1Q15 Earnings Podcast Script
April 16, 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 first quarter 2015 results. Please reference our 2015 first quarter earnings release issued today, April 16th, in addition to other information available on our Investor Relations website, to supplement this podcast. Today we also announced a permanent change to our capital structure and our intent to buy back $3 billion in stock by the end of 2017. In just a moment, we will provide some additional commentary regarding this important communication.

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.

Our capital structure announcement details our plan to repurchase $3 billion of our stock over the next three years. This represents approximately 19 percent of today's market capitalization. Year to date, we have purchased $150 million in shares. The additional repurchases will be funded with a combination of $1.2 billion of internally generated cash and $1.8 billion of new, permanent debt over the next three years. Here are some important points to keep in mind:

- The cost of debt is at historic lows.
- The issuance of permanent debt will increase the efficiency of our balance sheet and will lower our cost of capital.
- We expect to issue $1 billion in long-term debt in June to help fund the program.
- Our new target debt ratio of 1.0-1.5x EBITDA was chosen specifically to preserve our access to the Tier 1 commercial paper market.
- The timing, size and structure of the share repurchase and debt issuance is flexible enough to allow for continued investment in the business, while being meaningful to the equity markets.
- We fully intend to continue our 43-year track record of increasing our dividend.
- Finally, the repurchase will be EPS accretive. The incremental $1 billion in repurchases, beyond the $400 million previously announced, should add $0.08 to $0.12 to earnings per share in 2015.

Let's move on to our quarterly results.

Company Results Summary

Today we reported our 2015 first quarter. Our performance was characterized by continued share gain in our U.S. business and in our single channel online businesses. At the same time, the strength of the U.S. dollar represented a significant headwind to our topline growth, as did our direct and indirect exposure to the oil and gas sectors in North America. With no evidence of any change to this pattern in sight, we have adjusted our full year guidance. At the end of this recording, we'll talk in more detail about our expectations and assumptions for the full year 2015.

Let's begin with an overview of the quarter. Company sales increased 2 percent. We had 63 selling days in the quarter, the same as the previous year. Operating earnings declined 1 percent and net earnings were down 3 percent. Earnings per share of $3.07 were flat versus the previous year. Results included $0.02 per share in charges related to the previously announced shutdown of the business in Brazil and $0.01 per share in charges for restructuring Fabory in Europe. Excluding the charges, earnings per share increased 1 percent to $3.10.

Let's now walk down the operating section of the income statement in more detail. Reported gross profit margins decreased 0.3 percentage point versus the prior year to 44.8 percent driven by lower gross profit margins in the Canadian segment and the Other Businesses. Company operating earnings declined 1 percent versus the 2014 quarter. This decrease was primarily driven by the performance of the business in Canada reflecting continued headwinds from the economy due to exposure to oil and gas, coupled with unfavorable foreign exchange. Operating expenses for the company increased 3 percent and included $33 million in incremental growth and infrastructure spending.

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 March,
- 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

Before we begin our sales discussion, please note that some of our businesses have a different number of selling days due to local holidays. Despite this, we use the number of selling days in the United States as the basis for our calculation of daily sales.

Company sales for the quarter increased 2 percent. The 2 percent sales growth included 1 percentage point from acquisitions, namely WFS Enterprises, Inc. (WFS), acquired in September of 2014 in Canada, and a 3 percentage points reduction from foreign exchange. Excluding acquisitions and foreign exchange, organic sales increased 4 percent driven exclusively by volume growth. By month, total daily sales growth was as follows: 3 percent in January, 2 percent in February and 1 percent in March.

Let's move on to sales by segment. We report two business 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. Our Other Businesses also include results from our single channel online businesses in Japan (MonotaRO), the United States (Zoro) and Europe.

Sales in the United States, which accounted for 78 percent of total company revenue in the quarter, increased 4 percent. The sales growth was driven by 2 percentage points from volume, 1 percentage point from sales of Ebola related safety products and 1 percentage point from higher sales to Zoro, the single channel online business in the United States. By month, daily sales increased 4 percent in January, 4 percent in February and 4 percent in March.

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

- Commercial was up in the high single digits driven by strong performance in the Healthcare sector;
- Light Manufacturing, Government and Retail were up in the mid-single digits;
- Heavy Manufacturing was up in the low single digits;
- Contractor was down in the low single digits and
- Natural Resources and Reseller were down in the mid-single digits.

Now let's turn our attention to the Canadian business. Sales in Canada represented 10 percent of total company revenues in the quarter. The business in Canada continues to face a challenging economy given the country's exposure to oil and gas. Results reported in U.S. dollars are further affected by the stronger U.S. dollar. Sales for our business in Canada declined 8 percent in the quarter but were up 3 percent in local currency. The 3 percent sales increase in local currency consisted of 7 percentage points from WFS and 2 percentage points from price. This growth was partially offset by a 5 percentage points decline in volume and a 1 percentage point decline from lower sales of seasonal products. The 5 percent volume decline for the quarter was primarily driven by lower sales to the Oil and Gas, Construction, Reseller, Commercial, Retail and Heavy Manufacturing customer end markets partially offset by growth to customers in the Utilities, Light Manufacturing, Transportation, Forestry, Mining and Government customer end markets.

On a geographic basis, sales in the province of Alberta, which represents more than a third of the company's business in Canada, was down in the mid-teens in local currency. Local currency sales for all provinces except Alberta and British Columbia were up versus the prior year. By month, daily sales in Canadian dollars increased 6 percent in January, 1 percent in February and 2 percent in March.

Let's conclude our discussion of sales for the quarter by looking at the Other Businesses. This group includes our operations in Asia, Europe and Latin America and represents about 12 percent of total company sales. Sales for this group increased 8 percent, 21 percent in local currency consisting of volume and price. The sales increase was primarily due to growth in our single channel online businesses in the United States and Japan as well as our multichannel business in Mexico.

March Sales

Earlier in the quarter, we reported sales results for January and February and shared some information regarding performance in those months. Let's now take a look at March. There were 22 selling days in March of 2015, one more than in 2014. Company daily sales increased 1 percent versus March of 2014. Sales results in March included 1 percentage point from acquisitions and a 3 percentage point decline from foreign exchange. Excluding acquisitions and foreign exchange, organic daily sales increased 3 percent driven by 4 percentage points from volume, partially offset by a 1 percentage point decline in price. We also benefitted from modest cost deflation, which helped mitigate the negative price realization in the United States. Price increases in Canada offset inflation from a weaker Canadian dollar on U.S. imports.

In the United States, daily sales in March increased 4 percent. This increase was due to a 5 percentage point increase in volume, partially offset by a 1 percentage point decline in price. March customer end market performance in the United States was as follows:

- Commercial was up in the high single digits driven by strong sales to customers in the Healthcare sector;
- Light Manufacturing was up in the mid-single digits;
- Heavy Manufacturing, Retail and Government were up in the low single digits;

- Contractor was down in the low single digits;
- Reseller was down in the mid-single digits and
- Natural Resources was down in the low double digits.

Daily sales in Canada for March were down 9 percent, but were up 2 percent in local currency. The 2 percent daily sales increase consisted of 6 percentage points from WFS and 3 percentage points from price, partially offset by a 6 percentage point decline in volume and a 1 percentage point decline from lower sales of seasonal products. The volume decline was driven by lower sales to the Oil & Gas, Contractor, Commercial, Government, Heavy Manufacturing and Retail customer end markets, partially offset by growth in the Utilities, Light Manufacturing, Transportation, Mining and Forestry customer end markets. On a geographic basis, sales performance in Canada was driven by softness in the province of Alberta, which represents slightly more than a third of our sales in Canada and was down mid-teens in local currency in March.

Daily sales in March for our Other Businesses increased 3 percent, 18 percent in local currency. The 18 percent daily sales growth in the Other Businesses was primarily driven by Zoro U.S. along with strong growth from the businesses in Japan and Mexico.

April Sales

Looking ahead to April, daily sales growth to date is running in line with the sales growth reported for March.

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

Operating Performance

Thanks Laura.

Since we have already analyzed company operating performance, let's move right into results by reportable segment. Operating earnings in the United States increased 4 percent versus the 2014 first quarter, with operating margins flat at 18.6 percent. Gross profit margins for the quarter declined 40 basis points driven by higher sales to Zoro U.S., reflecting the lower transfer price used to account for these intersegment sales. Excluding Zoro U.S., gross profit margins were flat versus the prior year. Operating expenses for the U.S. segment increased 3 percent and included $22 million in incremental growth and infrastructure related spending.

Let's move on to our business in Canada. Operating earnings decreased 56 percent versus the prior year. The decrease was driven by the 8 percent sales decline, unfavorable foreign exchange, lower gross profit margins and negative expense leverage. Gross profit margins in Canada declined 70 basis points versus the prior year, due to lower gross profit margins at WFS. Excluding WFS, gross profit margins were flat versus the prior year as price increases and higher freight revenue were offset by unfavorable foreign exchange from products sourced from the United States. The Canadian business increased prices in the first quarter to offset unfavorable foreign exchange rates on product sourced from the United States. Despite the headwinds in Canada, we continue to invest in the business through this difficult macroeconomic environment to strengthen our operations and better position the business for the long term.

The Other Businesses generated $10 million in operating earnings in the 2015 quarter versus $8 million in 2014. This performance was primarily driven by strong results from Zoro in the United States and MonotaRO in Japan, along with reduced losses in China. In addition, costs associated with the previously announced shutdown of the business in Brazil and planned restructuring expenses for Fabory in Europe partially offset earnings for the Other Businesses in the first quarter and are expected to continue into the second half of 2015. The charges related to Brazil and Fabory resulted in a reduction to earnings per share of approximately $0.02 and $0.01 per share in the quarter, respectively, and are excluded from company guidance. For the full year, planned shutdown costs for Brazil and restructuring costs for Fabory are estimated to be $0.09 and $0.04 per share, respectively.

Other

Below the operating line, other income and expense was a net expense of $4 million in the 2015 first quarter versus $3 million in the 2014 first quarter. This $1 million increase was primarily the result of higher foreign currency transaction losses and lower interest income from lower average cash balances.

For the quarter, the effective tax rate in 2015 was 38.4 percent versus 37.7 percent in 2014. The increase was primarily due to more earnings in the United States relative to other jurisdictions with lower tax rates. We are still projecting an effective tax rate of 37.7 to 38.8 percent for the full year 2015.

Cash Flow

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $156 million in the 2015 first quarter versus $168 million in the 2014 first quarter. The company used the cash generated, along with cash on hand, to invest in the business and return cash to shareholders through share repurchase and dividends. Capital expenditures were $99 million in the 2015 first quarter versus $66 million in the first quarter of 2014. The increase in capital expenditures versus prior year was attributable to investments in our distribution network, primarily the distribution center in the northeast United States, and IT-related spending. We returned $223 million to shareholders through $73 million in dividends and $150 million to buy back 634,000 shares of stock.

Now let's take a look at guidance.

2015 Guidance

As reported in our first quarter earnings release, we lowered our 2015 sales and earnings per share guidance. There are three primary factors contributing to this change:

1. The weakness in oil and gas prices will dampen the industrial economy in North America, reducing our expectations for macroeconomic growth.
2. Despite softness in the U.S. economy, we see share gain opportunities with large customers and instead of hiring 200 new sales representatives in 2015, we now plan to add 400. Admittedly, this will create expense headwinds in the near term in addition to lower expense leverage on lower sales volume, but it will ultimately help Grainger extend its advantaged position in the MRO marketplace. In addition, many of our cost productivity projects are delivering at or above plan, mitigating some of the lost expense leverage. Accordingly, we now expect approximately $150 million in incremental growth and infrastructure spending for the full year of 2015, versus the $130 million midpoint originally forecasted. The $150 million estimate represents the high end of the growth and infrastructure spending range.
3. Lastly, we updated EPS guidance for the accretion from $1 billion of additional share repurchases now planned in 2015.

We now expect 1 to 4 percent sales growth and earnings per share of $12.25 to $12.95. Let's look more closely at the underlying elements of our expectations versus normalized results in 2014:

1. We'll begin with sales:
    a. We now expect sales growth of 1 to 4 percent, down from 3 to 7 percent, reflecting a reduction of 100 basis points from a weaker economy and 100 basis points from lower than expected sales from the multichannel model, primarily in Canada.

   b. We have also revised our full year price realization estimate to 0 percent given the current environment.

2. Moving on to gross profit margins:
   a. For the full year, we now expect gross margins to be flat to down as much as 20 basis points.
   b. For the 2015 second quarter, we are expecting gross profit margins to expand or contract as much as 10 basis points versus 2014.
   c. Please keep in mind as you model margins for the second quarter and the remainder of the year, our first quarter included supplier support for our annual customer trade shows. As a result, both gross profit and operating expenses as a percent of sales are inflated by about 100 basis points.
3. Let's take a closer look at operating margin expectations:
   a. In 2015, we anticipate operating margin to be flat to down as much as 40 basis points versus 2014. As our guidance implies, given our commitment to growth and infrastructure investments, we lose operating leverage below about 4 percent sales growth.
   b. For the 2015 second quarter, margins are forecasted to decline 25 to 45 basis points versus the 2014 second quarter due to the anticipated incremental growth and infrastructure spending in the second quarter. Please see Exhibit 3 for more information.
4. Finally, earnings per share:
   a. As noted in our revised guidance, we now expect EPS of $12.25 to $12.95 reflecting the headwinds from the economy and the incremental sales force hires, partially offset by the success of our productivity programs and expected accretion from the $1 billion in incremental share repurchases in 2015.

Conclusion

Please mark your calendar for the following upcoming events:

1. On April 29th we will host our Annual Meeting of Shareholders. The script from that meeting will be available on our website following the event.
2. On May 6th, Court Carruthers, Senior Vice President and Group President, Americas, will present at the Robert W. Baird Growth Stock Conference in Chicago. The event will be webcast.
3. We plan to report April sales information on May 13th.
4. And finally, on May 20th, Jim Ryan and Ron Jadin will present at the Electrical Products Group meeting in Longboat Key, FL. This event will also be webcast.

We appreciate your support and thank you for your interest in Grainger. If you have any questions, please contact Laura Brown at 847.535.0409, Casey Darby at 847.535.0099 or me at 847.535.0881.

Exhibit 1
2015 Sales Guidance

	April 16, 2015	January 26, 2015	November 12, 2014
Economy/Share Gain	4% - 7%	6% - 9%	6% - 9%
Price	0%	0% - 1%	0% - 1%
Organic Sales	4% - 7%	6% - 10%	6% - 10%
F/X	-3%	-3%	-1%
Company Sales	1% - 4%	3% - 7%	5% - 9%

Note: As of April 16, 2015.

Exhibit 2
2015 EPS Guidance

	April 16, 2015	January 26, 2015	November 12, 2014
Sales ($B)	$10.10 - $10.40	$10.30 - $10.70	$10.40 - $10.80
V% vs. prior yr.	1% - 4%	3% - 7%	5% - 9%
Op Margin	13.8% - 14.2%	14.2% - 14.6%	14.3% - 14.7%
bps vs. prior yr.	-40 - 0	0 - 40	0 - 40
EPS	$12.25 - $12.95	$12.60 - $13.60	$12.90 - $13.80

Note: (1) As of April 16, 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	$33	$31	$22	$27	$7
2Q	30E	20	37	24	11
3Q		17	40	19	19
4Q		10	31	1	30
FY	$150E (2)	$78	$132	$71	$67

Notes: (1) As of April 16, 2015.
(2) The company expects 2015 incremental growth spending of $115-$150 million. The $150 million estimate represents the high end 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

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**	