1Q13 Earnings Podcast Script
April 16, 2013

Introduction

Hello, this is Laura Brown, Senior Vice President of Communications and Investor Relations. With me is Bill Chapman, Senior Director of Investor Relations. The purpose of this podcast is to provide you with additional information regarding Grainger's first quarter 2013 results. Please also reference our 2013 first quarter earnings release issued today, April 16th, in addition to other information available on our Investor Relations website, to supplement this podcast.

Before we begin, please remember that certain statements and projections of future results made in the press release and in this podcast 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

Today we reported results for the 2013 first quarter and raised our 2013 sales and earnings guidance. We raised the low end of the guidance ranges to reflect the solid start to the year and account for an increase in growth spending. We now expect sales to grow 5 to 9 percent and are forecasting EPS of $11.30 to $12.00 for the full year 2013. At the end of this recording, we'll talk more about our revised guidance and assumptions.

Company sales for the quarter increased 4 percent versus the 2012 first quarter, 6 percent on a daily basis. We had 63 selling days in the quarter, one less than the previous year. Operating earnings and net earnings increased 13 percent. Earnings per share were $2.94 for the quarter, an increase of 14 percent versus the 2012 first quarter.

Let's now walk down the operating section of the income statement in more detail. Gross profit margins increased 80 basis points to 45.2 percent versus 44.4 percent in 2012, primarily driven by the United States segment. Company operating margin increased 120 basis points to 15.1 percent versus 13.9 percent a year ago. The earnings growth was driven by the 4 percent sales increase and operating expenses growing at a slower rate than sales. Operating expenses increased 3 percent, including $22 million in incremental growth-related spending versus the 2012 first quarter. These growth investments include additional sales coverage, eCommerce, advertising, IT systems and expansion of the company's distribution center network.

We took a cautious approach to spending in the 2013 first quarter given the uncertainty surrounding the threat of the fiscal cliff at the end of December. Given a modestly improving economic backdrop and solid performance in the quarter, we are increasing the estimated amount of incremental growth-related spending to $160 million for the year. We had originally forecasted $135 million in incremental growth-related investment in 2013, but also bracketed this number with $25 million on either side based on sales growth. We view our commitment to higher growth spending as an example of our leadership in the MRO industry and an attractive opportunity to gain market share over the long term.

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 March,
- Second, operating performance by segment,
- Third, cash generation and capital deployment,
- And finally, we'll wrap up with a discussion of our 2013 guidance and other key items.

Quarterly Sales

As mentioned earlier, company sales for the quarter increased 4 percent on a reported basis and 6 percent on a daily basis. Daily sales growth by month was as follows: 8 percent in January, 6 percent in February and 3 percent in March. Daily sales growth in March was affected by the timing of the Easter Holiday, which I will cover in more detail in the March sales section.

The 6 percent increase in daily sales in the quarter included 3 percentage points from volume, 2 percentage points from price, 1 percentage point from acquisitions and 1 percentage point from sales of seasonal products, partially offset by a 1 percentage point drag from foreign exchange. .

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

Sales in the United States, which accounted for 77 percent of total company revenue in the quarter, increased 4 percent, 6 percent on a daily basis. The 6 percent daily sales growth for the quarter was driven by 3 percentage points from price, 2 percentage points from volume and 1 percentage point from the Techni-Tool business acquired on December 31, 2012. Daily sales increased 7 percent in January, 7 percent in February and 4 percent in March.

Let's review sales performance by customer end market in the United States:

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

Now let's turn our attention to the Canadian business. Sales in Canada represented 12 percent of total company revenues. For the quarter, sales in Canada increased 4 percent in U.S. dollars and 5 percent in local currency. On a daily basis in U.S. dollars, sales increased 5 percent and consisted of 8 percentage points from volume, partially offset by a 2 percentage point decline from the timing of the Easter Holiday and 1 percentage point decline from foreign exchange. By month, daily sales in Canadian dollars increased 8 percent in January, 8 percent in February and 3 percent in March. Sales performance in Canada was driven by strong growth to customers in the construction, commercial, forestry, oil and gas and light manufacturing end markets.

Let's conclude our discussion of sales for the quarter by looking at the Other Businesses. Again, this group includes our operations primarily in Asia, Europe and Latin America and currently represents about 11 percent of total company sales. Sales for this group increased 4 percent, 5 percent on a daily basis, which consisted of 6 percentage points from volume and price and 4 percentage points from the acquired business in Brazil, partially offset by a 5 percentage point decline from unfavorable foreign exchange. The sales increase was primarily due to solid revenue growth in Japan and Mexico, coupled with incremental sales from Brazil.

March Sales

Earlier in the quarter, we reported sales results for January and February and shared some information regarding performance in those months. Let's now take a look at March, which was affected by the timing of the Easter Holiday and customer spending pull backs related to sequestration within the government end market. There were 21 selling days in March of 2013 versus 22 days in the same month of 2012. Company sales increased 3 percent on a daily basis in March of 2013 versus March of 2012. The daily sales growth in March included 3 percentage points from volume, 2 percentage points from price, 1 percentage point from the acquisitions, partially offset by a 2 percentage point decline from the timing of the Easter Holiday and 1 percentage point decline from foreign exchange.

In the United States, March daily sales increased 4 percent. This increase was due to a 3 percentage point increase from price, 1 percentage point increase in volume, 1 percentage point from the Techni-Tool acquisition, partially offset by a 1 percentage point decline from the timing of the Easter Holiday. March customer end-market performance in the United States was as follows:

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

Uncertainty in the United States surrounding sequestration contributed to a decline in sales to the government end market. Sales weakness in the government end market was driven by federal government agencies, while sales to state and local government increased versus March 2012. As a point of reference, Government represented 15 percent of U.S. sales in the 2013 first quarter.

Daily sales in Canada for March were flat in U.S. dollars, up 3 percent in local currency. The flat daily sales consisted of 8 percentage points from volume, offset by a 5 percentage point decline from the timing of the Easter Holiday and 3 percentage point decline from foreign exchange. The Canadian business was closed on Good Friday, whereas the U.S. business was open. As a reminder, we use the number of selling days in the United States as the basis for our calculation of daily sales companywide. Sales growth in Canada was driven by strong performance in the construction, commercial, forestry, government and light manufacturing end markets.

Daily sales for our Other Businesses increased 3 percent in March, consisting of 6 percentage points from volume and price, 5 percentage points from the acquisition in Brazil, partially offset by negative 7 percentage points from unfavorable foreign exchange and 1 percentage point decline from the timing of the Easter Holiday. In local currency, sales for the business in Japan grew in the high teens, but most of that growth was offset by the weakening of the Japanese yen versus the U.S. dollar.

April Sales

Daily sales growth in the month of April is currently trending in the high single digits. As a reminder, the comparison should be more favorable as Easter was in April of 2012. If you normalize both March and April for Easter, daily sales growth in April is running slightly ahead of March.

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 reportable segment. Operating earnings in the United States increased 11 percent versus the 2012 first quarter, while the operating margin increased 110 basis points to 18.7 percent. This performance was driven by the 4 percent sales growth, higher gross profit margins and positive operating expense leverage. Gross profit margins for the quarter increased 80 basis points driven by price increases exceeding cost inflation and growth of private label products, partially offset by unfavorable selling mix. Operating expenses grew at a slower rate than sales and included $20 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 11 percent versus the prior year, in both U.S. dollars and local currency. The improvement in operating performance was driven by higher sales and positive operating expense leverage, despite an incremental $2 million in growth-related spending. Gross margins in Canada were essentially flat versus the prior year. The 4 percent growth in sales and lower operating expenses contributed to a 70 basis point increase in the operating margin to 11.6 percent.

The Other Businesses generated $8 million in operating earnings in the 2013 first quarter versus $11 million in the 2012 first quarter. The decline in earnings performance for the quarter versus the prior year was primarily driven by operating losses for the acquired business in Brazil and lower earnings for some of the smaller businesses in Asia and Latin America. The earnings decline was partially offset by strong earnings growth in Japan and operating earnings growth in Europe related to lower expenses from restructuring actions taken in the 2012 fourth quarter.

Other

Below the operating line, interest expense, net of interest income, was $2.3 million in 2013 first quarter versus $2.5 million in the 2012 first quarter.

For the quarter, the effective tax rate in 2013 was 37.3 percent versus 37.4 percent in 2012. The company is currently projecting an effective tax rate of 37.3 to 37.7 percent for the full year 2013.

Cash Flow

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $176 million, up 66 percent versus $106 million in 2012. Cash flow in the 2013 quarter benefitted from higher earnings, lower inventory purchases and a lower management incentive payout versus the prior year. We used the cash to invest in the business and return cash to shareholders through share repurchase and dividends. Capital expenditures for the quarter were $43 million versus $41 million in 2012. We paid dividends of $57 million, reflecting the 21 percent increase in the quarterly dividend announced in April of 2012. In addition, we bought back 315,000 shares of stock for $70 million and ended the quarter with 5.0 million shares remaining on our share repurchase authorization. In total, we returned $127 million to shareholders in the quarter.

2013 Guidance

As reported in our 2013 first quarter earnings release, we raised the low end of our 2013 sales guidance by 2 percentage points and increased the low end of our 2013 earnings per share guidance by $0.45. We now expect 5 to 9 percent sales growth and earnings per share of $11.30 to $12.00. Let's look more closely at the underlying elements of our current expectations:

1. Let's begin with sales.
    a. The new guidance range for daily sales growth implies roughly 5 to 10 percent daily sales growth for the remainder of the year.
    b. In the absence of any material changes in the economy, we expect reported daily sales growth to accelerate slightly through the year, driven by contributions from our growth programs and easier comparisons.
    c. We anniversary the Brazil acquisition in May of 2013.
    d. We have 1 additional selling day in the 2013 third quarter, although selling days for the full year are equal to 2012.
    e. And, we are now forecasting a range of -1 to 0 percentage points related to foreign exchange. (See Exhibit 2)

2. Moving on to gross profit margins, we are forecasting gross margin expansion of 20 to 30 basis points for the full year.
    a. Gross profit margins in the second quarter should be above last year's second quarter but below the 2013 first quarter. Consistent with prior years, the first quarter included supplier support provided for annual customer trade shows. As a result, both gross profit and operating expenses as a percent of sales are inflated by about 100 basis points.
    b. Unlike 2012, we are not expecting any interim price increases for the remainder of the year given the low inflation environment for commodities.
    c. We also expect that stronger sales growth to large customers with lower pricing will create headwinds, particularly in the back half of the year.

3. Operating expenses should generate 20 to 30 basis points of cost leverage for the full year.
    a. Incremental growth spending of $160 million for the year will accelerate and will drive sequential increases in operating expenses for the remaining three quarters.
    b. Roughly 40 percent of the incremental growth spending will occur in the front half of the year, with the remaining 60 percent hitting in the second half.
    c. Work is underway to build out a new enterprise system for the businesses in Canada and Mexico. Costs for the project are back-end loaded, but could affect 2013 operating margins in Canada by 50 to 100 basis points depending on the pace of spending.
4. We expect 40 to 60 basis points of operating margin expansion for the full year versus 2012, through the combination of gross margin expansion and better cost leverage.
5. Finally, we are now forecasting foreign exchange, primarily related to the Japanese yen, to be a headwind of $0.05 to $0.07 per share for the full year.

Conclusion

Please mark your calendar for the following events scheduled during the next four weeks:

1. On April 24th we will host our Annual Meeting of Shareholders. The script from that presentation will be available on our website following the event.
2. On May 7th, Court Carruthers, Senior Vice President and President Grainger United States, will present at the Robert W. Baird Growth Stock Conference in Chicago. The event will be webcast.
3. Finally, we will release April sales on Friday, May 10th.

Thank you for your interest in Grainger. If you have any questions, please do not hesitate to contact Laura Brown at 847.535.0409, Casey Darby at 847.535.0099 or me at 847.535.0881.

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Exhibit 1

2013 Guidance

	Current 4/16/13			1/24/13		
Sales ($B)	$9.4	-	$9.8	$9.3	-	$9.8
V% vs. prior yr.	5%	-	9%	3%	-	9%
Op Margin	14.2%	-	14.4%	13.9%	-	14.4%
bps vs. prior yr.	40	-	60	10	-	60
EPS	$11.30	-	$12.00	$10.85	-	$12.00

Notes: 1) As of 4/16/13.
2) Excluding adjustments noted in the fourth quarter 2012 earnings release, 2012 full year operating margin was 13.8% and earnings per share were $10.43.

Exhibit 2

2013 Sales Guidance

	Current 4/16/13	1/24/13
Economy/Volume	3% - 6%	0% - 5%
Price	2%	2% - 3%
Organic Sales	5% - 8%	2% - 8%
F/X, Sales Days	-1% - 0%	0%
Acquisitions	1%	1%
Company Sales	5% - 9%	3% - 9%

Note: As of 4/16/13.

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Exhibit 3

Incremental Growth Spending
($ in Millions)

	2013 Incremental vs. 2012	2012 Incremental vs. 2011	2011 Incremental vs. 2010
1Q	$22	$27	$7
2Q		24	11
3Q		19	19
4Q		1	30
FY		$71	$67

Notes: 1) As of 4/16/13.
2) The company expects 2013 incremental growth spending of $160 million.

Exhibit 4

Selling Days: 2013 vs. 2012

Month	2013	2012	Difference
January	22	21	1
February	20	21	-1
March	21	22	-1
1Q	63	64	-1
April	22	21	1
May	22	22	0
June	20	21	-1
2Q	64	64	0
July	22	21	1
August	22	23	-1
September	20	19	1
3Q	64	63	1
October	23	23	0
November	20	21	-1
December	21	20	1
4Q	64	64	0
Full Year	255	255	0