2Q13 Earnings Podcast Script
July 17, 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 2013 second quarter results. Please also reference our 2013 second quarter earnings release issued today, July 17th, 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 second quarter. Company sales for the quarter increased 6 percent versus the 2012 second quarter. There were 64 selling days in both quarters. Operating earnings increased 11 percent and net earnings increased 14 percent. Earnings per share were $3.03 for the quarter, an increase of 15 percent versus the 2012 second quarter. The 2013 second quarter included a $0.03 per share tax benefit which we will discuss later in the podcast. Excluding this benefit, earnings per share increased 14 percent. We also narrowed our guidance ranges for both 2013 sales and earnings per share which Bill will cover in detail at the end of the podcast.

Let's now walk down the operating section of the income statement in more detail. Gross profit margins increased 50 basis points to 44.0 percent versus 43.5 percent in 2012, primarily driven by Canada and the Other Businesses. Company operating margin increased 70 basis points to 14.7 percent versus 14.0 percent a year ago. Both reportable segments and the Other Businesses contributed to the increase in company operating margin, which was driven by the 6 percent sales increase, higher gross margins and operating expense leverage. Operating expenses increased 5 percent, including $37 million in incremental growth-related spending versus the 2012 second quarter. These growth investments include additional sales coverage, eCommerce, inventory management, advertising, IT systems and expansion of the company's distribution center network.

We are continuing to aggressively invest in our growth drivers and are now estimating incremental growth-related spending of $150 million for 2013, $10 million less than we forecasted in the first quarter. The $10 million reduction in our estimate is largely driven by timing.

Given that we are at the mid-year point, we thought it would be helpful to provide an update on our growth drivers:

- We added approximately 75 new sales representatives in the United States and expect to hire another 100 by year-end. In addition, we've aggressively expanded our sales force in several of our international businesses including Canada, Brazil and Mexico, where we've hired more than 70 new sales representative year to date.
- Our eCommerce sales continue to grow at twice the rate of our other channels. For the first half of 2013, eCommerce sales represented 32 percent of total company sales, up 200 basis points from full year 2012.

- We added more than 6,200 Keepstock installations in the United States in the first half of the year and are still targeting 10,000 installations for the full year. Outside of the United States, and primarily in Canada, we added nearly 1,400 new KeepStock installations in the first six months of the year.

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 2013 guidance and other key items.

Quarterly Sales

As mentioned earlier, company sales for the quarter increased 6 percent. Daily sales growth by month was as follows: 8 percent in April, 5 percent in May and 5 percent in June. As a reminder, April included a 2 percentage point benefit from the timing of the Easter holiday. The 6 percent increase in sales in the quarter included 4 percentage points from volume, 2 percentage points from price and 1 percentage point from acquisitions, partially offset by a 1 percentage point drag from unfavorable 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 7 percent. This sales growth was driven by 4 percentage points from volume, 2 percentage points from price and 1 percentage point from the Techni-Tool business acquired on December 31, 2012. Daily sales increased 9 percent in April, 6 percent in May and 6 percent in June. The timing of the Easter holiday contributed 1 percentage point to daily sales growth in April.

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, and Natural Resources were up in the mid-single digits;
- Government and Retail were up in the low single digits; and
- Reseller was down in the low single digits.

Our continued success with manufacturing customers further reinforces our commitment to add products and services to best serve customers in this important end market. The addition of more sales representatives, more products and more KeepStock installations are all contributing to share gain.

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 3 percent in U.S. dollars and 5 percent in local currency. The 3 percent sales growth in U.S. dollars consisted of 2 percentage points from volume, 2 percentage points from favorable timing of the Easter holiday and 1 percentage point from sales of products used by customers following the flooding in Alberta, partially offset by a 2 percentage point decline from unfavorable foreign exchange. By month, daily sales in Canadian dollars increased 9 percent in April, 2 percent in May and 3 percent in June. The timing of the Easter holiday and an extra selling day in Canada versus the prior year contributed 5 percentage points to daily sales growth in April. Sales performance in Canada was driven by strong growth to customers in the forestry, construction 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 represented 11 percent of total company sales in the quarter. Sales for this group increased 5 percent which consisted of 9 percentage points from volume and price and 2 percentage points from the acquired business in Brazil, partially offset by a 6 percentage point decline from unfavorable foreign exchange. The sales increase was primarily due to solid revenue growth in Mexico and the timing of the Brazil acquisition in the 2012 second quarter. In local currency, sales for the business in Japan grew in the high teens, but that growth was offset by the weakening of the Japanese yen versus the U.S. dollar.

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 20 selling days in June of 2013 versus 21 days in the same month of 2012. Company sales increased 5 percent on a daily basis in June of 2013 versus June of 2012. The daily sales growth in June included 4 percentage points from volume, 1 percentage point from price, 1 percentage point from the Techni-Tool acquisition, partially offset by a 1 percentage point decline from unfavorable foreign exchange.

In the United States, June daily sales increased 6 percent driven by 4 percentage points from volume, 1 percentage point from price and 1 percentage point from Techni-Tool. June customer end market performance in the United States was as follows:

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

June is the fiscal year-end for many state governments. Our government business benefitted from strong growth among state government customers. In fact, daily sales to state and local government grew in the high single digits for the month of June. Sales performance for our federal government business improved sequentially, but declined in the low single digits. Sequestration remains a headwind for our federal government business.

Daily sales in Canada for June increased 3 percent in U.S. dollars and in local currency. The 3 percent daily sales growth consisted of 1 percentage point from volume and 2 percentage points from sales of flood-related products. Sales growth in Canada was driven by solid performance in the forestry, government and light manufacturing end markets.

Daily sales for our Other Businesses increased 4 percent in June, consisting of 11 percentage points from volume and price, partially offset by a 7 percentage points drag from unfavorable foreign exchange. In local currency, daily sales for our business in Japan grew in the mid-twenties, but were offset by a weaker Japanese yen versus the U.S. dollar.

July Sales

Daily sales growth in the month of July is currently trending slightly below the growth rate reported for June, primarily due to a very light selling day on Friday, July 5th.

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 9 percent versus the 2012 second quarter, while the operating margin increased 40 basis points to 18.2 percent. This performance was driven by the 7 percent sales growth and positive operating expense leverage. Gross profit margins for the quarter were essentially flat versus the prior year. We were able to increase prices above product cost inflation, however this was effectively offset by unfavorable selling mix tied to stronger sales to large customers. Operating expenses grew at a slower rate than sales and included $33 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 U.S. dollars. The improvement in operating performance was driven by higher sales and higher gross margins. Gross margins increased 140 basis points to 39.9 percent. The gross profit margin improvement was due to cost savings from freight consolidation, higher supplier rebates and favorable mix. Approximately half of the improvements are expected to continue into future periods. The operating margin in Canada increased 90 basis points to 12.9 percent.

The Other Businesses generated $13 million in operating earnings in the 2013 second quarter versus $11 million in the 2012 second quarter. This improvement was primarily driven by earnings growth in Japan and Europe, partially offset by lower earnings, and in some cases larger losses, for some of the smaller businesses in Asia and Latin America.

Other

Below the operating line, interest expense, net of interest income, was $2.4 million in 2013 second quarter versus $2.3 million in the 2012 second quarter.

The tax rate in the quarter was 36.5 percent versus 37.9 percent in the 2012 quarter. The 2013 second quarter tax rate reflected a benefit from a resolution of foreign tax matters in the current period that resulted in a benefit to earnings per share of approximately $0.03 per share. Excluding this benefit, the effective tax rate for the quarter was 37.3 percent. The company continues to project an effective tax rate for the year 2013 of 37.3 to 37.7 percent.

Cash Flow

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $210 million, up 59 percent versus $132 million in 2012. Cash flow in the 2013 quarter benefitted from higher earnings and lower inventory purchases versus the prior year. The company used the cash to invest in the business and return cash to shareholders through share repurchases and dividends. Capital expenditures for the quarter were $40 million versus $56 million in 2012. We paid dividends of $67 million, reflecting the 16 percent increase in the quarterly dividend announced in April of 2013. In addition, we bought back 521,000 shares of stock for $133 million and ended the quarter with 4.5 million shares remaining on our share repurchase authorization. In total, we returned $200 million to shareholders in the quarter.

2013 Guidance

As reported in our 2013 second quarter earnings release, we lowered the top end of our 2013 sales guidance by 1 percentage point and raised the bottom end of our 2013 earnings per share guidance by $0.10 per share. We now expect 5 to 8 percent sales growth and earnings per share of $11.40 to $12.00. Let's look more closely at our current expectations:

1. Let's begin with sales.
   a. The primary change since April relates to foreign exchange. We are now forecasting foreign exchange to be a 1 percentage point drag on sales for the full year, versus the 0 to -1 imbedded in our previous sales guidance.
   b. The new guidance range implies roughly 4 to 10 percent daily sales growth for the remainder of the year.
   c. We have 1 additional selling day in the 2013 third quarter, although selling days for the full year are equal to 2012.

2. Moving on to gross profit margins, we are forecasting gross margin expansion of 30 to 40 basis points for the full year.
   a. Keep in mind that much of the gross margin expansion was realized in the first half of the year, with gross margins increasing 60 basis points.
   b. Therefore, were are expecting gross profit margins in the back half of the year to increase a more modest 10 to 20 basis points.
   c. Unlike 2012, we are not planning any interim price increases for the remainder of the year given the low inflation environment for commodities.
   d. As we saw in the U.S. business during the second quarter, stronger sales growth to large customers with lower pricing will continue to create some headwinds.

3. We expect full year operating margin expansion of 35 to 65 basis points.
    a. This expansion was front-end loaded, with 95 basis points of improvement coming in the first half of the year.
    b. For the second half of the year, we are forecasting that operating margins will decline 25 basis points on the low end and will increase 40 basis points on the high end.
    c. Incremental growth spending, now estimated to be $150 million for the year, will accelerate. Details are provided in Exhibit 3.
    d. 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 reduce second half 2013 operating margins in Canada by 100 to 150 basis points depending on the pace of spending.

4. Finally, we are now forecasting foreign exchange, primarily related to the Japanese yen, to represent a $0.07 to $0.10 per share drag for the full year.

5. To summarize, 2013 will be a tale of 2 halves. In the first half of the year, we enjoyed nice operating margin expansion, fueled by robust gross margins and strong earnings leverage. As our growth initiative and SAP project spending accelerates in the back half of 2013, coupled with limited gross margin expansion, we are expecting much more modest operating leverage.

Conclusion

Finally, please mark your calendar for the following important dates:

- We plan to release July sales on Monday, August 12th;
- We are scheduled to report third quarter results on Wednesday, October 16th;
- And finally, you are invited to attend our Annual Analyst Meeting on Wednesday, November 13th, which will be held at our brand new distribution center in Minooka, Illinois. This new facility is 1 million square feet and is highly automated.

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. Have a great day!

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Exhibit 1

2013 Guidance

	Current 7/17/13	4/16/13	1/24/13
Sales ($B)	$9.4 - $9.7	$9.4 - $9.8	$9.3 - $9.8
V% vs. prior yr.	5% - 8%	5% - 9%	3% - 9%
Op Margin	14.15% - 14.45%	14.2% - 14.4%	13.9% - 14.4%
bps vs. prior	35 – 65	40 - 60	10 - 60
EPS	$11.40 - $12.00	$11.30 - $12.00	$10.85 - $12.00

Notes: 1) As of 7/17/13.
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 7/17/13	4/16/13	1/24/13
Economy/Volume	3% - 6%	3% - 6%	0% - 5%
Price	2%	2%	2% - 3%
Organic Sales	5% - 8%	5% - 8%	2% - 8%
F/X, Sales Days	-1%	-1% - 0%	0%
Acquisitions	1%	1%	1%
Company Sales	5% - 8%	5% - 9%	3% - 9%

Note: As of 7/17/13.

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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	37	24	11
3Q	47E	19	19
4Q	44E	1	30
FY	$150E	$71	$67

Notes: 1) As of 7/17/13.
2) The company expects 2013 incremental growth spending of $150 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