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4Q11 Earnings Release Podcast Script
January 25, 2012

Introduction

Hello, this is Laura Brown, Senior Vice President of Communications and Investor Relations. With me is Bill Chapman, Director of Investor Relations. The purpose of the audio web cast is to provide you with some additional color and perspective on Grainger's fourth quarter 2011 results. Please be sure to reference our earnings release issued January 25th, in addition to other information available on our Investor Relations website, to supplement this web cast.

Before we go any further, 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 across all businesses and acceleration in spending on our growth programs was the story for the quarter. Continued strong organic sales performance in the quarter, with 9 percent volume growth, is evidence that we continue to gain market share.

For the 2011 fourth quarter, the company reported record sales of $2.1 billion, an increase of 14 percent versus $1.8 billion in the 2010 quarter. Net earnings of $148 million increased 12 percent and earnings per share of $2.04 increased 11 percent versus $1.83 in 2010.

In the earnings release and at the end of this podcast script, we provided a walk down of items to help explain results for the quarter and highlight what items were not reflected in our guidance. The 2011 fourth quarter included:

- A $0.16 per share charge from the closure of 27 branches in the U.S. business, and
- A $0.07 per share gain from the sale of our 49 percent ownership in a joint venture MRO Korea.

These 2 items combined represented a $0.09 net reduction to earnings per share, resulting in adjusted EPS of $2.13. The 2010 fourth quarter included a $0.04 per share benefit from the change to the company's paid time off policy. Excluding these items in both years, earnings per share increased 19 percent in the fourth quarter of 2011 versus the 2010 quarter.

In a few moments we'll take a closer look at sales results for the quarter. In the meantime, let's walk down the income statement. Our gross profit margin for the quarter increased 180 basis points versus last year. The increase in the company's gross profit margin was driven by a number of factors that are explained at the segment level. In addition, the inclusion of the Fabory business for the quarter contributed to gross margin expansion, but was a drag on the company's operating margin.

Company operating earnings of $221 million for the 2011 fourth quarter increased 5 percent. If you exclude the $18 million pre-tax expense from the branch closures in the 2011 quarter and the $4 million pre-tax benefit from the change in paid time off policy in the 2010 quarter, operating earnings were up 16 percent for the quarter. Adjusting for these items, company operating margin for the quarter increased by 20 basis points to 11.6 percent versus the prior year, the strong margin expansion in the first 3 quarters of 2011 was tempered in the final quarter by $31 million in incremental growth-related spending. This included new sales representatives, eCommerce, advertising and expenses for our new

800,000 square foot distribution center in northern California. In addition, the Fabory business posted an operating loss for the quarter.

Net earnings and earnings per share for the 2011 fourth quarter also included a benefit from a lower tax rate than in the 2010 fourth quarter. The effective tax rate was 32.9 percent and 36.6 percent in the 2011 and 2010 fourth quarters, respectively. The lower tax rate resulted primarily from a lower state tax expense, tax law changes in Japan enacted in late November of 2011 and higher earnings in foreign jurisdictions with lower tax rates. The $31 million in incremental growth-related expenses contributed to this lower tax rate, as the spending was concentrated in the United States, which has Grainger's largest and most profitable business, with one of the highest tax rates in the company.

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 December,
- Second, our operating performance by segment,
- Third, cash generation and capital deployment,
- And finally, we'll wrap up with a discussion on our 2012 guidance and other key items of interest.

Quarterly Sales

As mentioned earlier, total company sales for the quarter increased 14 percent versus the prior year. There were 63 selling days in the quarter; the same as the 2010 fourth quarter. Strong volume growth was responsible for the majority of the revenue increase contributing 9 percentage points, followed by 5 percentage points from acquisitions, 2 percentage points from price, partially offset by a 2 percentage point drag from product sales related to the 2010 oil spill in the Gulf of Mexico.

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

Sales in the United States segment, which accounted for about 77 percent of total company revenue in the quarter, increased 8 percent. The sales increase in the United States was driven primarily by 8 percent volume growth and 3 percentage points from price. This growth was partially offset by a 2 percentage points drag from oil spill-related sales in 2010 and a 1 percentage point headwind from lower sales of seasonal products due to the unusually warm weather in the 2011 quarter.

All U.S. end-markets, except reseller, posted growth versus the 2010 fourth quarter.

- Heavy manufacturing and commercial were up in the low double digits;
- Light manufacturing and retail were up in the high single digits;
- Government was up in the mid single digits;
- Contractor was up in the low single digits; and
- Reseller was down in the mid-teens due to the difficult comparison with strong oil spill related sales in the 2010 fourth quarter.

Now let's turn our attention to our Canadian business, which accounted for about 12 percent of total company revenues. For the quarter, sales in Canada increased 13 percent in U.S. dollars and were up 14 percent in local currency. Volume growth contributed 13 percentage points to the sales increase, while acquisitions completed during the last 12 months contributed 1 additional percentage point. This growth was partially offset by a 1 percentage point headwind from foreign exchange. The sales increase in Canada was led by strong growth to customers in the construction, heavy manufacturing, agriculture and mining sectors of the economy.

Let's conclude our review of sales for the quarter by looking at the Other Businesses. Again, this group includes our operations in Europe, Japan, Mexico, India, Colombia, China, Puerto Rico, Panama and the Dominican Republic and currently represents about 11 percent of total company sales. Sales for this group were up 95 percent, primarily the result of the incremental sales from Fabory, combined with strong revenue growth in Japan and Mexico. Excluding Fabory, sales for the Other Businesses increased 26 percent in the quarter.

December Sales

Earlier in the quarter, we reported sales results for October and November and shared some information regarding December sales performance during the month. Total company sales increased 10 percent in December 2011 versus December of 2010. Both months had 21 selling days. Contributing to higher daily sales growth in December were 9 percentage points due to volume, which is consistent with the quarter and ahead of the 8 percent volume growth for the full year, 4 percentage points from acquisitions and 2 percentage points due to price. This sales growth was partially offset by a 3 percentage point drag related to the oil spill and a 2 percentage point headwind due to lower sales of seasonal products.

In the United States, sales for the month of December increased 5 percent. This growth consisted of 8 percentage points of volume and 2 percentage points from price, offset by a 3 percentage point drag related to the oil spill and a 2 percentage point drag from lower sales of seasonal products. Here is how each of our U.S. customer end-markets performed in December:

- Heavy manufacturing was up in the low double digits;
- Commercial and retail were up in the high single digits;
- Light manufacturing and government were up in the mid single digits;
- Contractor was down in the low single digits; and
- Reseller was down in the high twenties due to the difficult comparison with strong oil spill related sales in December of 2010.

In Canada, sales in December increased 9 percent in U.S. dollars and 11 percent in local currency. Volume accounted for about 12 percentage points of the growth, offset by 2 percentage points from foreign exchange and 1 percentage point from lower sales of seasonal products. From a customer end-market standpoint, we saw the strongest growth in sales to the heavy manufacturing, retail, and commercial markets.

January Sales

With 5 selling days left in the month, daily sales growth in January is trending above December and slightly above the high end of our 10 to 14 percent range for the full year. In the U.S. business, we are seeing stronger growth among customers in the Heavy and Light Manufacturing end markets, and a recovery in the Contractor market which was hurt by the warm weather in December. While sales growth from our new Territory Sales Representatives is tracking to plan, a disproportionate amount of our organic revenue growth is being driven by large, contract customers with lower gross profit margins. Month to date sales results in Canada and Mexico are also running ahead of our daily sales growth in the 2011 fourth quarter. Consistent with December and the fourth quarter, a portion of the sales growth in January is attributable to the incremental sales from Fabory.

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

Thanks Laura.

Operating Performance

The story behind the company's operating results in the quarter can best be told by reviewing segment performance. So, let's begin with the United States.

Reported operating earnings in the United States increased 5 percent versus the 2010 fourth quarter, up 15 percent excluding the charge related to the 2011 branch closures and the 2010 paid time off benefit. The growth in operating earnings was primarily driven by the 8 percent sales growth and improved gross profit margins. Gross profit margins for the quarter increased 170 basis points driven primarily by price increases exceeding cost increases, positive selling mix from a decline in sales of lower margin sourced products primarily attributable to the oil spill in 2010, growth of our private label business, and lower excess and obsolete requirements.

Operating expenses in the U.S increased 15 percent on a reported basis, 10 percent excluding the 2 items just noted. The 10 percent increase in operating expenses was driven by higher volume-related expenses and growth-related spending including new sales representatives, eCommerce, advertising and incremental expenses for the new 800,000 square foot distribution center in northern California.

One of the growth programs that contributed to the operating expense growth in the quarter was our sales force expansion. We hired our 6th wave of Territory Sales Representatives, or TSRs, and now have more than 500 of these new sales representatives calling on customers across the United States. As we shared at our Analyst Meeting in November, we are very excited about the additional reach these sellers provide as they call on both existing and prospective customers. We estimate that TSRs will account for approximately 1 percentage point of our expected sales growth in 2012 and 2 percentage points in 2013. On average, a TSR costs approximately 40 percent less than an Account Manager and are generating sales with gross profit margins north of 50 percent. As we build out our coverage, we expect to hire another 300 TSRs in 2012.

Another growth program we are aggressively funding is eCommerce. In 2011, we transacted approximately $2 billion in sales through eCommerce, representing about 25 percent of total company sales. We are also in the midst of transitioning to a new U.S. platform that should allow for more functionality, speed and personalization. Most recently, we officially launched our new mobile site that interacts seamlessly with Grainger.com. It enables users with smart phones to search for products, create personal lists, view real-time inventory availability, approve and place orders. Customers can then choose to have those products shipped from a distribution center or picked up at a local branch through the branch locator tool. Our mobile platform fully leverages our multi-channel business model.

Let's now look at the strong operating performance for our business in Canada. Operating earnings increased 121 percent in U.S. dollars and 123 percent in local currency. Gross profit margins in Canada increased 250 basis points due primarily to effective price-cost management and growth of our private label business. Operating expenses in Canada increased 1 percent, primarily the result of effective cost management and easy comparisons with the 2010 quarter that included start-up related costs for the new distribution center in British Columbia.

Operating earnings for our Other Businesses, which again includes our operations in Europe, Latin America and Asia, were flat versus the 2010 fourth quarter at $5 million. Led by Japan, Mexico and Colombia, earnings improved over the prior year fourth quarter in virtually all countries with the exception of recent start-ups and Fabory, our business in Europe acquired on August 31, 2011. Excluding Fabory, operating earnings for this group were $6 million in the quarter. From an EPS perspective, Fabory generated $0.04 per share of dilution for the company in the quarter and $0.02 per share of dilution for the 4 months since the acquisition. As a reminder, we originally expected Fabory to be earnings neutral for 2011, but performance was not as strong as expected due to softer sales and customer mix, primarily due to the economic climate in Europe.

Cash Flow

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $164 million versus $104 million in 2010. We used the cash generated to invest in the business and pay $48 million in dividends, which reflects the 22 percent increase in the quarterly dividend rate announced last April, or 66 cents per share. We also bought back 284,000 shares of stock for $50 million. Capital expenditures for the quarter were $66 million, which was primarily invested in expanding the capacity of our distribution center network in the United States.

Now let's take a look at the full year. Operating cash flow was $724 million in 2011 versus $596 million in 2010. Capital expenditures for the year were $197 million and $128 million in 2010. Most of the year-over-year increase in capital spending was attributable to investments in our distribution network. In addition, we also funded a portion of the Fabory acquisition with cash and paid down debt. We bought back 1 million shares during 2011 for $151 million and have approximately 7.1 million shares remaining on the current authorization. In addition, we paid shareholders $181 million in dividends in 2011. So for the full year, we returned a total of $332 million to shareholders in the form of dividends and share repurchases.

2012 Guidance

At our Analyst Meeting in November, we issued sales and earnings guidance for 2012 and we reiterated that guidance today. We continue to expect 2012 sales to grow in the range of 10-14 percent and 2012 EPS in the range of $9.90 - $10.65. We also expect operating margin expansion of 20 to 50 basis points including Fabory, and 50 to 80 basis points on an organic basis.

Here are a few additional considerations as you refine your models:

1. Organic sales growth in the 2012 first quarter is off to a strong start, benefiting from a number of new, large customer contracts that began with an initial lift in early January.
2. Keep in mind that a healthy portion of our top line growth is also coming from emerging markets, including acquisitions like Fabory, which should continue to contribute about 4 to 5 percentage points of our growth in the first 8 months of the year, albeit at lower operating margins.
3. We will have 64 selling days in the first quarter, which is the same number as the 2011 first quarter.
4. Gross profit margins in the 2012 first quarter should expand versus the 2011 fourth quarter and the first quarter of 2011, but will be tempered by faster organic growth from larger, contract customers with lower gross profit margins.
5. Organic growth investments are expected to ramp up throughout the 2012 first quarter, similar to the 2011 fourth quarter. As we move through the year, difficult prior year operating expense comparisons will ease, particularly as we anniversary the opening of the northern California distribution center and the Fabory acquisition in the third quarter, which should then allow for better earnings leverage.
6. We expect the effective tax rate for 2012 to be 37.9 percent.
7. As a result, we expect 2012 first quarter earnings per share to grow in line with sales growth, with improved earnings leverage later in the year.
8. Finally, we remain committed to delivering top quartile total shareholder return, which is forecasted at 18 to 19 percent in 2012 as detailed on Exhibit IV.

Conclusion

Thank you for your interest in Grainger. Be sure to mark your calendar for the following dates:

- January sales release on Monday, February 13th
- 2011 Form 10K filing on Monday, February 27th
- 1st Quarter 2012 earnings release on Tuesday, April 17th
- Tour of our new distribution center in Patterson, California on Wednesday, June 6th

If you have any questions, please do not hesitate to contact Laura at 847.535.0409 or me at 847.535.0881.

Exhibit I
Adjustments to Reported 2011 EPS

	Twelve Months Ended December 31, 2011	2010	% Change
Diluted Earnings Per Share as reported:	$9.07	$6.93	31%
Charge for U.S. branch closures	0.16		
Settlement of prior year tax examinations	(0.12)		
Gain on sale of MRO Korea Joint Venture	(0.07)		
Benefit from change in paid time off policy		(0.28)	
Write down of deferred tax asset		0.15	
Subtotal	(0.03)	(0.13)	
Diluted Earnings Per Share as adjusted:	$9.04	$6.80	33%

	Three Months Ended December 31, 2011	2010	% Change
Diluted Earnings Per Share as reported:	$ 2.04	$1.83	11%
Charge for U.S. branch closures	0.16		
Gain on sale of MRO Korea	(0.07)		
Benefit from change in paid time off policy		(0.04)	
Subtotal	0.09	(0.04)	
Diluted Earnings Per Share as adjusted:	$2.13	$1.79	19%

Exhibit II
2012 Sales Guidance

	2012E*
Economy/Share Gain	5 - 8%
Oil Spill Sales	0
Price	2 - 3%
Organic Sales (daily)	**7 - 11%**
F/X	0%
Acquisitions	3%
Company (reported)	**10 - 14%**

* Reiterated 1/25/2012

Exhibit III
2012 EPS Guidance*

	Total Company	Organic Estimate
Sales $B	**$8.8 – $9.2**	**$8.4 - $8.8**
EPS	$9.90 - $10.65	$9.86 - $10.61
Sales growth	10% - 14%	6% - 10%
EPS growth	11% - 19%	10 – 19%
Operating Margin	**13.4% - 13.7%**	**13.9% -14.2%**
bps vs. prior year	20 – 50	50 - 80

* Reiterated 1/25/2012 (Organic excludes foreign exchange and acquisitions.)

Exhibit IV
Total Shareholder Return

	2012E Organic*	2012E Company*
Sales	8%	12%
Op Margin	6%	3%
Op Earnings	**14%**	**15%**
Share Repurch./Taxes	2%	2%
EPS	**16%**	**17%**
Dividend Yield	2%	2%
TSR	**18%**	**19%**
Net Working Assets	8%	18%
Op Margin bps vs. PY	65 bps	35 bps

* Reiterated 1/25/2012 (Organic excludes foreign exchange and acquisitions.)

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Exhibit V

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**