)

Exhibit 2

Selling Days: 2012 vs. 2011

Year	1Q	1Q	3Q	4Q	Total
2012	64	64	63	64	255
2011	64	64	64	63	255
Diff	0	0	-1	+1	0