GRAINGER
FOR THE ONES WHO GET IT DONE

3Q15 Earnings Podcast Script
October 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 2015 third quarter results. To supplement this podcast, please also reference our 2015 third quarter earnings release issued today, October 16th, in addition to other information available on our Investor Relations website.

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 SEC filings, including our most recent periodic reports filed on Form 10-K and Form 10-Q, which are available on our Investor Relations web site, for a discussion of factors that relate to forward-looking statements.

I'd like to begin by providing some context regarding the current environment for industrial companies. We've talked about the impact of oil and gas prices, the strong U.S. dollar and China's economic slowdown on our performance. In addition, the performance of the following key indicators over the past twelve months further illustrates these challenges:

- The ISM Purchasing Managers Index was 50.2 in September, down versus last year, indicating an economy no longer in expansion mode overall.
- The Industrial Production Index has fallen for most of the year as well.
- The Canadian dollar has fallen 21 percent.
- Copper prices are down 22 percent.

- Cold rolled steel prices are down 25 percent.
- And crude oil prices are down 60 percent.

The drop in the price of raw materials underscores the weak demand environment and over-supply of commodities, and in many cases the weakness has sped up in the past three months. As these economic indicators decline, we've seen that downturn take hold in the industrial economy. In response, we have begun the process of bringing our cost structure in line with current trends and activity levels:

- We announced the closure of 26 branches and eliminated 170 field positions in the United States.
- In Canada, we have eliminated more than 100 roles and closed four branches since the beginning of June.
- We have substantially completed the closure of our business in Brazil.
- We continued to restructure our Fabory business in Europe, which is expected to be completed this year.
- We decided to transition our business in Costa Rica from a local branch based model to being served via our U.S.-based Export operations.

These actions resulted in a $0.11 charge to earnings per share in the quarter. You can expect more actions in the fourth quarter and into next year.

At the same time, we took advantage of our strong financial position to invest in the future growth and performance of the business as follows:

- We added more than 100 sales representatives in the third quarter and 300 year-to-date to better serve and penetrate large customers.
- We created a team to focus solely on our medium-sized business.
- We acquired Cromwell Group (Holdings) Limited in the U.K. to further our growth in attractive MRO markets and leverage our Internet expertise.
- We took advantage of our improved capital structure, and weakness in the stock market, to aggressively buy back stock.
- And we have made investments that lower our tax rate.

You can expect us to share additional information at our Analyst Meeting on November 12th.

Company Results Summary

So let's take a look at our 2015 third quarter results and our revised sales and earnings guidance. Please note that the following analysis EXCLUDES the $0.11 per share of charges unless specifically noted. Please see Exhibit 1 for detail on the charges. Company sales declined 1 percent. Operating earnings were down 9 percent. Net earnings decreased 13 percent, reflecting higher interest expense. Adjusted earnings per share were $3.03 for the quarter, a decrease of 8 percent versus the 2014 third quarter.

Now, let's walk down the operating section of the income statement on an adjusted basis. Gross profit margins in the quarter decreased 110 basis points to 41.9 percent versus 43.0 percent in 2014, primarily driven by faster growth with lower margin customers, lower supplier rebates tied to lower-than-expected volume and price deflation versus slight cost inflation, due to the higher cost of imported U.S.-sourced products for the business in Canada. Operating expenses excluding charges were down 1 percent in the quarter, driven primarily by lower payroll and benefits and included $43 million in incremental growth and infrastructure-related spending versus the 2014 third quarter. Company operating margin decreased 110 basis points to 13.9 percent versus 15.0 percent in the prior year, primarily due to lower gross profit margins.

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 September;
- 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 I mentioned, total company sales for the quarter were down 1 percent. The sales performance included 2 percentage points from acquisitions and a 3 percentage point reduction from unfavorable foreign exchange. Excluding acquisitions and foreign exchange, organic sales were flat, consisting of 1 percentage point from volume and a 1 percentage point decline from price. By month, daily sales declined 1 percent in July, 2 percent in August and were flat in September. Sales in September included a 4 percentage point contribution from Cromwell.

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.

Sales in the U.S. segment, which accounted for 78 percent of total company revenues in the quarter, were flat. This was composed of 1 percentage point from intercompany sales to Zoro and a 1 percentage point decline from price. Daily sales increased 1 percent in July, were flat in August and declined 2 percent in September.

Let's review U.S. sales performance by customer end market for the quarter:

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

Low oil prices continue 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 our Canadian business. Sales in Canada represented 8 percent of total company revenues in the quarter and decreased 23 percent, down 8 percent in local currency. The 8 percent sales decrease consisted of a 17 percentage point decline from volume, partially offset by 4 percentage points from acquisitions and 5 percentage points from price. Sales performance in Canada was driven by declines in the Construction, Oil and Gas, Retail, Commercial, Transportation, Government, and Heavy and Light Manufacturing end markets. By month, daily sales in local currency declined 4 percent in July, 7 percent in August and 13 percent in September. We also lapped the acquisition of WFS Enterprises, Inc. on September 2nd.

Let's wrap up our discussion of sales for the quarter by looking at the Other Businesses. The Other Businesses represented 14 percent of total company sales in the quarter. Sales for this group were up 18 percent and consisted of 12 percentage points of growth from the Cromwell acquisition and 22 percentage points from volume and price, partially offset by a 16 percentage point decline from unfavorable foreign exchange. The organic sales increase was primarily driven by the single channel online businesses in Japan and the United States.

September Sales

Earlier in the quarter, we reported sales results for July and August and shared some information regarding performance in those months. Let's now take a look at September. There were 21 selling days in September 2015, the same as the prior year. Company sales were flat in September of 2015 versus September of 2014. The sales performance included 4 percentage points from acquisitions and a 3 percentage point reduction from foreign exchange. September was the first month to include sales from Cromwell, and we lapped the WFS acquisition. Excluding acquisitions and foreign exchange, organic sales declined 1 percent, primarily driven by lower volume.

In the United States, September sales declined 2 percent, which included a 2 percentage point decline from volume and a 1 percentage point decline from price, partially offset by 1 percentage point from intercompany sales to Zoro. Let's review sales performance by customer end market in the United States for the month of September:

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

In the Government end market, we saw strong performance from State customers as we focused on two of the largest departments of state budgets, the Department of Corrections and the Department of Transportation. For the month of September, the direct and indirect effect of the energy sector accelerated to a 2 percent drag on sales.

Sales in Canada for September declined 28 percent in U.S. dollars and were down 13 percent in local currency. The 13 percent decrease consisted of an 18 percentage point decrease from volume partially offset by 5 percentage points from price. On an organic basis, sales performance was driven by declines in the Construction, Oil and Gas, Commercial, Light and Heavy Manufacturing, Retail and Transportation end markets, partially offset by growth in the Utilities, Government, Mining and Forestry end markets.

Sales for our Other Businesses increased 40 percent in September, consisting of 36 percentage points from the Cromwell acquisition and 18 percentage points from volume and price, partially offset by a 14 percentage point drag from unfavorable foreign exchange from the Other Businesses. Similar to the quarter, organic sales growth in September was driven by the single channel online businesses in Japan and the United States.

October Sales

Daily sales in the month of October are currently down in the low single digits, including the benefit from Cromwell. Excluding Cromwell, sales performance is currently down in the mid-single digits. As a reminder, October 2014 included 1 percent of sales from Ebola-related products.

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 jump right into performance by reportable segment. As a reminder, all figures exclude the $0.11 per share of charges unless specifically noted.

Operating earnings in the United States decreased 5 percent versus the 2014 third quarter. This performance was driven by lower gross profit margins, partially offset by lower operating expenses. Gross profit margins for the quarter decreased 120 basis points versus the prior year, primarily driven by price deflation exceeding cost deflation and higher sales to Zoro reflecting the lower transfer price used to account for these intercompany sales. Excluding Zoro, gross profit margins were down 90 basis points versus the prior year. Operating expenses decreased 2 percent in the quarter versus the prior year. Expenses were driven primarily by lower payroll and benefits which were partially offset by incremental growth and infrastructure spending of $30 million. The operating margin for the U.S. segment decreased 80 basis points to 18.1 percent versus 18.9 percent in the prior year. In the absence of the growth spending, we realized attractive operating leverage.

Let's move on to results for our business in Canada, adjusted for restructuring. Operating earnings were down 83 percent in U.S. dollars versus the prior year. The lower operating performance was primarily the result of lower sales, lower gross profit margins and higher operating expenses as a percentage of sales driven by incremental costs from the WFS acquisition and SAP implementation. Gross profit margins declined 130 basis points primarily due to unfavorable foreign exchange from products from U.S.-based suppliers and the lower margins at WFS, partially offset by price increases. The operating margin in Canada for the third quarter was 2.2 percent versus 9.9 percent in the prior year. Incremental costs from the SAP implementation were $6 million in U.S. dollars. Excluding SAP costs, operating earnings were down 61 percent in U.S. dollars and the operating margin was 5.0 percent.

On an adjusted basis, the Other Businesses generated $15 million in operating earnings in the 2015 third quarter versus $5 million in the 2014 third quarter. The earnings increase for the quarter versus the prior year was driven by strong results from the single channel businesses in Japan and United States, and included a $2 million contribution from Cromwell, partially offset by an incremental $2 million in start-up costs for the single channel online business in Europe.

Other

Other income and expense was a net $21 million expense in the 2015 third quarter versus a net $3 million expense in the 2014 third quarter. The increase in expense was driven by $12 million in higher net interest expense and $6 million in losses on the company’s clean energy investment.

- The incremental $12 million net interest expense was driven by the $1 billion in long-term debt issued in June to buy back company shares. Beyond 2015, the company intends to issue new permanent debt of $400 million in both 2016 and 2017 to continue the share buyback program as announced in April.
- Our investment in a limited liability company established to produce clean energy generated a loss of $6 million in the quarter. As part of supporting

the operations of this entity, Grainger receives its share of energy tax credits. For the full year, energy credits are expected to result in a reduction of approximately 1.3 percentage point in the company's effective tax rate.

The company's tax rate for the quarter was 38.4 percent compared to 39.1 percent in the 2014 third quarter. The lower tax rate in 2015 reflects the benefit of the energy tax credits, partially offset by a higher proportion of earnings from the United States versus other jurisdictions with lower tax rates. The company is currently projecting an effective tax rate of approximately 37.2 to 37.6 percent for full year 2015.

Cash Flow

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $366 million versus $329 million in 2014. The company used the cash generated and cash on hand to invest in the business and return cash to shareholders through share repurchases and dividends. Capital expenditures for the quarter were $82 million versus $84 million in 2014. Our full year capital spending range is now $300 million to $350 million, driven by postponing the construction of a new Edmonton distribution center, moving SAP in Canada to 2016 and the timing of other supply chain infrastructure projects. We paid dividends of $77 million, reflecting the 8 percent increase in the quarterly dividend announced in April of 2015. In addition, we bought back 3.4 million shares of stock for $735 million and ended the quarter with 10.3 million shares remaining on our share repurchase authorization. In total, we returned $812 million to shareholders in the quarter.

2015 Guidance

As reported in our 2015 third quarter earnings release, we lowered our sales and earnings guidance for the year given the performance to date and the expectation of continued economic weakness. With the change in the industrial economy, our guidance reflects what we're seeing in our customers' business.

Let's take a look at our current expectations. All figures include Cromwell and all comparisons are to prior year unless otherwise noted:

1. We'll begin with sales.
   a. For the full year, we now expect sales growth in the range of down 0.5 percent to up 0.5 percent. Excluding Cromwell, we expect sales to be down 2 percent to down 1 percent.
   b. For the fourth quarter, the new guidance implies a sales range of down 3 percent to up 0.5 percent sales growth. Excluding Cromwell, we expect sales to be down 7 to down 4 percent in the quarter. Also in the fourth quarter, we are up against difficult comps as 2014 included a 1 percentage point lift from sales of Ebola-related products.

2. Let's move on to gross profit margins.
   a. For the full year, we are forecasting gross margin contraction of about 80 basis points.
   b. For the fourth quarter, we are expecting gross profit margins to decrease 150 basis points. Price deflation and the mix of faster growth with lower-margin customers are driving the decrease. The mix from Cromwell accounts for about 20 basis points of the expected gross profit margin decline.

3. Let's take a look at operating margins, which are adjusted to exclude charges. Keep in mind these margins are inclusive of the gross profit factors discussed above.
   a. For the full year, we expect operating margin contraction of 85 to 100 basis points. This includes incremental growth and infrastructure spending for the year at the high end of our range, as detailed in Exhibit 4.

b. For the fourth quarter, we are expecting operating margin contraction of 195 to 250 basis points. The contraction in gross margin drives most of the change, with the lack of operating expense leverage a factor based on a more conservative view of expected sales volume. Cromwell represents about a 50 basis point drag on operating margin in the quarter, due to mix and eCommerce-related investments.

4. Next, the tax rate.
   a. We are forecasting an effective tax rate of 37.2 to 37.6 percent for the full year and for the 2015 fourth quarter. This range is higher than what we forecasted in July because earnings in lower tax rate jurisdictions represent a lower percentage of total company earnings.
   b. Clean energy investments are expected to contribute $0.09 per share to earnings for the full year.

Conclusion

Please mark your calendar for the following important dates:

- On Thursday, November 12th, we plan to release October sales, and we will host our Annual Analyst Meeting at our headquarters in Lake Forest, IL.
- On Tuesday, November 17th, Will Lomax, Vice President and Controller, and Bill Chapman, Senior Director of Investor Relations, will participate in the Barclays Select Series: Industrial Distribution Forum in New York, NY.

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.

Exhibit 1
Reported vs. Adjusted Earnings

	Three Months Ended September 30,		
	2015	**2014**	% Change
Diluted Earnings Per Share as reported:	$2.92	$3.30	-12%
U.S. branch closures	0.06		
Company restructuring	0.05		
Diluted Earnings Per Share as adjusted:	$3.03	$3.30	-8%

	Nine Months Ended September 30,		
	2015	**2014**	% Change
Diluted Earnings Per Share as reported:	$9.24	$9.30	-1%
U.S. branch closures	0.06		
Company restructuring	0.10		
Retirement plan transition		0.15	
Diluted Earnings Per Share as adjusted:	$9.40	$9.45	-1%

Note: As of October 16, 2015.

Exhibit 2
Sales Guidance

	October 16, 2015	**July 17, 2015**
Economy/Volume	1.5% – 2.5%	4% – 6%
Price	(1)%	(1)%
Organic Sales	0.5% – 1.5%	3% – 5%
Acquisitions	2%	0%
F/X	(3)%	(3)%
Company Sales	(0.5)% – 0.5%	0% – 2%

Note: As of October 16, 2015.

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Exhibit 3
2015 EPS Guidance

	October 16, 2015	July 17, 2015
Sales ($B)	$9.9 – 10.0	$10.0 – $10.2
V% vs. prior yr.	(0.5)% – 0.5%	0% – 2%
Gross Margin bps vs. prior yr.	(80)	(60)
Op. Margin	13.2% – 13.3%	13.5% – 13.8%
bps vs. prior yr.	(100) – (85)	(70) – (40)
EPS	$11.60 – $11.80	$12.00 – $12.50

Note: As of October 16, 2015. Excludes unusual items as reported by the company in its quarterly earnings releases.

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	43	17	40	19	19
4Q	49E	10	31	1	30
FY	$150E (2)	$78	$132	$71	$67

Notes: (1) As of October 16, 2015.
(2) The company expects 2015 incremental growth spending of $140-150 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**	

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