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**3Q13 Earnings Podcast Script**
**October 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 2013 third quarter results. Please also reference our 2013 third quarter earnings release issued today, October 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

For purposes of this podcast, we are excluding the $76 million in reserves, or $0.66 per share, we announced in last year's third quarter related to litigation with the General Services Administration and United States Postal Service.

Today we narrowed our guidance for the full year and now expect sales growth of 5 to 6 percent and earnings per share of $11.45 to $11.65. While we expect to achieve record results for the year 2013 with 10 to 12 percent EPS growth, this year has been a tale of two halves. In the first half of the year, we experienced solid operating margin expansion, increased gross margins and strong earnings leverage. As our growth initiatives and IT project spending have accelerated, and our gross margin expansion has eased, the second half of 2013 is resulting in more modest operating leverage.

For the 2013 third quarter, we were pleased with the volume growth in our U.S. business given the challenging economic environment. Earnings growth in the United States was in line with our expectations. However, our businesses outside of the United States remain affected by weaker macroeconomic conditions and unfavorable foreign exchange rates, and performed below our expectations.

With that as a backdrop, let's review the 2013 third quarter. Company sales increased 5 percent, 4 percent on a daily basis. There were 64 selling days in the quarter, one more than in 2012. Operating earnings increased 5 percent and net earnings increased 4 percent. Earnings per share were $2.95 for the quarter, an increase of 5 percent versus the 2012 third quarter. 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 walk down the operating section of the income statement in more detail. Gross profit margins increased 20 basis points to 43.8 percent versus 43.6 percent in 2012, primarily driven by Canada and the Other Businesses. Company operating margin was flat with the prior year at 14.5 percent. Operating expenses increased 6 percent, including $40 million in incremental growth-related spending versus the 2012 third 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 currently forecasting approximately $36 million in growth spending in the 2013 fourth quarter, which brings our full year forecast to $135 million. In the quarter, we added approximately 100 new sales representatives in the United States, bringing our year to date total to nearly 200. eCommerce sales continued to grow faster than the rest of the business and currently represents 33 percent of total company sales. We also added more than 4,000 KeepStock installations in the quarter, bringing our year to date total to more than 11,000 installations in the United States. These KeepStock installations include Vendor Managed Inventory, Customer Managed Inventory and Vending solutions.

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, 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, total company sales for the quarter increased 5 percent, 4 percent on a daily basis. The 4 percent increase in daily sales in the quarter consisted of 4 percentage points from volume and 1 percentage point from acquisitions partially offset by a 1 percentage point decline attributable to unfavorable foreign exchange. By month, daily sales increased 4 percent in July, 4 percent in August and 2 percent in September.

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 78 percent of total company revenues in the quarter, increased 7 percent, 6 percent on a daily basis. This daily sales growth was driven by 5 percentage points from volume and 1 percentage point from acquisitions. Daily sales increased 6 percent in July, 5 percent in August and 5 percent in September.

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

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

Now let's turn our attention to the Canadian business. Sales in Canada represented 11 percent of total company revenues in the quarter. For the quarter, sales in Canada decreased 1 percent, 2 percent on a daily basis in U.S. dollars. In local currency, sales increased 4 percent, 2 percent on a daily basis. The 2 percent daily sales growth consisted primarily of 2 percentage points from volume. By month, daily sales in local currency increased 2 percent in July, 4 percent in August and were flat in September. Sales performance in Canada was led by solid growth to customers in the oil and gas, forestry, light manufacturing and utilities end markets. Volume growth in Canada continues to be negatively affected by the weak global demand for Canadian commodities and the general softening of the Canadian economy.

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 were up 1 percent, flat on a daily basis and consisted of 7 percentage points from volume and price, offset by a 7 percentage point decline from unfavorable foreign exchange. The sales increase was primarily due to revenue growth in Mexico and Europe, along with strong growth from Zoro Tools, our U.S.-based online business. Sales for the business in Japan grew in the mid-teens in local currency. Due to the significant weakening of the Japanese yen versus the U.S. dollar, sales for this business decreased in the high single digits in U.S. dollars.

**September Sales**

Earlier in the quarter, we reported sales results for July and August and shared some information regarding performance in those months. Let's now take a look at September. There were 20 selling days in September of 2013 versus 19 days in the same month of 2012. Company sales increased 2 percent on a daily basis in September of 2013 versus September of 2012. The daily sales growth in September included 3 percentage points from volume, 1 percentage point from the Techni-Tool acquisition, partially offset by a 2 percentage point decline from unfavorable foreign exchange.

In the United States, September daily sales increased 5 percent driven by 4 percentage points from volume and 1 percentage point from Techni-Tool. September customer end market performance in the United States was as follows:

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

Sales performance for our federal government business, which represents approximately 25 percent of our government business in the United States, declined in the high single digits. Sequestration and the government shutdown remain significant headwinds for our federal government business. In contrast, sales to our state and local government business grew in the low single digits in September.

Daily sales in Canada for September decreased 6 percent in U.S. dollars and were flat in local currency. The sales performance in Canada was led by solid growth to customers in the oil and gas, light manufacturing and agriculture end markets offset by a decline in sales to the heavy manufacturing, construction, retail and commercial end markets.

Daily sales for our Other Businesses decreased 4 percent in September, consisting of 3 percentage points from volume and price that was more than offset by a 7 percentage points drag from unfavorable foreign exchange.

**October Sales**

October will be the first month with sales contribution from the E&R Industrial Inc. acquisition completed in the 2013 third quarter. This business is expected to add approximately 200 basis points to company sales growth for the next twelve months. Excluding the incremental sales from E&R, daily sales growth in the month of October is currently trending above the 4 percent daily sales growth rate reported for the third quarter.

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. As a reminder, results in this discussion will exclude the $76 million in reserves, or $0.66 per share, we announced in last year's quarter related to litigation with the General Services Administration and United States Postal Service.

Operating earnings in the United States increased 6 percent versus the 2012 third quarter. This performance was driven by the 7 percent sales growth and positive operating expense leverage. Gross profit margins for the quarter decreased 30 basis points versus the prior year driven by strong growth and share gain among large customers, which carry lower margins. In addition, unlike the past two years, the company did not implement mid-year price increases due to a lower inflationary environment in 2013. Operating expenses grew at a slightly slower rate than sales despite the increase in incremental growth-related spending of $36 million on areas such as new sales representatives, eCommerce and advertising. The operating margin for the U.S. segment decreased 20 basis points to 18.0 percent versus the prior year.

Let's move on to our business in Canada. Operating earnings decreased 7 percent versus the prior year in U.S. dollars. The lower operating performance was primarily the result of approximately $3.5 million in incremental spending for the new IT system scheduled for installation in late 2014. Excluding the IT investment, the business generated positive operating leverage. Gross profit margins increased 40 basis points. The gross profit margin improvement was due to cost savings from freight consolidation and higher supplier rebates. The operating margin in Canada decreased 80 basis points to 11.7 percent versus the prior year.

The Other Businesses generated $6 million in operating earnings in the 2013 third quarter versus $9 million in the 2012 third quarter. The earnings decline for the quarter was primarily driven by weaker performance in Mexico, Colombia and Brazil, partially offset by improved earnings from Zoro Tools. Strong earnings growth in Japan was essentially offset by the relative weakness in the Japanese Yen versus the U.S. dollar.

**Other**

Below the operating line, interest expense, net of interest income, was $2.9 million in the 2013 third quarter versus $4.0 million in the 2012 third quarter.

The tax rate in the quarter was 38.0 percent versus 37.1 percent in the 2012 quarter. The increase was primarily due to lower earnings in foreign jurisdictions with lower tax rates. We are currently projecting an effective tax rate for the full year 2013 of 37.4 to 37.8 percent.

**Cash Flow**

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $354 million, up 5 percent versus $338 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 $65 million versus $59 million in 2012. We paid dividends of $65 million, reflecting the 16 percent increase in the quarterly dividend announced in April of 2013. In addition, we bought back 300,000 shares of stock for $77 million and ended the quarter with 4.2 million shares remaining on our share repurchase authorization. In total, we returned $142 million to shareholders in the quarter.

**2013 Guidance**

As reported in our 2013 third quarter earnings release, we narrowed the top end of our sales and EPS guidance for full year 2013. We now expect 5 to 6 percent sales growth and earnings per share of $11.45 to $11.65. This guidance includes E&R Industrial, which we will begin reporting in the 2013 fourth quarter. As a reminder, we expect E&R to be earnings neutral in 2013, but will result in gross and operating margin dilution as we will detail in a moment. For purposes of comparison we have excluded the $0.25 per share in restructuring charges recorded in the 2012 fourth quarter. With that as a backdrop, let's take a look at our current expectations:

1. We'll begin with sales.
    a. The primary changes since July relate to slower growth outside the United States and lower expectations for price inflation.
    b. We now expect price inflation to only contribute 1 percentage point to sales growth versus the 2 percentage points included in our previous guidance. Price in the 2013 third quarter rounded down to zero and we do not anticipate any interim price increases in 2013, unlike the last few years.
    c. The new guidance implies roughly 6 to 8 percent daily sales growth for the fourth quarter including $50 million in revenue from the E&R Industrial acquisition. Excluding E&R, sales are expected to grow 4 to 6 percent in the fourth quarter.
2. Moving on to gross profit margins, we are forecasting gross margin expansion of about 30 basis points for the full year versus 2012.
    a. Keep in mind that much of the gross margin expansion was realized in the first half of the year, when gross margins increased 60 basis points over prior year.
    b. We are expecting gross profit margins in the fourth quarter to decrease by about 40 basis points. If you exclude E&R, our guidance includes approximately 20 basis points of gross margin expansion.
    c. We anticipate that our share gains will continue to come from our larger, lower margin customers. While the resulting earnings growth is substantial, it continues to create negative mix.
    d. Lastly, we are squarely in a period of low inflation and are not seeing much product cost inflation. As a result, we are also not expecting any price inflation for the remainder of 2013.
3. Let's take a look at company operating margin. We expect full year operating margin expansion of 40 to 60 basis points.
    a. Again, this expansion was front-end loaded, with 95 basis points of improvement coming in the first half of the year.

b. For the 2013 fourth quarter, we are forecasting that operating margins will decline 20 basis points on the low end and increase 50 basis points on the high end. Excluding E&R, operating margins are expected to increase 10 basis points on the low end and 80 basis points on the high end.
c. Keep in mind, the relatively wide range of outcomes in the 2013 fourth quarter is a reflection of the direct relationship between our volume growth and our ability to generate productivity savings. The better the growth, the stronger the productivity.
d. Our assumptions include $36 million in incremental growth spending in the fourth quarter. Details are provided in Exhibit 3.
e. As we noted in the 2013 third quarter release, work is underway to build out a new enterprise system for the businesses in Canada and Mexico. Although the majority of the costs for this project will be incurred in 2014, margins in Canada are expected to decline given $4.5 million in IT spending forecasted for the 2013 fourth quarter.

4. Finally, we are forecasting foreign exchange to represent a $0.09 per share drag for the full year, including $0.03 for the 2013 fourth quarter.

Looking at the full year, 2013 should be another record year, with earnings per share growing at twice the rate of sales under both our high and low guidance scenarios. Keep in mind 2013 will be a tale of two halves, with strong margin expansion in the first half, followed by much more modest expectations in the second half tied to limited gross margin expansion and higher spending on growth and infrastructure initiatives. And those investments, over the long term, will better position Grainger to gain more share, build additional scale and lead the consolidation of the large and fragmented MRO market.

## Conclusion

To conclude, please mark your calendar for the following important dates:

- On Tuesday, November 12th we plan to release October sales; and
- On Wednesday, November 13th, we will host our Annual Analyst Meeting. This year's event will be held at our new national distribution center in Minooka, Illinois. This new facility is 1 million square feet and is highly automated. If you would like to register or have questions please contact Linda D'Agostino at 847.535.4280 or email linda.d'agostino@grainger.com.

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 10/16/13 | 7/17/13 | 4/16/13 | 1/24/13 |
|---|---|---|---|---|
| **Sales($B)** | $9.4 - $9.5 | $9.4 - $9.7 | $9.4 - $9.8 | $9.3 - $9.8 |
| V% vs. prior yr. | 5% - 6% | 5% - 8% | 5% - 9% | 3% - 9% |
| **Op Margin** | 14.2% - 14.4% | 14.2% - 14.5% | 14.2% - 14.4% | 13.9% - 14.4% |
| bps vs. prior | 40 – 60 | 35 – 65 | 40 - 60 | 10 - 60 |
| **EPS** | $11.45 - $11.65 | $11.40 - $12.00 | $11.30 - $12.00 | $10.85 - $12.00 |

Notes: 1) As of 10/16/13.
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.
3) The current guidance, dated 10/16/13, includes E&R in the 2013 fourth quarter.

## Exhibit 2

## 2013 Sales Guidance

| | Current 10/16/13 | 7/17/13 | 4/16/13 | 1/24/13 |
|---|---|---|---|---|
| Economy/Volume | 3% - 4% | 3% - 6% | 3% - 6% | 0% - 5% |
| Price | 1% | 2% | 2% | 2% - 3% |
| **Organic Sales** | 4% - 5% | 5% - 8% | 5% - 8% | 2% - 8% |
| F/X, Sales Days | -1% | -1% | -1% - 0% | 0% |
| Acquisitions | 2% | 1% | 1% | 1% |
| **Company Sales** | 5% - 6% | 5% - 8% | 5% - 9% | 3% - 9% |

Notes: 1) As of 10/16/13.

2) The current guidance, dated 10/16/13, includes E&R in the 2013 fourth quarter.

## 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** | 40 | 19 | 19 |
| **4Q** | 36E | 1 | 30 |
| **FY** | $135E | $71 | $67 |

Note: As of 10/16/13.

## 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 |