To Our Shareholders:

In 2016, the industrial economy continued to be hampered by a challenging demand environment complicated by a lack of inflation, which put pressure on revenue and gross margins. Yet amidst these challenges, Grainger made progress by executing our strategy and staying ahead of customer needs. We strengthened the value we deliver to our customers and effectively managed expenses while identifying opportunities to improve our long-term competitiveness.

Our 2016 financial highlights were:

- Company sales of $10.1 billion, up 2 percent from 2015.
- Reported earnings per share of $9.87, down 15 percent from 2015. On an adjusted basis, earnings per share were $11.58, down 3 percent versus 2015.
- Cash generated from operations of $1.0 billion with free cash flow of $774 million, up 23 percent from 2015.
- Cash returned to shareholders of $1.1 billion in the form of approximately 3.6 million of shares repurchased for $790 million and $303 million in dividends paid.

While the broad line industrial maintenance, repair and operating (MRO) distribution market remains extremely attractive, it continues to evolve with customer behavior shifting to digital channels. The ease of finding products and prices online enables greater comparison shopping, requiring industrial distributors to balance higher customer expectations – all of which increase pressure on pricing and margins.

Grainger is addressing these opportunities and challenges from a position of strength. Our eCommerce capabilities, advantaged supply chain network, robust IT systems and comprehensive customer service provide a solid starting point for extending our leadership in the market.

Grainger's value proposition resonates in economies with high gross domestic product per capita and a developed infrastructure. As a result, we have refocused our efforts in North America, Japan and Western Europe. While the MRO markets in these geographies have contracted in the past several years, industry fragmentation provides Grainger with long-term growth potential. Our size, scale and service capabilities position us well to gain share going forward.

As a company and in each of our core markets, we have five priorities:

1. Create unique value for customers,
2. Ensure an effortless customer experience,
3. Reduce our cost base,
4. Create a great team member experience and
5. Be responsible stewards of the business.

Based on these priorities, we made significant changes in 2016 to our U.S. business, which represents 74 percent of total revenue. To better serve customers of all sizes, we further aligned our large-customer sales team to industry-specific verticals, created an inside sales force focused on medium-sized customers, opened our new Northeast Distribution Center and invested in digital capabilities. Grainger now has eCommerce solutions for customers of all sizes and types. Today, more than 65 percent of orders originate digitally and this number will continue to grow. Ensuring a competitively advantaged digital capability and leveraging our existing online solutions will be critical for future success. Also in 2016, we were diligent in reducing our cost structure in the United States, including optimizing our branch network and announcing a consolidated contact center network.

Given the changing nature of competition in the MRO space, we are introducing a more competitive pricing structure in the United States starting in early 2017. The new structure will better enable customer acquisition with the Grainger brand and increase penetration with existing customers.

The past year presented significant challenges for our Canadian business, Acklands–Grainger. The combination of weaker oil and gas prices and the implementation of a new enterprise resource planning (ERP) system put pressure on Acklands–Grainger's performance. The ERP system is now stable, the team has adapted to the new systems and processes and we are focused on improving our service and cost structure to return to profitability.

In 2016 we continued to focus our international activities on the highest-return geographies by investing where we know the greatest growth and profit potential exists, including Western Europe, through the launch of Cromwell Direct; Japan, through MonotaRO; and Mexico, where we continue to see strong growth after the ERP implementation there. In non-core markets, we have narrowed our scope looking to sustain profitability.

In 2017, Grainger will focus on the following initiatives:

- Execute the pricing changes in the United States to attract and acquire new customers to Grainger and capture a higher share of wallet with existing customers.
- Accelerate share gain with large customers in the United States, leveraging changes made to the sales organization in 2016.
- Regain share with medium-sized customers in the United States through our inside sales team and innovative digital solutions.
- Accelerate the rapid growth in revenue and earnings through our single channel online businesses MonotaRO, Zoro and Cromwell Direct.
- Reverse the decline in our Canadian business by improving service, adjusting the cost structure and continuing to diversify our customer base.
- Reduce our cost base everywhere throughout the company.
- Improve our team member experience through focused development and improved processes.

As a result, we expect to generate attractive returns for our shareholders.

We remain committed to fulfilling our purpose of helping professionals keep their operations running and their people safe. We take great pride in serving the hardworking people that power economies in our core markets. To succeed, we develop strong relationships with our customers. Whether those relationships are built on the phone, online, in a customer's business or at a branch, our team members are at the heart of Grainger. As we start our 90th year, people will continue to be what makes the difference. We know our legacy is shaped both by what we do and how we do it.

As we move ahead, we would like to thank Gary Rogers for his service to Grainger. Gary has been a Grainger director for over 12 years and is retiring from the Board. We appreciate the strategic insight, innovative thinking and judgment Gary has brought to Grainger.

While Grainger is well-positioned to meet the current and future needs of our customers, we know that we must earn our customers' respect. What we do now and going forward will make the difference in our success with our customers. If we execute well and focus on our priorities, we will gain share by acquiring new customers and growing with existing customers. We are committed to growing in any economic cycle and continuing to make responsible decisions for our customers, team members and shareholders and the communities we serve. That's our legacy and our future.

James T. Ryan
Chairman of the Board

D.G. Macpherson
Chief Executive Officer

February 28, 2017

2016 CEO Transition

October 1, 2016, marked an important transition in company leadership as D.G. Macpherson was named Chief Executive Officer (CEO) and was also appointed to the Board of Directors, with Jim Ryan continuing to serve as Chairman of the Board.

Only the fourth CEO in the company's 90-year history, Ryan's transition brings to a close his remarkable career of nearly eight years as CEO and nearly 36 years of continuous service. Under Ryan's leadership, Grainger transitioned from a largely bricks-and-mortar industrial supplier to a leading-edge digital company with multiple channels to meet the changing needs of businesses and institutions.

Prior steps in this succession plan included promoting Macpherson to COO in August 2015. In that role, Macpherson was responsible for Grainger's day-to-day operations and reported to Ryan. Macpherson had served the company since 2008 in various roles as Senior Vice President and Group President.

Macpherson's transition to CEO has been a seamless one, as he leads with values that are the hallmark of Grainger: relentlessly focusing on customers, consciously operating with high ethics, persistently developing talent at all levels and continually evolving the business.