GRAINGER
FOR THE ONES WHO GET IT DONE

# 2Q15 Earnings Podcast Script
July 17, 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 2015 second quarter results. Please also reference our 2015 second quarter earnings release issued on July 17th, in addition to other information available on our Investor Relations website, to supplement this podcast.

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.

## Company Results Summary

Today we reported results for the 2015 second quarter and updated our sales and earnings per share guidance for the full year. We delivered a solid quarter from an EPS standpoint, and while our gross profit margin was less than we expected, we were able to generate positive cost leverage as an offset.

I'd like to share with you what we are seeing in the market. We remain in a soft demand environment. Deflationary commodity prices, the strength of the U.S. dollar and the economy in Canada continue to be headwinds. Despite all this, we continue to gain share with customers who value a broad product offering, inventory management services, technical services and fast reliable delivery. In addition, we're growing rapidly with small customers through Zoro and MonotaRO. And we remain focused on productivity to fund our growth and infrastructure investments and reduce the effect of lower gross profit margins.

Last month, we announced that DG Macpherson will assume the newly created role of Chief Operating Officer effective August 1. We expect this move will ensure tighter coordination between operating functions, business units and business models. Also last month, we issued $1 billion in new 30-year debt. We are using the proceeds as part of our $3 billion share buyback program announced on April 16th.

Before we begin the review of results, I'd like to remind you that there were adjustments to reported results in the second quarters of both 2015 and 2014. In 2015, we took $0.02 per share in charges related to restructuring at Fabory and the shutdown of the Brazil business. In 2014, we recorded a $0.15 per share charge related to the transition of Fabory's employee retirement plan in Europe.

During the 2015 second quarter, Grainger invested in a limited liability company established to produce clean energy. In addition to supporting the operations of this entity, we receive a pro-rata share of energy tax credits. Tax credits earned, net of operating losses, from this investment lowered the company's effective tax rate in the 2015 second quarter and contributed approximately $0.09 per share to earnings. For the full year, energy credits are expected to result in a 1.4 percentage point reduction in the company's effective tax rate.

With that as a backdrop, let's look at our results for the 2015 second quarter. Company sales for the quarter increased 1 percent versus the 2014 second quarter. Excluding foreign exchange and acquisitions, organic sales increased 3 percent. There were 64 selling days in both quarters. Reported operating earnings increased 5 percent, or 1 percent adjusted. Reported net earnings increased 7 percent and adjusted net earnings were up 3 percent. Reported earnings per share were $3.25 for the quarter, an increase of 11 percent versus the 2014 second quarter. Excluding the adjustments from both years, earnings per share were $3.27, up 6 percent versus the prior year.

We also revised guidance for sales and earnings per share, which Bill will cover in detail at the end of the podcast. Our 2015 guidance issued on April 16, 2015, included 1 to 4 percent sales growth and earnings per share of $12.25 to $12.95. We now expect 2015 sales growth of 0 to 2 percent and earnings per share of $12.00 to $12.50, which includes the benefit of the energy tax credits.

Let's now walk down the operating section of the income statement in more detail. Gross profit margins in the second quarter decreased 50 basis points to 42.6 percent versus 43.1 percent in 2014, due primarily to faster growth with lower gross margin customers, lower supplier rebates tied to volume and price deflation versus cost inflation driven by foreign exchange. Operating expenses for the company declined 3 percent driven by lower payroll and benefits. The company generated $28 million of productivity savings to fund $25 million of incremental growth and infrastructure spending. Total company operating earnings were $357 million, an increase of 5 percent versus the prior year. The reported operating margin was 14.1 percent, an increase of 50 basis points versus the prior year. The adjusted operating margin was 14.2 percent, an increase of 10 basis points versus the prior year.

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, operating performance by segment,
- Third, cash generation and capital deployment and
- Finally, we'll wrap up with a discussion of our 2015 guidance.

**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.

As mentioned earlier, company sales for the quarter increased 1 percent. Daily sales growth by month was as follows: up 1 percent in April, flat in May and up 1 percent in June. Results for the quarter included 1 percentage point from acquisitions and a 3 percentage point reduction from foreign exchange. Excluding acquisitions and foreign exchange, organic sales increased 3 percent driven by 4 percentage points from volume partially offset by a 1 percentage point decline in price.

Let's move on to sales by segment. We report two business segments, the United States and Canada. Our remaining operations are reported under Other Businesses.

Sales in the United States, which accounted for 78 percent of total company revenue in the quarter, increased 2 percent. Results for the quarter included 2 percentage points from volume and 1 percentage point from intercompany sales, primarily to Zoro, partially offset by a 1 percentage point decline from price.

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

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

Low oil prices continued to affect our Natural Resources and Heavy Manufacturing customers. Based on our analysis of relevant SIC codes, oil represented about a 1 percent drag on U.S. sales in the quarter.

Now let's turn our attention to the Canadian business. Sales in Canada represented 9 percent of total company revenues. For the quarter, sales increased 2 percent in local currency and declined 9 percent in U.S. dollars versus the prior year. The 2 percent sales increase consisted of 8 percentage points from the WFS acquisition and 4 points from price. This was partially offset by a 10 percentage point decline in volume. Based on our estimates, we believe the vast majority of the volume decline is attributable to direct and indirect exposure to oil and gas. On an organic basis, declines during the quarter in the Commercial, Oil and Gas, Retail, Construction, Heavy Manufacturing, Forestry and Transportation customer end markets more than offset growth to customers in the Government, Mining, Utilities and Light Manufacturing end markets. From a geographic standpoint, sales in Alberta were down 18 percent, compared to all other provinces which were up 3 percent in aggregate.

Let's conclude our discussion of sales for the quarter by looking at the Other Businesses, which represented 13 percent of total company sales. Sales for the Other Businesses increased 7 percent, consisting of 21 percentage points of growth from volume and price, partially offset by a 14 percentage point decline from foreign exchange. The sales increase was primarily due to growth from the single channel online businesses of Zoro U.S. and MonotaRO and also the business in Mexico.

**June Sales**

Earlier in the quarter, we reported sales results for April and May and shared some information regarding performance in those months. Let's now take a look at June. There were 22 selling days in June of 2015 versus 21 days in the same month of 2014. Daily company sales increased 1 percent in June versus the prior year. The daily sales increase included 1 percentage point from acquisitions and a 3 percentage point reduction 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 from price.

In the United States, June daily sales increased 3 percent driven by 3 percentage points from volume and 1 percentage point from intercompany sales, primarily to Zoro, partially offset by a 1 percentage point decline from price. June customer end market performance in the United States was as follows*:*

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

Low oil prices continued to affect our Natural Resources and Heavy Manufacturing customers. Based on our analysis of relevant SIC codes, oil represented about a 1 percent drag on U.S. sales in the month.

Daily sales in Canada for June were up 1 percent in local currency and declined 11 percent in U.S. dollars. The local currency increase was driven by 8 percentage points from the WFS acquisition and 4 percentage points from price, partially offset by an 11 percentage point decrease in volume. As a reminder, we will anniversary the WFS acquisition on September 2, 2015.

In Canada, on an organic basis, declines during the month in the Commercial, Oil and Gas, Retail, Construction, Heavy Manufacturing, Forestry, Light Manufacturing and Transportation customer end markets more than offset growth to customers in the Government, Mining and Utilities end markets. From a geographic standpoint, sales in Alberta were down 17 percent, compared to all other provinces which were flat to the prior year in aggregate.

Daily sales for our Other Businesses increased 6 percent in June, consisting of 20 percentage points from volume and price, partially offset by 14 percentage points decrease from foreign exchange. The daily sales increase was primarily due to strong revenue growth from Zoro U.S, Japan and Mexico.

**July Sales**

Sales growth in the month of July is currently trending slightly below the growth rate reported for June.

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 talk about performance by reportable segment.

In the United States, gross profit margins for the quarter declined 70 basis points primarily driven by faster growth with larger customers, higher sales to Zoro, reflecting the lower transfer price used to account for these intersegment sales, and price deflation exceeding cost deflation. Excluding Zoro, gross profit margins were down 40 basis points versus the prior year. Operating expenses were down slightly in the quarter driven primarily by lower payroll and benefits which offset incremental growth and infrastructure spending of $23 million. Operating earnings for the U.S. segment increased 1 percent in the quarter driven by the 2 percent sales growth and positive operating expense leverage, partially offset by lower gross profit margins.

We also wanted to provide a midyear update on our growth initiatives in the United States. Year to date, we have hired 80 sales representatives, with a plan to hire several hundred total by year end. Most of the new sellers will call on our large customers where we see additional opportunity to gain share. In addition, eCommerce represented 40 percent of sales in the first half of the year, up from 35 percent in first half 2014.

Let's move on to our business in Canada. The gross profit margin in Canada declined 110 basis points versus the prior year, driven by unfavorable foreign exchange from products sourced from the United States and inventory markdowns related to the Toronto DC move, partially offset by price increases and higher freight revenue. Excluding WFS, gross profit margins were down 30 basis points. Operating earnings in Canada declined 51 percent in the 2015 second quarter, driven by the 9 percent sales decline, lower gross profit margins and negative expense leverage.

Because of the effect of foreign exchange, we wanted to also share Canada's results in local currency. Operating expenses in Canada increased 10 percent in local currency due to the WFS acquisition, relocation to the new Toronto distribution center and SAP implementation costs. As a reminder, in the second quarter of 2014, we wrote off $4 million of capitalized software development costs. Operating earnings in Canada were down 44 percent in local currency, representing a 330 basis point decline in operating margin. We have taken measured actions primarily in Alberta to reduce headcount and freeze open roles.

Operating earnings for the Other Businesses were $15 million in the 2015 second quarter, which included $2 million of restructuring charges. Operating earnings in the 2014 second quarter were essentially break-even, which included $14 million for the retirement plan transition in Europe and $2 million for the write-off of capitalized software development costs for Mexico. Adjusting for these items, earnings increased $2 million versus the prior year. The results included strong performance from Zoro U.S. and Japan and also an incremental $3 million in expense for the single channel online business in Europe.

**Other**

Below the operating line, other income and expense was a net $8 million expense in the 2015 second quarter versus a net $2 million expense in the 2014 second quarter. The increase was driven by higher interest expense associated with the $1 billion in long-term debt issued in early June bearing an interest rate of 4.6 percent. In addition, the investment in clean energy made during the quarter generated losses that contributed to the increase in other expense. Accounting guidance requires us to record the tax credit provision based on a full year estimate of the annual rate, applied to the year-to-date earnings. Accordingly, the 2015 second quarter includes the benefit of half the annual energy tax credits anticipated for the year. When netted against the losses generated in the quarter, the energy investment generated $6.4 million or $0.09 of earnings per share. On a full year basis, the expected impact is also $0.09 of earnings per share. The full year estimate takes into consideration the forecasted operating loss from the date of investment, associated tax benefit and the tax credits expected for the year.

The tax rate for the quarter was 35.4 percent compared to 38.2 percent in the 2014 second quarter. Excluding the benefit of the energy tax credits for the first quarter of 2015 recorded in the second quarter, the tax rate for the 2015 second quarter was 36.9 percent. In comparison, the 2014 second quarter reflected a higher tax rate due to the effect of the retirement plan transition in Europe. Excluding the retirement plan transition cost, the tax rate was 37.7 percent in the 2014 second quarter. The company expects to benefit from the energy tax credits going forward and is currently projecting an effective tax rate of approximately 36.6 to 37.2 percent for 2015.

**Cash Flow**

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $213 million versus $161 million in 2014. On April 16, 2015, the company announced a plan to repurchase $3 billion of stock over the next three years. In June, the company issued $1 billion in new 30-year debt to fund part of the share repurchase program. The net EPS impact of the buyback in the quarter was negative by one cent as the borrowing costs exceeded the share repurchase benefit. We continue to expect $0.08 to $0.12 EPS benefit for the full year. We bought back 1.3 million shares of stock for $293 million in the second quarter and ended the quarter with 13.7 million shares remaining on our share repurchase authorization. Grainger returned a total of $373 million to shareholders in the quarter including $80 million in dividends, reflecting the 8 percent increase in the quarterly dividend announced in April of 2015. Capital expenditures were $71 million in the quarter versus $90 million in the second quarter of 2014. While we still anticipate full year capital spending of $375 million to $425 million, we are likely to be at the low end of that range. Spending will be back-half weighted as investment in the new Northeast Distribution Center picks up.

**2015 Guidance**

As reported in our 2015 second quarter earnings release, we revised our 2015 sales and earnings per share guidance to reflect a softer top line, lower gross profit margins and a lower effective tax rate. For the full year 2015, we now expect 0 to 2 percent sales growth and earnings per share of $12.00 to $12.50. This guidance assumes incremental growth spending of $150 million, although we are currently assessing our spending plan for the back half of the year given the tenor of business. Let's look more closely at our current expectations:

1. We'll begin with sales:
    a. We now expect sales to be flat to up 2 percent. This compares to our April guidance of up 1 to 4 percent and reflects a weaker economy and lower than expected sales in oil and gas and heavy manufacturing in both the United States and Canada.
    b. We have also revised our full year price realization estimate to negative 1 percent versus flat given the current deflationary environment.
    c. From an organic growth perspective, the midpoint of our sales guidance anticipates second half sales consistent with our second quarter results. The low end of our sales guidance is based on further weakness in the economy, oil and gas and the further strengthening of the U.S. dollar.
    d. As a reminder, we anniversary the WFS acquisition at the beginning of September.

2. Moving on to gross profit margins:
    a. For the full year, we now expect gross margins to be down about 60 basis points.
    b. For the back half of 2015, we are expecting gross profit margins to contract about 60 to 80 basis points versus 2014. Gross profit margin compression in the second half is slightly worse than the second quarter as we lap prior year pricing actions.

3. Let's take a closer look at operating margin expectations:
    a. For the full year, we expect our operating margin to be down between 40 and 70 basis points, depending on volume. Growth and infrastructure investments will continue with the expectation of fueling market share gains.
    b. In the back half of the year, we intend to drive continued productivity and manage expenses to fund incremental growth and infrastructure spending. However, margins versus the second half

of 2014 are forecasted to decline 90 to 110 basis points, primarily due to the anticipation of back-half weighted growth spending. Please see Exhibit 4 for more information.

4. The other interest and expense section of the income statement will look dramatically different going forward.
    a. Interest expense will increase in the second half of the year due to the new $1 billion debt offering which carries a 4.6 percent interest rate.
    b. Also, the loss from the clean energy investment is expected to be $9 million to $11 million per quarter for the third and fourth quarters.

5. Finally, earnings per share:
    a. As noted in our revised guidance, we now expect EPS of $12.00 to $12.50 reflecting the headwinds from the economy and the expected margin compression from lower gross profit margins and continued growth and infrastructure spending, partially offset by our productivity programs.
    b. As a reminder, similar to April guidance, our new EPS guidance reflects the benefit of $0.08 to $0.12 of accretion from the $1 billion in incremental share repurchases in 2015, all of which should be realized in the back half of the year.
    c. Finally, our EPS guidance includes the lower tax rate of 36.6 to 37.2 percent for the full year.

**Important Dates**

Finally, please mark your calendar for the following important dates:

- On August 13th we plan to release July sales.
- On August 19th, Paul Miller, Vice President of Global eCommerce, Customer Information & Innovation, will present at the ITG Industrial Conference in Milwaukee, WI.
- And finally, we will host our Annual Analyst Meeting on November 12th, which will be held at our headquarters in Lake Forest, IL.

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. Thank you for your interest in Grainger.

GRAINGER®
FOR THE ONES WHO GET IT DONE

# Exhibit 1
## 2015 Reported and Adjusted EPS

| | Three Months Ended June 30, | | |
|---|---|---|---|
| | 2015 | 2014 | % Change |
| (dollars in thousands) | | | |
| Net earnings reported | 220,548 | 205,915 | 7% |
| Restructuring costs in Brazil and Europe | 1,676 | | |
| Retirement plan transition in Europe | | 10,229 | |
| Net earnings adjusted | 222,224 | 216,144 | 3% |

| | Three Months Ended June 30, | | |
|---|---|---|---|
| | 2015 | 2014 | % Change |
| Diluted Earnings Per Share as reported: | $3.25 | $2.94 | 11% |
| Restructuring costs in Brazil and Europe | 0.02 | | |
| Retirement plan transition in Europe | | 0.15 | |
| Diluted Earnings Per Share as adjusted: | $3.27 | $3.09 | 6% |

| | Six Months Ended June 30, | | |
|---|---|---|---|
| | 2015 | 2014 | % Change |
| (dollars in thousands) | | | |
| Net earnings reported | 431,563 | 422,568 | 2% |
| Restructuring costs in Brazil and Europe | 3,504 | | |
| Retirement plan transition in Europe | | 10,229 | |
| Net earnings adjusted | 435,067 | 432,797 | 1% |

| | Six Months Ended June 30, | | |
|---|---|---|---|
| | 2015 | 2014 | % Change |
| Diluted Earnings Per Share as reported: | $6.32 | $6.00 | 5% |
| Restructuring costs in Brazil and Europe | 0.05 | | |
| Retirement plan transition in Europe | | 0.15 | |
| Diluted Earnings Per Share as adjusted: | $6.37 | $6.15 | 4% |

**Exhibit 2**
**2015 Sales Guidance**

| | July 17, 2015 | April 16, 2015 |
|---|---|---|
| Economy/Volume | 4% - 6% | 4% - 7% |
| Price | -1% | 0% |
| **Organic Sales** | 3% - 5% | 4% - 7% |
| F/X | -3% | -3% |
| **Company Sales** | 0% - 2% | 1% - 4% |

Note: As of July 17, 2015.

**Exhibit 3**
**2015 EPS Guidance**

| | July 17, 2015 | April 16, 2015 |
|---|---|---|
| **Sales ($B)** | $10.0 - $10.2 | $10.1 - $10.4 |
| V% vs. prior yr. | 0% - 2% | 1% - 4% |
| Gross Margin bps vs. prior yr. | (60) | (20) - 0 |
| **Op. Margin** | 13.5% - 13.8% | 13.8% - 14.2% |
| bps vs. prior yr. | (70) - (40) | (40) - 0 |
| **EPS** | $12.00 - $12.50 | $12.25 - $12.95 |

Note: As of July 17, 2015. Excludes unusual items as reported by the company in its quarterly earnings releases.

GRAINGER®
FOR THE ONES WHO GET IT DONE

**Exhibit 4**
**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** | 25 | 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 July 17, 2015.
(2) The company expects 2015 incremental growth spending of $115-150 million. The $150 million estimate represents the high end of the range. However, the company is currently assessing its spending plan for the back half of the year.

**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** | |