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4Q13 Earnings Release Podcast Script
January 24, 2014

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 fourth quarter 2013 results. Please also reference our 2013 fourth quarter earnings release issued today, January 24th, 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: 2013

Today we reported results for the year 2013 and updated our earnings per share and sales guidance for 2014. For the full year 2013, company sales increased 5 percent to $9.4 billion. Net earnings increased 16 percent to $797 million and earnings per share increased 17 percent to $11.13. Operating cash flow increased 21 percent to $986 million. Despite a challenging economic environment, this was a solid year for Grainger as we continued to invest in infrastructure and growth designed to accelerate our share gains within the MRO market and increase our size and scale.

We also updated our guidance. We now expect 2014 earnings per share of $12.10 to $12.85 and sales of 5 to 9 percent growth. This change is largely due to a weaker Canadian dollar in recent months and the divestiture of a number of the direct marketing Specialty Brands that were sold on December 31, 2013. Our 2014 guidance issued on November 13, 2013 called for earnings per share of $12.25 to $13.00 and sales of 6 to 10 percent growth.

To better understand our performance, the majority of the analysis and commentary for the remainder of the podcast excludes the effect of the charges in 2013 and 2012. Details regarding the charges can be found in the 2013 fourth quarter earnings press release and Exhibit 1 of this podcast posted on the Investor Relations section of our website.

Excluding the charges from the years 2013 and 2012, company operating earnings increased 8 percent, while net earnings increased 9 percent. Earnings per share were $11.52 for the year, representing a 10 percent increase versus $10.43 in 2012. Unfavorable foreign exchange was a significant headwind throughout the year, reflecting a $0.08 per share reduction to earnings per share.

Company Results Summary: 2013 Fourth Quarter

Now let's turn to the 2013 fourth quarter. Results were within the expectations issued at our Analyst Day in November. Guidance for the 2013 fourth quarter included 6 to 8 percent sales growth and earnings per share of $2.53 to $2.73. Company sales in the fourth quarter increased 7 percent. Excluding the charges from 2013 and 2012, operating earnings increased 3 percent, while net earnings increased 6 percent. Adjusted earnings per share were $2.59 for the quarter, representing an increase of 7 percent versus the 2012 fourth quarter. Unfavorable foreign exchange was a headwind, while the acquired businesses with lower gross margins and integration costs negatively affected operating margins. E&R Industrial (E&R) was slightly accretive to earnings in the quarter, performing ahead of our original expectations.

Let's now walk down the operating section of the income statement. Gross profit margins were 42.3 percent versus 43.6 percent in the 2012 fourth quarter. The 130 basis points decrease was driven by lower gross margins from the acquired businesses, which accounted for approximately two-thirds of the decrease. The remainder of the decline related to faster growth with lower margin customers. In our third quarter podcast, we forecasted that gross profit margins would decline as much as 40 basis points. The actual decline was larger than expected due to E&R's strong sales performance and the addition of the Safety Solutions acquisition in December. In addition, higher than expected freight costs and lower than expected supplier rebates contributed to the decline.

On an adjusted basis, company operating earnings for the quarter increased 3 percent. The earnings growth was driven by the 7 percent sales increase and operating expenses growing at a slower rate than sales. Operating expenses grew 4 percent including $31 million in incremental growth-related spending. Incremental growth spending for the full year 2013 was $132 million versus 2012. Operating expenses benefited from $22 million in gains from the sale of fixed assets and the divestiture of the direct marketing Specialty Brands in the fourth quarter. The majority of the gains were offset by severance and other related costs. A schedule summarizing incremental growth spending for 2010 through 2013 can be found in Exhibit 4 of this podcast posted on the Investor Relations section of our website. Company operating margin decreased 40 basis points to 12.3 percent versus 12.7 percent a year ago. In our third quarter podcast, we shared that operating margins in the fourth quarter could decline as much as 20 basis points. The actual decline exceeded our estimate primarily due to strong performance from E&R, the Safety Solutions acquisition and unfavorable foreign exchange, which was more of a factor than we anticipated. Excluding the acquisitions, the company operating margin for the fourth quarter would have been flat versus 2012.

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, the month of December and January sales so far,
- Second, operating performance by segment,
- Third, cash generation and capital deployment,
- And finally, we'll wrap up with a discussion of our 2014 guidance and other key items.

Now, let's discuss 2013 fourth quarter, December and January sales in more detail.

Quarterly Sales

As mentioned earlier, company sales for the quarter increased 7 percent. We had 64 selling days in the quarter, the same as the previous year. The 7 percent sales growth for the quarter consisted of 5 percentage points from volume, 4 percentage points from acquisitions and 1 percentage point from sales of seasonal products, partially offset by a 2 percentage points decline from unfavorable foreign exchange and 1 percentage point from Hurricane Sandy-related sales in 2012. Daily sales growth by month was as follows: 7 percent in October, 5 percent in November and 9 percent in December. December included 2 months of sales from E&R. Sales for this new acquisition had been reported on a 1 month lag and caught up in December. As a result, the sales contribution from acquisitions, which also includes Techni-Tool and Safety Solutions, was higher in the month.

Let's move on to sales by segment. We report two 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 revenue in the quarter, increased 10 percent. Daily sales growth by month was as follows: 10 percent in October, 7 percent in November and 12 percent in December. The 10 percent sales growth was driven by 5 percentage points from volume, 6 percentage points from acquisitions and 1 percentage point from sales of seasonal products, partially offset by a 1 percentage point decline from price and 1 percentage point from an unfavorable comparison to sales related to Hurricane Sandy in 2012.

Let's review sales performance by customer end market in the United States. Here is the sales performance, excluding acquisitions, for each respective customer end market in the quarter:

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

Within Government, sales to state and local customers, which accounted for approximately 75 percent of our government sales, grew in the mid-single digits, while sales to federal customers were down in the mid-teens for the quarter.

Now let's turn our attention to the Canadian segment. Sales in Canada represented 11 percent of total company revenues in the quarter. For the quarter, sales in Canada decreased 3 percent in U.S. dollars and increased 3 percent in local currency. Sales consisted of 3 percentage points from volume offset by 6 percentage points from unfavorable foreign exchange. By month, daily sales in Canadian dollars increased 1 percent in October, 3 percent in November and 6 percent in December. Sales performance in Canada was driven by growth in the Commercial, Transportation, Light Manufacturing and Forestry 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 3 percent, which consisted of 11 percentage points of growth from volume and price, partially offset by an 8 percentage point decline from unfavorable foreign exchange. Sales growth in the Other Businesses were driven by Zoro Tools and the business in Mexico. The business in Japan grew more than 20 percent in local currency but the growth was offset by the weakness in the Japanese yen versus the U.S. dollar.

December Sales

Earlier in the quarter, we reported sales results for October and November and shared some information regarding performance in those months. Let's now take a look at December. There were 21 selling days in December of 2013 versus 20 in the same month of 2012. Total company sales increased 9 percent on a daily basis in December of 2013 versus December of 2012. The daily sales growth in December included 6 percentage points from acquisitions, 4 percentage points from volume, 2 percentage points from sales of seasonal products, partially offset by 2 percentage points from unfavorable foreign exchange and 1 percentage point from price. As I mentioned earlier, E&R contributed 2 months of sales in December, so the sales contribution from acquisitions was higher in the month versus the rest of the quarter.

In the United States, December daily sales increased 12 percent driven by 7 percentage points from acquisitions, 4 percentage points from volume, 2 percentage points from sales of seasonal products, partially offset by 1 percentage point from price. December customer end market performance in the United States, excluding acquisitions, was as follows:

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

Similar to the quarter, sales to state and local Government customers grew in the low single digits, while sales to federal customers were down in the low double digits for the month.

Daily sales in Canada for December decreased 2 percent in U.S. dollars but were up 6 percent in local currency. The 2 percent daily sales decline consisted of 5 percentage points from volume, 1 percentage point from sales of seasonal products, offset by 8 percentage points from unfavorable foreign exchange. Sales growth in Canada was driven by strong performance in the Commercial, Transportation, Retail, Utilities and Forestry end markets.

Daily sales for our Other Businesses increased 4 percent in December, consisting of 13 percentage points from volume and price, partially offset by a negative 9 percentage points from unfavorable foreign exchange. Strong sales growth of nearly 20 percent in Japan was offset by the weakness in the Japanese yen versus the U.S. dollar.

January Sales

Let's move on to January. The story thus far has been weather and foreign exchange. In the United States, sales including acquisitions were flat the first five business days of the month due to the extreme cold and snow across much of the country. During the next 10 business days, sales rebounded to the mid to upper single digits. As the month progresses, cold weather and snow in the United States and Canada continue to be an issue. Outside of the United States, foreign exchange in Canada and Japan continues to be a significant headwind. Combined with softness in Europe, we expect total company daily sales growth in the low single digits for the month of January. As a reminder, January sales will exclude the direct marketing Specialty Brands divested at the end of December. These businesses contributed approximately $96 million in revenue in 2013. Now, I would like to turn the discussion over to Bill Chapman.

Operating Performance

Thanks Laura.

Since we have already analyzed company operating performance, we will discuss performance by reporting segment. As a reminder, results in this discussion exclude the charges detailed in the earnings press release and Exhibit 1 of this podcast which is posted on the Investor Relations section of our website.

Adjusted operating earnings in the United States increased 7 percent versus the 2012 fourth quarter driven by the 10 percent sales growth and positive expense leverage, partially offset by lower gross profit margins. Gross profit margins for the quarter decreased 180 basis points driven by lower gross margins from the acquired businesses and faster growth with lower margin customers. Of the 180 basis point decline, nearly two-thirds is related to the acquisitions with lower gross margins. Positive expense leverage was driven by the 10 percent sales growth versus a 5 percent increase in operating expenses and included

$28 million in incremental growth-related spending on areas such as new sales representatives, eCommerce and Inventory Management. The U.S. operating margin decreased 50 basis points to 16.3 percent, primarily due to the acquired businesses with lower gross profit margins. Excluding the acquisitions, the adjusted operating margin for the U.S. segment would have increased 20 basis points in the quarter versus the prior year.

Let's move on to our business in Canada. Operating earnings decreased 10 percent versus the 2012 fourth quarter, down 5 percent in local currency. The decrease was driven by lower gross profit margins, the 3 percent sales decline due to unfavorable foreign exchange and negative expense leverage.
Gross margins in Canada decreased 20 basis points versus the prior year. This decline was primarily due to product cost inflation exceeding price inflation driven by unfavorable foreign exchange, which is a function of purchasing approximately one-third of Canada's products from the United States.
Contributing to the lower operating performance was approximately $2 million in incremental spending related to IT system investments.

On an adjusted basis, the Other Businesses generated $3 million in operating earnings in both the 2013 and 2012 quarters. Strong operating performance from Zoro Tools offset lower performance from most of the other businesses. In addition, the business in Japan generated strong earnings growth in local currency, which was more than offset by unfavorable foreign exchange. We are currently evaluating the operating performance and strategic direction of some of the international businesses that are not meeting expectations.

Other

Other income and expense was a net expense of $2 million in the 2013 fourth quarter versus net expense of $5 million in the 2012 fourth quarter. The decrease was primarily attributable to lower average borrowings and lower average interest rates in the 2013 fourth quarter versus the 2012 fourth quarter.

For the quarter, the effective tax rate in 2013 was 37.3 percent versus 37.6 percent in 2012. For the year, the effective tax rate was 37.3 percent versus 37.5 percent in 2012. The company is currently projecting an effective tax rate of 37.4 to 37.8 percent for the year 2014. The higher expected tax rate in 2014 is primarily a function of higher earnings in jurisdictions with higher tax rates.

Cash Flow

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $246 million versus $240 million in 2012. We used the cash generated during the quarter to invest in the business, fund acquisitions and return cash to shareholders through share repurchases and dividends. Capital expenditures for the quarter were $124 million versus $95 million in 2012. We paid dividends of $67 million in the quarter, reflecting the 16 percent increase in the quarterly dividend announced in April of 2013. In addition, we bought back 606,000 shares of stock for $159 million and ended the quarter with 3.6 million shares remaining on our share repurchase authorization. In total, we returned $226 million to shareholders in the quarter.

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2014 Guidance

At our Analyst Meeting in November, we issued sales and earnings guidance for 2014. As reported in our 2013 fourth quarter earnings release, we adjusted our guidance and we now expect 2014 earnings per share of $12.10 to $12.85 and sales of 5 to 9 percent growth. This change is primarily related to increased unfavorable foreign exchange and the divestiture of the direct marketing Specialty Brands. Now, let's take a closer look at some of our assumptions for the full year 2014 and the 2014 first quarter:

1. We'll start with sales.
    a. For the full year, the change from our original sales guidance relates primarily to an increase in unfavorable foreign exchange, largely in Canada and to a lesser extent Japan, and the divestiture of the direct marketing Specialty Brands, reducing total company sales by 1 percent.
    b. Also, January will be the first month to reflect the annual price increase in the U.S. business. We expect 1 percent price inflation for full year 2014.
2. Let's move on to gross profit margins.
    a. For the full year, on an organic basis, gross margin expansion could reach 30 basis points at the high end driven by the United States and Canada. On a reported basis, we are forecasting minimal gross margin expansion versus 2013 due to lower gross margins from the acquired businesses.
    b. For the first quarter, we expect organic gross profit margins to be up approximately 20 basis points. On a reported basis, we are expecting gross profit margins to decrease by about 30 basis points due to the acquired businesses.

c. Lastly, the company's annual customer trade shows held in the first quarter typically results in gross profit margins and operating expenses that are about 100 basis points above the run rate for the full year.

3. And now, let's take a closer look at company operating margin expectations.
   a. For the full year, on an organic basis, we continue to expect 15 to 45 basis points of expansion. On a reported basis, we are forecasting full year operating margin expansion of 10 to 40 basis points, which is a change from November guidance of 0 to 30 basis points. This change is tied to the divestiture of the direct marketing Specialty Brands in December and lower sales from Canada due to larger headwinds from foreign exchange.
   b. For the 2014 first quarter, on a reported basis, we are forecasting that operating margins could decline 50 to 100 basis points from the carryover effect of growth and infrastructure spending and the acquisition of the lower margin businesses which occurred in the second half of 2013. This will create an unfavorable comparison during the first half of 2014. On an organic basis, operating margins are forecasted to decline as much as 40 basis points in the quarter. Please see Exhibit 4 for a schedule of growth spending in this podcast posted in the Investor Relations section of our website.
   c. In 2014, we anticipate unfavorable operating margin expansion in the first half followed by stronger operating margin expansion in the second half.

4. Lastly, we are forecasting foreign exchange to represent a $0.15 per share drag for the full year 2014 versus our November guidance.

Conclusion

Please mark your calendar for the release of January sales on Thursday, February 13th. 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
Adjustments to Reported EPS

	Twelve Months Ended December 31,		
	2013	2012	% Change
Diluted Earnings Per Share as reported:	$11.13	$9.52	17%
GSA/USPS settlement		0.66	
Goodwill impairment			
U.S. Segment	0.11	0.04	
Other Businesses	0.18		
Restructuring			
Other Businesses	0.10	0.18	
Charge for U.S. branch closures		0.03	
Subtotal	0.39	0.91	
Diluted Earnings Per Share as adjusted:	$11.52	$10.43	10%

	Three Months Ended December 31,		
	2013	2012	% Change
Diluted Earnings Per Share as reported:	$ 2.20	$ 2.17	1%
Goodwill impairment			
U.S. Segment	0.11	0.04	
Other Businesses	0.18		
Restructuring			
Other Businesses	0.10	0.18	
Charge for U.S. branch closures		0.03	
Subtotal	0.39	0.25	
Diluted Earnings Per Share as adjusted:	$2.59	$2.42	7%

Exhibit 2
2014 Sales Guidance

	January 24, 2014 2014 E	November 13, 2013 2014 E
Economy/Volume	4% - 8%	4% - 8%
Price	1%	1%
Organic Sales	5% - 9%	5% - 9%
F/X	-1%	0%
Acquisitions	1%	1%
Company Sales	5% - 9%	6% - 10%

Note: As of January 24, 2014.

Exhibit 3
2014 EPS Guidance
Total Company

	January 24, 2014	November 13, 2013
Sales ($B)	$ 9.9 - $10.3	$ 10.1 - $10.4
V% vs. prior yr.	5% - 9%	6% - 10%
Op Margin	14.2% - 14.6%	14.3% - 14.6%
bps vs. prior yr.	10 - 40	0 - 30
EPS	$12.10 - $12.85	$12.25 - $13.00

Note: As of January 24, 2014.

2014 EPS Guidance
Organic

	January 24, 2014	November 13, 2013
Sales ($B)	$ 9.7 - $10.1	$ 9.9 - $10.3
V% vs. prior yr.	5% - 9%	5% - 9%
Op Margin	14.6% - 14.9%	14.5% - 14.8%
bps vs. prior yr.	15 - 45	15 - 45
EPS	$12.15 - $12.90	$12.23 - $12.98

Note: As of January 24, 2014. Excludes E&R and Safety Solutions acquisitions.

Exhibit 4
Incremental Growth Spending
($ in Millions)

	2014 Incremental vs. 2013	2013 Incremental vs. 2012	2012 Incremental vs. 2011	2011 Incremental vs. 2010
1Q	$41E	$22	$27	$7
2Q		37	24	11
3Q		40	19	19
4Q		31	1	30
FY	$130E	$132	$71	$67

Notes: 1) As of January 24, 2014.
2) The company expects 2014 incremental growth spending of $130 million.

Exhibit 5
Acquisition / Divestiture Schedule

Acquired / Divested	Date	Revenue
Techni-Tool (Acquired)	December 31, 2012	2011 Sales of $88 Million
E & R Industrial, Inc. (Acquired)	August 23, 2013	2012 Sales of $180 Million
Safety Solutions, Inc. (Acquired)	December 2, 2013	2012 Sales of $63 Million
Specialty Brands (Divested)	December 31, 2013	2013 Sales of $96 Million

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Exhibit 6

Selling Days: 2014 vs. 2013

Month	2014	2013	Difference
January	22	22	0
February	20	20	0
March	21	21	0
1Q	63	63	0
April	22	22	0
May	21	22	-1
June	21	20	1
2Q	64	64	0
July	22	22	0
August	21	22	-1
September	21	20	1
3Q	64	64	0
October	23	23	0
November	19	20	-1
December	22	21	1
4Q	64	64	0
Full Year	255	255	