2Q11 Earnings Release Podcast Script
July 19, 2011

Introduction

Hello, this is Laura Brown, Senior Vice President of Communications and Investor Relations. With me is Bill Chapman, Director of Investor Relations. We are pleased to share with you an update regarding Grainger's second quarter 2011 results via this audio web cast. Please also reference our 2011 second quarter earnings release issued July 19th, in addition to other information available on our Investor Relations website, to supplement this web cast.

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

Strong sales growth, consistent execution and impressive gross margin expansion was the story for the quarter. We are very pleased with our continued ability to gain share due to expanding our product line, our sales force, eCommerce capabilities, onsite services and our international operations. As a result of the strong year-to-date performance, we have raised our full year sales and EPS guidance. We now expect sales to grow 9 to 10 percent and are forecasting EPS in the range of $8.40 to $8.70 for the full year 2011, excluding unusual items. Please note that our guidance reflects tougher comparisons on the top line, continued strong gross profit margins and higher growth-related spending in the back half of the year. At the end of this recording we'll talk in more detail about our revised guidance and our assumptions.

We'll start with total company results, then dig deeper into our segments. Company sales increased 12 percent versus the 2010 second quarter. We had the same number of selling days this quarter as 2010, so reported sales growth and daily sales growth were the same. Operating earnings increased 23 percent, while net earnings increased 32 percent. As highlighted in our release, earnings per share of $2.34 for the quarter is an all-time company record and represents a 35 percent increase versus 2010.

There was an unusual item in both the 2011 and the 2010 second quarters. The 2011 quarter included a 12 cent per share benefit primarily from the settlement of tax examinations for 2007 and 2008. As mentioned previously, please note that this 12 cent per share tax benefit is <u>not</u> included in our guidance. The 2010 second quarter included an 8 cent per share benefit from the change in the company's paid time off, or PTO, policy. Additional details can be found in the second quarter earnings releases for 2011 and 2010.

In a few moments we'll take a closer look at sales results for the quarter; let's now walk down the operating section of the income statement. Gross profit margins increased to 43.1 percent, up 120 basis points versus last year, as we were successful at expanding gross margins in the United States, Canada and our Other Businesses. Our size and scale gives us a considerable advantage versus other distributors when it comes to effectively managing product cost inflation. Once again this quarter, we were able to increase prices in line with the market and ahead of product cost inflation. We'll provide more detail when we review the business by segment.

Gross profit margins generally follow a fairly consistent seasonal pattern, with lower gross margins in the second and third quarters than in the first quarter. As a reminder, supplier funding for our annual customer trade shows was a major contributor to the 44 percent gross margin reported in the 2011 first quarter.

Reported company operating earnings for the quarter increased 23 percent, while operating margins were 13.2 percent, up 120 basis points versus the prior year. If you exclude the $10 million benefit in 2010 from the PTO change, operating earnings were up 30 percent and operating margins were up 180 basis points. This strong performance was driven by the 12 percent sales growth, the 120 basis point improvement in gross profit margins and positive expense leverage, excluding the PTO benefit. Strong execution across the board in the United States, Canada and the Other Businesses contributed to this impressive performance.

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, our operating performance by segment,
- Third, cash generation and capital deployment,
- And finally, we'll wrap up with a discussion of our revised 2011 guidance and other key items of interest.

<u>Quarterly Sales</u>

As mentioned earlier, sales for the company increased 12 percent for the quarter. Daily sales growth by month was as follows: 14 percent in April, 11 percent in May, and 12 percent in June. Of the 12 percent sales growth for the quarter, volume contributed 8 percentage points and price added 2 percentage points. Foreign exchange contributed 2 percentage points, while acquisitions added 1 percentage point. The difficult comparison from last year's oil spill related sales represented a drag of 1 percentage point.

Let’s move on to sales by segment. We report two segments, the United States and Canada. Our remaining operations in Japan, Mexico, India, Puerto Rico, China, Colombia and Panama are reported under a grouping titled Other Businesses.

Sales in the United States, which account for about 81 percent of total company revenue, increased 9 percent in the quarter. By month, daily sales in the United States were up 10 percent in April, 8 percent in May and 8 percent in June. The 9 percent sales growth for the quarter consisted of 7 percent volume growth and 3 percentage points from price, partially offset by a 1 percentage point drag from the oil spill. In May, we put through a modest price increase in the U.S. business tied to commodity inflation.

Now we’ll cover our sales performance by customer end market in the United States. Domestic growth initiatives, including product line expansion, sales force expansion, eCommerce and MRO-related services such as KeepStock®, are helping the company grow faster than the economy and gain additional market share. As a result, sales to all customer end-markets we serve in the United States were positive in the quarter as follows:

- Heavy Manufacturing was up in the mid-teens;
- Light Manufacturing and Commercial were up in the high single digits;
- Contractors and Retail were up in the mid-single digits; and
- Government and Reseller were up in the low-single digits.

Now let's turn our attention to the Canadian business. Sales in Canada represent about 13 percent of total company revenues. For the quarter, sales in Canada increased 24 percent in U.S. dollars and 16 percent in local currency. On a daily basis in Canadian dollars, sales were up 16 percent in April, up 15 percent in May and up 17 percent in June. The 16 percent sales growth in the quarter consisted of 12 percent volume growth, 3 percentage points from acquisitions and 1 percentage point from price. From a customer standpoint, sales growth in Canada was driven by impressive strength in the oil and gas, heavy manufacturing, agriculture and mining, and retail/wholesale customer end-markets.

Let's conclude our review of sales for the quarter by looking at the Other Businesses. Again, this group includes our operations in Japan, Mexico, India, Puerto Rico, China, Colombia and Panama and currently represents about 6 percent of total company sales. Sales for this group increased 49 percent, primarily the result of strong growth in Japan and Mexico, and sales reported from the business we acquired in Colombia. Sales for our business in Japan benefitted early in the quarter from sales of emergency supplies following the earthquake and tsunami. Although smaller in size, the remaining businesses within this group also delivered strong sales growth in the quarter.

June Sales

Earlier in the quarter, we reported sales results for April and May and shared some information regarding sales performance in the month. Let's now take a closer look at June. There were 22 selling days in June of 2011 and 2010. Total company sales were up 12 percent in June versus June of 2010. The 12 percent growth consisted of 8 percent volume growth, 2 percentage points each from price inflation and foreign exchange, and 1 percentage point from acquisitions, partially offset by a 1 percentage point drag from the oil spill related sales in 2010.

In the United States, June sales were up 8 percent. This growth consisted of 6 percentage points of volume along with 3 percentage points from price, partially offset by 1 percentage point from sales related to last year's oil spill. Daily sales growth in June to each of our U.S. customer end-markets was as follows:

- Heavy Manufacturing was up in the mid-teens;
- Light Manufacturing and Commercial were up in the high single digits;
- Contractors and Retail were up in the mid-single digits;
- Government was flat; and
- Reseller was down high single digits reflecting the strong sales of oil spill-related products in 2010.

Sales in Canada for June increased 25 percent in U.S. dollars, up 17 percent in local currency. The 17 percent sales growth consisted of 14 percent volume and 3 percent from acquisitions. Customers in the agriculture and mining, retail/wholesale, oil and gas, and heavy manufacturing end-markets accounted for the largest increases in sales growth in June.

Sales for our Other Businesses increased 60 percent in June, primarily the result of strong growth in Japan and Mexico, along with sales for our business in Colombia. Consistent with the quarter, the remaining businesses within this group also delivered strong sales growth in June. As a reminder, starting in July, we pass the anniversary of the Colombian acquisition.

July Sales

Sales growth so far in the month of July is tracking roughly in line with the growth rate posted in June, excluding the headwind from oil spill related sales. As a reminder, sales related to the 2010 Gulf of Mexico oil spill clean up contributed 3 percentage points to the 21 percent daily growth in July of last year.

Now I would like to turn the discussion over to Bill Chapman.

Thanks Laura.

Operating Performance:

Since we have already covered company operating performance, let's jump right into performance by segment.

Reported operating earnings in the United States increased 17 percent versus the 2010 second quarter and operating margin increased 120 basis points to 16.6 percent. If you exclude the benefit from the PTO change in 2010, operating earnings in the United States increased 22 percent and operating margins expanded 180 basis points versus the prior year. This performance was driven by 9 percent sales growth and a higher gross profit margin. Gross profit margins in the United States increased 120 basis points. The gross margin expansion was primarily due to effective product cost management and the ability to raise prices with the market and ahead of product cost increases. Operating expenses grew in line with sales growth for the quarter, and were up 6 percent excluding the PTO benefit from the prior year.

Let's move on to our business in Canada. At the end of the 2010 fourth quarter, we shared with you the plan for improving performance. We're happy to report that we continued to make substantial progress in the 2011 second quarter, as operating earnings increased 130 percent versus the prior year. Strong sales growth, coupled with higher gross margins and tight cost controls, contributed to operating margins jumping 530 basis points to 11.4 percent. The gross margin expansion in Canada was driven by a number of factors including product cost deflation tied to the tailwind created by the strength of the Canadian dollar. A first quarter price increase, less price discounting and a more favorable customer mix also contributed to the growth in gross profit margins in the second quarter. Having reached the anniversary of actions taken last year to improve gross margins, we are expecting roughly 25 to 50 basis points of year-over-year gross margin expansion in the back half of the year. In the second half of 2011 we will be filling a number of open volume-related positions and will be opening a new distribution center in Saskatchewan. As a result, we expect to generate about 150 to 200 basis points of year-over-year operating expense leverage in the back half of the year in Canada.

Operating performance in the quarter for our Other Businesses was impressive, the direct result of our focus on driving growth and improving profitability. This group posted operating earnings of $8.6 million for the quarter versus $1.9 million a year ago. Strong operating performance in Japan and Mexico led the improved results for this group.

Other

The effective tax rate for the quarter was 35.0 percent versus 39.1 percent in 2010 mainly due to the 12 cent per share benefit primarily related to the settlement of tax examinations for 2007 and 2008. Excluding this benefit, the effective tax rate is now expected to be 38.7 percent for the full year due to higher earnings forecasted in foreign jurisdictions with lower tax rates and a slightly lower overall effective state tax rate.

Cash Flow

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $191 million versus $173 million in 2010. The growth in accounts receivable resulted in a slight drag on cash flow for the quarter. This increase was greater than the growth in sales due to a postal strike in Canada and the timing of quarter-end, both temporarily influencing the timeliness of cash processing. We used the cash generated during the quarter to invest in the business and return capital to shareholders through dividends. Capital expenditures for the quarter were $52 million. Dividends paid to shareholders were $47 million, representing the 22 percent increase in the quarterly dividend rate announced in April. The company did not buy back any stock during the quarter and has approximately 7.7 million shares remaining on its share repurchase authorization.

2011 Guidance

As reported in our second quarter earnings release, we raised both sales and earnings per share guidance for the full year 2011. We expect sales growth in the range of 9 to 10 percent and EPS in the range of $8.40 to $8.70. Company guidance does not include the $0.12 cent per share benefit primarily from the settlement of tax examinations for 2007 and 2008. So, let's look at the underlying elements of our expectations:

- First, as we have consistently communicated, sales comparisons in the back half of the year are more difficult, in part due to sales related to the oil spill clean up in 2010. Oil spill-related sales added 3 percentage points to 19 percent daily sales growth in the 2010 third quarter and 2 percentage points to 14 percent daily sales growth in the fourth quarter of 2010. Additional detail can be found on the Exhibits at the end of this podcast script.
- Second, we expect gross profit margins in the third and fourth quarters to be similar to the 2011 second quarter, with some slight price erosion as the year goes on, which is typical. As a reminder, supplier funding for our customer trade shows in March made the 44 percent gross profit margin the 2011 first quarter different from the rest of the year.
- Third, our investments in proven growth drivers, such as new sales representatives, eCommerce and advertising will continue to accelerate throughout the year. In fact, we expect to add more than double the number of new sales representatives in 2011 than originally planned, going from 150 to 300 new hires. We're also stepping up the pace of our eCommerce and advertising investments. The opening of our new 800,000 square foot super regional distribution center in northern California in the 2011 fourth quarter will also result in additional operating expense. For the full year, about $60 to $70 million in growth-related spending should spread as follows:
    - $8 million in 1Q
    - $11 million in 2Q
    - $40 - $50 million in 2H

- Finally, the lower effective tax rate of 38.7 percent projected for the year 2011, excluding the 12 cent per share benefit in the 2011 second quarter, should offset a higher average share count than we had originally forecasted, since we are currently building excess cash in anticipation of potential M&A activity.

To summarize, our EPS guidance implies roughly 140 to 170 basis points of operating margin expansion for the full year versus the 11.5 percent in 2010, adjusted for the PTO benefit, which is even stronger earnings growth than we had forecasted in April.

We are very excited about our record results in the quarter and the opportunities going forward to gain share in this large and consolidating market. Never before have businesses and institutions been so focused on driving productivity and cost savings, and we look forward to helping our customers with these initiatives given our broad array of MRO products and services.

Conclusion

Thank you for your interest in Grainger. Please mark your calendar for the release of July sales on Wednesday, August 10th. If you have any questions, please do not hesitate to contact Laura Brown at 847.535.0409 or me at 847.535.0881.

Exhibit I
2011 Guidance

	April	July*
Sales	**$7.7 - $7.9**	**$7.8 - $7.9**
V% vs. prior year	7% - 10%	9% - 10%
Operating Margin	**12.7% - 13.1%**	**12.9% - 13.2%**
bps vs. prior year	120 - 160	140 - 170
EPS	**$8.10 - $8.60**	**$8.40 - $8.70**

* Effective 7/19/2011

Exhibit II
2011 Sales Growth Bridge

	1H Actual	Year Estimate*
Economy/Share Gain	7%	6 -7%
Oil Spill Sales	0%	(1)%
Price	2%	2%
Organic Sales (daily)	**9%**	**7 – 8%**
Sales Days	1%	0%
F/X	1%	1%
Acquisitions	1%	1%
Company (reported)	**12%**	**9 – 10%**

* Effective 7/19/2011

Exhibit III
Oil Spill Contribution to Daily Sales in 2010

Month	Percentage point contribution
January	0
February	0
March	0
1Q	**0**
April	0
May	1
June	1
2Q	**1**
July	3
August	3
September	3
3Q	**3**
October	1
November	2
December	3
4Q	**2**
Year	**1**