4Q14 Earnings Release Podcast Script
January 26, 2015

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 2014 results. Please also reference our 2014 fourth quarter earnings release issued today, January 26th, in addition to other information available on our Investor Relations website, to supplement this podcast.

As a reminder, 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.

As mentioned in the press release, we lowered our 2015 guidance to reflect the 10 percent weakening in the Canadian dollar since our Analyst Meeting in November. To put this in perspective, Canada is our second-largest business behind the United States, representing 11 percent of total company sales in 2014. Roughly 20 percent of our Canadian sales are tied directly to the oil and gas industry. Beyond our direct exposure, the Canadian economy and the Canadian dollar tend to correlate closely with natural resources prices, more specifically oil. Because of this, we have taken a fresh look at our expected performance in Canada based on current exchange rates and weaker economy.

As a result, we now expect 2015 sales growth of 3 to 7 percent and earnings per share of $12.60 to $13.60. Our 2015 guidance issued on November 12, 2014, called for sales growth of 5 to 9 percent and earnings per share of $12.90 to

$13.80. At the end of the podcast, we will provide more color around the revised guidance.

Company Results Summary: 2014

Before we analyze our results, let's review some highlights from full year 2014.

- We saw continued strong performance in the United States with operating margins expanding 60 basis points to 18.2 percent.
- As promised, we took actions to address several smaller underperforming businesses.
- Our single channel online model continued its strong growth.
- And, we spent an incremental $78 million on growth and infrastructure and $387 million in gross capital spending to create long-term competitive advantage.

With that as a backdrop, let's take a look at our performance. Today we reported results for the year 2014. For the full year, company sales increased 6 percent to $10.0 billion. Net earnings increased 1 percent to $802 million and earnings per share increased 3 percent to $11.45.

As described in the earnings release, the fourth quarter contained restructuring and impairment charges that lowered reported earnings by $0.66 per share. To better understand our performance, the majority of the analysis and commentary for the remainder of the podcast excludes the effect of charges in 2014 and 2013. Details regarding the charges can be found in the earnings release, posted on the Investor Relations section of our website.

Excluding charges from 2014 and 2013, company operating earnings increased 6 percent for the year, while net earnings increased 4 percent. Adjusted earnings per share were $12.26 for the year, representing a 6 percent increase versus $11.52 in 2013. Adjusted EPS grew faster than net earnings due to fewer shares outstanding as a result of our stock repurchases.

Company Results Summary: 2014 Fourth Quarter

Now let's turn to the 2014 fourth quarter. Overall, results were within the expectations issued at our Analyst Meeting on November 12th. Company sales in the fourth quarter increased 6 percent. Excluding the charges from 2014 and 2013, operating earnings increased 9 percent, while net earnings increased 6 percent. Adjusted earnings per share were $2.80 for the quarter, representing an increase of 8 percent versus the 2013 fourth quarter.

Let's now walk down the operating section of the income statement. Adjusted gross profit margins were 42.5 percent, flat with the 2013 fourth quarter due to improvement in the United States, offset by gross profit declines in Canada and Fabory in Europe.

On an adjusted basis, company operating earnings for the quarter increased 9 percent. The earnings growth was driven by the 6 percent sales increase and operating expenses growing at a slower rate than sales. Adjusted operating expenses grew 4 percent including $10 million in incremental growth-related spending. Throughout the year, we continued to invest in growth and infrastructure designed to accelerate our share gains and increase our size and scale. Incremental growth spending for the full year 2014 was $78 million versus 2013. A schedule summarizing incremental growth spending for 2011 through 2015 can be found in Exhibit 3 of this podcast. Adjusted company operating margins increased 40 basis points to 12.7 percent for the quarter from 12.3 percent a year ago.

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 2015 guidance and other key items.

Quarterly Sales

As mentioned earlier, company sales for the quarter increased 6 percent. We had 64 selling days in the quarter, the same as the previous year. The 6 percent sales growth for the quarter consisted of 7 percentage points from volume, 1 percentage point from price and 1 percentage point from sales of Ebola related safety products, partially offset by a 2 percentage point decline from unfavorable foreign exchange and a 1 percentage point negative variance from lapping an extra month of sales in the fourth quarter of 2013 from E&R Industrial, Inc.

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 and also include results for the single channel online model businesses in Japan, the United States and Europe.

Sales in the United States, which accounted for 77 percent of total company revenue in the quarter, increased 6 percent. The 6 percent sales growth for the quarter was driven by 6 percentage points from volume, 1 percentage point from price and 1 percentage point from sales of Ebola related safety products, partially offset by a 1 percentage point negative variance from the extra month of E&R sales in the fourth quarter of 2013 and a 1 percentage point negative variance from the divestiture of several Specialty Brands on December 31, 2013.

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

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

For perspective, Natural Resources represents approximately 4 percent of sales in the U.S. segment, with sales growth driven by Oil & Gas and Refining & Mining customers. The strong performance in Commercial was driven by sales of Ebola related safety products to healthcare customers.

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 increased 3 percent in U.S. dollars, 11 percent in local currency. The 11 percent sales increase consisted of 7 percentage points from WFS Enterprises, Inc., acquired on September 2, 2014, and a 4 percentage point increase from volume. The volume increase in Canada was led by growth to customers in the Government and Utilities 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 12 percent of total company sales. Sales for this group increased 13 percent in the 2014 fourth quarter versus the prior year. This performance consisted of 21 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 was driven by MonotaRO in Japan and Zoro in the United States, partially offset by lower sales from Fabory in Europe.

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 22 selling days in December of 2014 versus 21 in the same month of 2013. Total company sales increased 3 percent on a daily basis in December of 2014 versus December of 2013. The daily sales growth in December included 7 percentage points from volume and 1 percentage point from sales of Ebola related safety products, partially offset by a 2 percentage point decline from unfavorable foreign exchange, a 2 percentage point negative variance from the extra month of E&R sales in the fourth quarter of 2013 and a 1 percentage point decline from lower sales of seasonal products.

In the United States, December daily sales increased 4 percent driven by 8 percentage points from volume and 1 percentage point from sales of Ebola related safety products, partially offset by a 3 percentage point negative variance from the extra month of E&R sales in fourth quarter 2013, a 1 percentage point decline from lower sales of seasonal products and a 1 percentage point negative variance from divestitures. December customer end market performance in the United States, excluding acquisitions, was as follows:

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

Similar to the quarter, the strong performance in Commercial was driven by sales of Ebola related safety products to healthcare customers.

Daily sales in Canada for December increased 2 percent in U.S. dollars and were up 10 percent in local currency. The 10 percent daily sales increase consisted of 7 percentage points from the WFS acquisition and a 4 percentage point increase from volume, partially offset by a 1 percentage point decline from lower sales of seasonal products. The organic growth in Canada was driven by the Heavy and Light Manufacturing and Government end markets.

Daily sales for the Other Businesses increased 7 percent in December, consisting of 18 percentage points from volume and price, partially offset by an 11 percentage point decline from unfavorable foreign exchange. The volume growth was driven by Zoro in the United States, which grew more than

100 percent in the month, while sales from the businesses in Mexico and Japan grew double digits in local currency.

<u>January Sales</u>

Let's move on to January. Daily sales growth in the month of January is currently trending in the mid-single digits. Now, I would like to turn the discussion over to Bill Chapman.

<u>Operating Performance</u>

Thanks Laura.

Since we have already reviewed company operating performance, we will discuss performance by reporting segment. As a reminder, results in this discussion <u>exclude</u> the charges detailed in the earnings press release, which is posted on the Investor Relations section of our website.

Operating earnings in the United States increased 11 percent versus the 2013 fourth quarter driven by the 6 percent sales growth and positive expense leverage. Gross profit margins for the quarter increased 10 basis points as a result of price increases exceeding cost increases, partially offset by faster growth with lower margin customers. Operating expenses increased 4 percent primarily due to productivity initiatives and lower than forecasted incremental investment spending of $1 million. The U.S. operating margin increased a healthy 70 basis points to 17.0 percent for the quarter versus the fourth quarter of 2013.

Let's move on to our business in Canada. Operating earnings declined 27 percent versus the 2013 fourth quarter, down 21 percent in local currency. This decrease was driven by lower gross profit margins. The gross profit margin in Canada declined 280 basis points versus the prior year, primarily due to product cost inflation exceeding price inflation driven by unfavorable foreign exchange, higher freight costs and lower supplier rebates, as well as negative mix from the WFS acquisition.

On an adjusted basis, the Other Businesses were breakeven in the 2014 fourth quarter versus generating $3 million in earnings in the 2013 period. The decline in adjusted earnings was more than driven by incremental expenses associated with the start-up of the single channel online model business in Europe, partially offset by strong operating performance from Zoro in the United States. In addition, operating earnings growth from MonotaRO in Japan was strong in local currency but was essentially flat in U.S. dollars.

Other

Other income and expense was a net expense of $5 million in the 2014 fourth quarter versus net expense of $2 million in the 2013 fourth quarter. The decrease was primarily attributable to higher foreign exchange transaction losses.

The reported tax rate in 2014 was 42.3 percent for the quarter and 39.1 percent for the full year. Excluding the effect of items separately disclosed and other fourth quarter tax items, the tax rate was 38.2 percent for the quarter and 2014, compared to 37.3 percent in the 2013 quarter and year. The increase was primarily due to a higher proportion of earnings in the United States versus geographies with lower tax rates and losses with no tax benefit. The company is currently projecting a tax rate of 37.7 to 38.8 percent for 2015.

Cash Flow

Lastly, let's take a look at our cash flow for the quarter. Operating cash flow was $297 million, or 152 percent of adjusted net income, versus $246 million in 2013. We used the cash generated during the quarter to invest in the business and return cash to shareholders through share repurchases and dividends. Gross capital expenditures for the quarter were $147 million versus $124 million in 2013. We paid dividends of $76 million in the quarter, reflecting the 16 percent increase in the quarterly dividend announced in April of 2014. In addition, we bought back 842,000 shares of stock for $208 million and ended the quarter with

8.5 million shares remaining on our share repurchase authorization. In total, we returned $284 million to shareholders in the quarter.

2015 Guidance

As we noted earlier, we adjusted our 2015 guidance to reflect current foreign exchange headwinds and the deteriorating macroeconomic environment in Canada and now expect sales growth of 3 to 7 percent and earnings per share of $12.60 to $13.60. Let's take a closer look at some of our assumptions for the full year and the first quarter. Keep in mind this reflects normalized results in 2014 as a basis for comparison:

1. We'll start with sales.
    a. For the full year, the change from our original guidance reflects lower organic growth in Canada and more headwinds from foreign exchange. The effect of foreign exchange reduces total company sales by 3 percent, compared to 1 percent in our November guidance.
    b. We originally expected 5 percent organic sales growth in Canada and now expect 2 percent growth in local currency, due to the weakening economy.
2. Let's move on to gross profit margins.
    a. We expect flattish gross profit margins for full year 2015 versus the full year 2014.
    b. For the first quarter, we forecast gross profit margins will be down 20 to 60 basis points versus the 2014 first quarter.
    c. As a reminder, the company's annual customer trade shows held in the first quarter typically result in gross profit margins and operating expenses that are about 100 basis points above the run rate for the full year, distorting sequential quarterly results.

3. Let's take a closer look at operating margin expectations.
   a. For the full year, we still expect 0 to 40 basis points of operating margin expansion, driven by expansion in the United States and the Other Businesses, partially offset by margin contraction in Canada due to higher investment levels and challenging macroeconomic conditions.
4. Finally, the effect of foreign currency translation, currency transaction and macroeconomic weakness is a reduction of $0.25 in earnings per share at the midpoint of our guidance.

Conclusion

Please mark your calendar for the release of January sales on Thursday, February 12th. 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
2015 Sales Guidance

	January 26, 2015 2015E	November 12, 2014 2015E
Economy/Share Gain	6% - 9%	6% - 9%
Price	0% - 1%	0% - 1%
Organic Sales	6% - 10%	6% - 10%
F/X	-3%	-1%
Company Sales	3% - 7%	5% - 9%

Note: As of January 26, 2015.

Exhibit 2
2015 EPS Guidance

	January 26, 2015			November 12, 2014		
Sales ($B)	$ 10.3	-	$10.7	$ 10.4	-	$10.8
V% vs. prior yr.	3%	-	7%	5%	-	9%
Op Margin	14.2%	-	14.6%	14.3%	-	14.7%
bps vs. prior yr.	0	-	40	0	-	40
EPS	$12.60	-	$13.60	$12.90	-	$13.80

Note: (1) As of January 26, 2015.
(2) November 12, 2014, guidance was based on forecast, not actual results.
(3) Excludes unusual items as reported by the company in its quarterly earnings releases.

Exhibit 3
Incremental Growth Spending
($ in Millions)

	2015 Incremental vs. 2014 [1]	2014 Incremental vs. 2013	2013 Incremental vs. 2012	2012 Incremental vs. 2011	2011 Incremental vs. 2010
1Q	$30E	$31	$22	$27	$7
2Q		$20	37	24	11
3Q		$17	40	19	19
4Q		$10	31	1	30
FY	$130E [2]	$78	$132	$71	$67

Notes: (1) As of January 26, 2015.
(2) The company expects 2015 incremental growth spending of $115-150 million. The $130 million estimate represents the midpoint of the range.

Exhibit 4
Acquisition / Divestiture Schedule

Action	Segment	Date	Pre-acquisition Revenue
Acquired Techni-Tool	U.S.	December 31, 2012	$88 Million
Acquired E&R Industrial, Inc.	U.S.	August 23, 2013	$180 Million
Acquired Safety Solutions, Inc.	U.S.	December 3, 2013	$63 Million
Divested Specialty Brands	U.S.	December 31, 2013	$96 Million
Acquired WFS Enterprises, Inc.	Canada	September 2, 2014	$90 Million

Note: E&R results were first consolidated in the fourth quarter of 2013.

Exhibit 5

Selling Days: 2015 vs. 2014

Month	2015	2014	Difference
January	21	22	-1
February	20	20	0
March	22	21	1
1Q	**63**	**63**	**0**
April	22	22	0
May	20	21	-1
June	22	21	1
2Q	**64**	**64**	**0**
July	22	22	0
August	21	21	0
September	21	21	0
3Q	**64**	**64**	**0**
October	22	23	-1
November	20	19	1
December	22	22	0
4Q	**64**	**64**	**0**
Full Year	**255**	**255**	