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4Q15 Earnings Release Podcast Script
January 26, 2016

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 2015 results.

This podcast is supplemented by our 2015 fourth quarter earnings release issued today, January 26th, and other information available on our Investor Relations website. This material contains forward looking statements that are based on our current view of the competitive market and the overall environment. Future risks and uncertainties could cause our actual results to differ materially. 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 website, for a discussion of factors that may affect our forward-looking statements. Tables reconciling non-GAAP measures accompany the script of this podcast and today's earnings release and are both available on our Investor Relations website.

The macroeconomic conditions faced by our industry in 2015 are well-documented and largely understood. What's less understood is that we took action by reducing costs and continued to invest more in the business. Our full year revenue was in line with our previous guidance, and adjusted earnings per share results were above the midpoint of our guidance.

As mentioned in the press release, we also reiterated our 2016 sales guidance of -1 to 7 percent and earnings per share guidance of $10.80 to $13.00, which was first issued on November 12, 2015. At the end of the podcast, we will provide more color around our assumptions.

Company Results Summary: 2015

Now, let's take a look at our performance. For the full year, company sales of $10 billion were flat with 2014. Net earnings decreased 4 percent to $769 million and earnings per share increased 1 percent to $11.58.

The year contained restructuring/non-operating items that lowered reported earnings by $0.36 per share. The year 2014 contained charges that lowered reported earnings by $0.81 per share. To better understand our performance, the majority of the analysis and commentary for the remainder of the podcast excludes the effect of these items in 2015 and 2014 unless specifically noted. Details regarding the items can be found in the earnings release, posted on the Investor Relations section of our website, and in the Exhibits at the end of this podcast.

Excluding these items from 2015 and 2014, company operating earnings decreased 5 percent for the year, while net earnings declined 8 percent. Adjusted earnings per share were $11.94 for the year, representing a 3 percent decline versus $12.26 in 2014. Earnings per share performance benefited from fewer shares outstanding as a result of 6.1 million shares repurchased during the year.

Company Results Summary: 2015 Fourth Quarter

Now let's turn to the 2015 fourth quarter. Company sales in the fourth quarter declined 1 percent. Reported operating earnings decreased 6 percent, and reported net earnings decreased 2 percent. Reported earnings per share were $2.30, a 7 percent increase versus the 2014 quarter.

Overall, our quarterly results were above our guidance issued at our Analyst Meeting on November 12th. As a reminder, our guidance does not include restructuring/non-operating items. Excluding the items from 2015 and 2014, adjusted operating earnings decreased 11 percent, while net earnings decreased

19 percent. Adjusted earnings per share were $2.49 for the quarter, representing a decline of 11 percent versus the 2014 fourth quarter. Results in 2015 benefited from a net $0.16 per share of non-repeating operating items in the fourth quarter, primarily related to the shift in timing of the implementation of SAP in Canada into 2016 and a one-time reduction in healthcare liabilities in the United States.

Let’s now walk down the operating section of the income statement. Adjusted gross profit margins were 40.5 percent, compared to 42.5 percent in the 2014 fourth quarter due to lower price, unfavorable customer mix and lower gross profit margins from the Cromwell acquisition.

On an adjusted basis, company operating earnings for the quarter decreased 11 percent. The earnings decline was driven by the 1 percent sales decrease and lower gross profit margins. Adjusted operating expenses declined 3 percent, including $32 million in incremental growth-related spending. Adjusted company operating margins decreased 130 basis points to 11.4 percent for the quarter from 12.7 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 2016 guidance and other key items.

Quarterly Sales

As mentioned earlier, company sales for the quarter decreased 1 percent. We had 64 selling days in the quarter, the same as the previous year. The 1 percent sales decline for the quarter consisted of a 2 percentage point decline from unfavorable foreign exchange, a 1 percentage point decline from price, a 1 percentage point decline from lower sales of seasonal products and a 1 percentage point decline from sales of Ebola related safety products in 2014 that did not repeat, partially offset by 4 percentage points from the Cromwell acquisition.

Let's move on to sales by segment. We report two segments, the United States and Canada. Our remaining operations, located primarily in Europe, Asia 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 74 percent of total company revenue in the quarter, decreased 3 percent. The 3 percent sales decline for the quarter was driven by 2 percentage point decline from volume, a 1 percentage point decline from price, a 1 percentage point decline from lower sales of seasonal products and a 1 percentage point decline from sales of Ebola related safety products in 2014 that did not repeat, partially offset by 1 percentage point from higher intercompany sales to Zoro and a 1 percentage point benefit from the timing of the Christmas holiday.

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

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

Weak oil prices continued to affect our sales to Natural Resources and Heavy Manufacturing customers. Based on our analysis of relevant SIC codes, oil represented about a 150 basis point drag on U.S. sales in the quarter. This compares to a 110 basis point drag for the year, indicating sequential deceleration.

Now let's turn our attention to the Canadian segment. Sales in Canada represented 8 percent of total company revenues in the quarter. For the quarter, sales in Canada decreased 27 percent in U.S. dollars, 14 percent in local currency. The 14 percent sales decrease consisted of a 17 percentage point decrease from volume and a 1 percentage point decrease from lower sales of seasonal products, partially offset by a 4 percentage point contribution from price. Weakness in the oil and gas industries continued to affect sales to Canada's customers. All end markets except Government and Forestry were down versus the prior year. From a geographic standpoint, sales in Alberta were down about 30 percent in the quarter, whereas sales in all other provinces in aggregate were down 4 percent versus the prior year.

Let's conclude our discussion of sales for the quarter by looking at the Other Businesses. Again, this group includes our operations primarily in Europe, Asia and Latin America and currently represents about 18 percent of total company sales. Sales for this group increased 41 percent in the 2015 fourth quarter versus the prior year. This performance consisted of 33 percentage points from the acquisition of Cromwell and 18 percentage points of growth from volume and price, partially offset by a 10 percentage point decline from unfavorable foreign exchange. Organic sales growth in the Other Businesses was primarily driven by MonotaRO in Japan and Zoro in the United States.

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 in both years. Total company sales were flat versus December 2014 and consisted of 4 percentage points from acquisitions and a 1 percentage point benefit from the favorable timing of the Christmas holiday, offset by a 2 percentage point decline from unfavorable foreign exchange, a 1 percentage point decline from volume, a 1 percentage point decline from price and a 1 percentage point decline from sales of Ebola related safety products in 2014 that did not repeat.

In the United States, December sales decreased 2 percent driven by a 2 percentage point decline in volume, a 1 percentage point decline in price, a 1 percentage point decline from sales of seasonal products and a 1 percentage point decline from lower sales of Ebola related safety products that did not repeat, partially offset by 1 percentage point from higher intercompany sales to Zoro and a 2 percentage point benefit from the timing of the Christmas holiday. December customer end market performance in the United States was as follows:

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

Daily sales in Canada for December decreased 30 percent in U.S. dollars and were down 17 percent in local currency. The 17 percent sales decrease consisted of an 18 percentage point decline from volume and a 1 percentage point decrease from sales of seasonal products, partially offset by a 2 percentage point benefit from price. Similar to the quarter, all end markets except Government and Forestry were down versus prior year. From a geographic standpoint, sales in Alberta were down about 30 percent in December, whereas sales in all other provinces in aggregate were down 8 percent versus the prior year.

Daily sales for the Other Businesses increased 41 percent in December, consisting of 30 percentage points from acquisitions and 18 percentage points from volume and price, partially offset by a 7 percentage point decline from unfavorable foreign exchange. The organic growth was driven by Zoro in the United States and MonotaRO in Japan.

January Sales

Let's move on to January. Please note that we benefited from New Year's Day falling on a Friday in 2016. In 2015, the holiday was on a Thursday, resulting in light sales on Friday, January 2. Daily sales growth in the month of January to date is trending better than December's flat sales performance, even after adjusting for the holiday benefit. Late January sales may be affected by the winter storm in the northeast. There were 25 branches closed on Friday, January 22, and at this point we do not have a clear picture as to the magnitude of lost sales. Now, I would like to turn the discussion over to Bill Chapman.

Operating Performance

Thanks Laura.

Since we have already reviewed operating performance at a company level, we will discuss performance by reporting segment. As a reminder, results in this discussion exclude the restructuring/non-operating items detailed in the earnings press release, which is posted on the Investor Relations section of our website, and in the Exhibits at the end of this podcast.

Adjusted operating earnings in the United States decreased 9 percent versus the 2014 fourth quarter driven by lower sales and a lower gross profit. Gross profit margins for the quarter decreased 160 basis points as a result of price deflation exceeding cost deflation and better relative performance with lower margin customers. Operating expenses declined due to lower employee benefits, partially offset by higher contract service costs and included $22 million of growth and infrastructure spending. On an adjusted basis, the U.S. operating margin decreased 90 basis points to 16.1 percent for the quarter versus the fourth quarter of 2014.

Let's move on to our business in Canada. Adjusted operating earnings declined 60 percent versus the 2014 fourth quarter. This decrease was driven by lower sales and a lower gross profit. The 2015 fourth quarter contained favorable inventory adjustments versus the 2014 quarter. The gross profit margin in Canada improved 150 basis points versus the prior year; in the absence of those inventory adjustments, the gross profit margin would have been down 200 basis points versus the prior year. Adjusted operating expenses in Canada were down 15 percent.

On an adjusted basis, the Other Businesses had $10 million in operating earnings in the 2015 fourth quarter versus breakeven in the 2014 period. The increase in adjusted earnings was driven by better performance from MonotaRO and Zoro. In addition, Cromwell's results were in line with our expectations.

Other

Other income and expense was a net expense of $17 million in the 2015 fourth quarter versus net expense of $5 million in the 2014 fourth quarter. This increase was primarily attributable to higher interest expense and losses from the company's investment in clean energy that began in 2015.

The effective tax rate in 2015 was 36.5 percent for the quarter and 37.2 percent for the full year. Excluding the effect of restructuring/non-operating items, the adjusted tax rate was 39.2 percent for the quarter and 37.6 percent for 2015, compared to 38.2 percent in the 2014 quarter and year. The increase in the adjusted quarterly rate was primarily due to a higher proportion of earnings in the

United States versus geographies with lower tax rates. The company's clean energy investment generated $0.09 per share of earnings for the year.

The company is currently projecting a tax rate of 35.2 to 36.2 percent for 2016, compared to the prior projection of 36.3 to 37.3 percent on November 12, 2015. The lower rate is driven by the incremental benefit from the company's second clean energy investment, which closed in early January of this year.

Cash Flow

Lastly, let's take a look at our cash flow for the quarter. Operating cash flow was $256 million versus $300 million in the 2014 quarter. We used the cash generated during the quarter, along with proceeds from debt, to invest in the business and return cash to shareholders through share repurchases and dividends. Gross capital expenditures for the quarter were $121 million versus $147 million in 2014. We paid dividends of $75 million in the quarter, reflecting the 8 percent increase in the quarterly dividend announced in April of 2015. In addition, we bought back 1.0 million shares of stock for $224 million and ended the quarter with 9.5 million shares remaining on our share repurchase authorization. Share repurchases made throughout the year contributed $0.21 to earnings per share in the fourth quarter. In total, we returned $299 million to shareholders in the quarter.

2016 Guidance

As we noted earlier, we reiterated our 2016 sales and EPS guidance. The following information is provided to help you better model our 2016 financials. Keep in mind this reflects adjusted results in 2015 as a basis for comparison:

1. Sales. Please note that the first quarter contains an extra sales day versus 2015. The trend reverses in the fourth quarter, when we have one less selling day versus 2015. Also, please be aware that the first quarter is our

most difficult comparison of 2016, as the 2015 first quarter saw the strongest sales growth from the U.S. segment. Please see Exhibit 6.

2. Canada. While the macroeconomic conditions are well understood, we want to stress that operating results in Canada will remain under pressure for much of 2016. The installation of SAP is the business' top priority, and there will be a stabilization period following. In addition, certain expenses tied to the installation of SAP that were planned to be spent in the fourth quarter of 2015 shifted to the first quarter of 2016. As a result, the first quarter will contain additional expense of $10 million.
3. Supplier funding. We've modified how we account for supplier support of our annual trade shows, which take place in the first quarter. Previously, both gross profit and operating expenses as a percent of sales were inflated in the first quarter, relative to other quarters, by about 100 basis points. Starting in 2016, a portion of the funds received from suppliers will now be accounted for as reduction in the trade show expenses rather than a reduction in cost of goods sold. In addition, the portion of funds applied to cost of goods sold will now be spread between the first and second quarters. While this change has no impact on the full year, operating expenses will now be inflated by about 55 basis points in the first quarter relative to other quarters. Gross profit will now be inflated by 35 basis points in the first quarter and 20 basis points in the second quarter. There is no impact to operating margin.
4. Gross profit margins. We expect gross profit margins to be down 50 to 70 basis points for full year 2016 versus the full year 2015, primarily driven by ongoing foreign exchange deterioration in Canada. For the first quarter, we forecast gross profit margins will be down 175 to 225 basis points versus the 2015 first quarter reflecting the change in accounting for supplier funding, which has an effect of 70 basis points, and the expectation of lower performance in Canada.
5. Operating margin. For the full year, we now expect operating margin will be down 40 to 150 basis points driven by 2015 results that were better

than our November guidance, including the $0.16 per share of non-repeating operating benefits, and lower 2016 expectations for Canada. For the first quarter, we forecast operating margins will be down 175 to 225 basis points versus the 2015 first quarter due primarily to lower gross profit margins as mentioned above. The supplier funding changes have no effect on operating margins.

6. Branch closures. As previously announced, we will continue to adjust the U.S. branch network in 2016 and plan to close 55 branches this year. Total restructuring costs are in line with the guidance given at the Analyst Meeting on November 12, 2015.
7. Clean energy investment. Our first investment in clean energy resulted in a benefit of $0.09 for the full year 2015. Earlier this month, we entered into a second clean energy investment. As a result, we now expect a $0.15 to $0.20 benefit to earnings per share in 2016 from the two investments. We expect the new investment will lower our effective tax rate by 250 to 300 basis points as reflected in our updated tax rate guidance.
8. Earnings per share. As compared to our November guidance, we expect to receive a $0.15 per share benefit in 2016 from a lower share count and the tax benefit from the second clean energy investment. However, that will be essentially offset by the timing of SAP spending and lower performance in Canada.

Conclusion

Please mark your calendar for the release of January sales on Thursday, February 11th. Thank you for your interest in Grainger. If you have any questions, please do not hesitate to contact Laura Brown at 847.535.0409, Michael Ferreter at 847.535.1439 or me at 847.535.0881.

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Exhibit 1
Reported vs. Adjusted Reconciliation for the Year

	Twelve Months Ended December 31,		
	2015	**2014**	% Change
Diluted Earnings Per Share as reported:	$11.58	$11.45	1%
Restructuring (United States)	0.33		
Restructuring (Canada)	0.05		
Restructuring (Other Businesses)	0.07		
Discrete tax items	(0.09)		
Business shutdown (Brazil)		0.40	
Pension change (Fabory)		0.15	
Restructuring (Fabory)		0.15	
Goodwill impairment (Colombia)		0.11	
Subtotal	0.36	0.81	
Diluted Earnings Per Share as adjusted:	$11.94	$12.26	(3)%

Exhibit 2
Reported vs. Adjusted Reconciliation for the Quarter

	Three Months Ended December 31,		
	2015	**2014**	% Change
Diluted Earnings Per Share as reported:	$2.30	$2.14	7%
Restructuring (United States)	0.26		
Restructuring (Canada)	0.03		
Restructuring (Other Businesses)	0.01		
Discrete tax items	(0.11)		
Business shutdown (Brazil)		0.40	
Restructuring (Fabory)		0.15	
Goodwill impairment (Colombia)		0.11	
Subtotal	0.19	0.66	
Diluted Earnings Per Share as adjusted:	$2.49	$2.80	(11)%

Exhibit 3
2016 Sales Guidance

	January 26, 2016	November 12, 2015
Economy/Share Gain	0% - 6%	(1)% - 6%
Price	(2)% - (1)%	(2)% - (1)%
Organic Sales	(2)% - 5%	(3)% - 5%
Acquisitions	3%	3%
F/X	(2)% - (1)%	-1%
Company Sales	(1)% - 7%	(1)% - 7%

Note: As of January 26, 2016.

Exhibit 4
2016 EPS Guidance

	January 26, 2016			November 12, 2015		
Sales ($B)	$ 9.9	-	$10.7	$ 9.9	-	$10.7
V% vs. prior yr.	(1)%	-	7%	(1)%	-	7%
Op Margin	12.0%	-	13.1%	12.1%	-	13.2%
bps vs. prior yr.	(150)	-	(40)	(110)	-	0
EPS	$10.80	-	$13.00	$10.80	-	$13.00

Notes:
(1) As of January 26, 2016.
(2) November 12, 2015, guidance was based on forecast, not actual results.
(3) Excludes restructuring/non-operating items as reported by the company in its quarterly earnings releases.
(4) Gross profit margin is expected to be down 50 to 70 basis points versus the 2015 year.

Exhibit 4
Incremental Growth Spending
($ in Millions)

	2015 Incremental vs. 2014	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	32	10	31	1	30
FY	$133	$78	$132	$71	$67

Exhibit 5
Fourth Quarter 2015 Guidance

	LOW		HIGH	
Sales ($B)	$2.4		$2.5	
EPS	$2.20		$2.40	
Sales growth	-3%		0%	
EPS growth	-21%		-14%	
Op Margin	10.2%		10.7%	
Op Margin expansion	(250)	bps	(195)	bps

Note: As of November 12, 2015.

Exhibit 6
Selling Days: 2016 vs. 2015

Month	2016	2015	Difference
January	20	21	-1
February	21	20	1
March	23	22	1
1Q	**64**	**63**	**1**
April	21	22	-1
May	21	20	1
June	22	22	0
2Q	**64**	**64**	**0**
July	20	22	-2
August	23	21	2
September	21	21	0
3Q	**64**	**64**	**0**
October	21	22	-1
November	21	20	1
December	21	22	-1
4Q	**63**	**64**	**-1**
Full Year	**255**	**255**	

Safe Harbor Statement

All statements in this communication, other than those relating to historical facts, are “forward-looking statements.” These forward-looking statements are not guarantees of future performance and are subject to a number of assumptions, risks and uncertainties, many of which are beyond our control, which could cause actual results to differ materially from such statements. These statements include, but are not limited to, statements about future strategic plans and future financial and operating results. Important factors that could cause actual results to differ materially from our expectations include, among others: higher product costs or other expenses; a major loss of customers; loss or disruption of source of supply; increased competitive pricing pressures; failure to develop or implement new technologies or business strategies; the outcome of pending and future litigation or governmental or regulatory proceedings, including with respect to wage and hour, anti-bribery and corruption, environmental, advertising, privacy and cybersecurity matters; investigations, inquiries, audits and changes in laws and regulations; disruption of information technology or data security systems; general industry or market conditions; general global economic conditions; currency exchange rate fluctuations; market volatility; commodity price volatility; labor shortages; facilities disruptions or shutdowns; higher fuel costs or disruptions in transportation services; natural and other catastrophes; unanticipated weather conditions; loss of key members of management; our ability to operate, integrate and leverage acquired businesses and other factors which can be found in our filings with the Securities and Exchange Commission, including our most recent periodic reports filed on Form 10-K and Form 10-Q, which are available on our Investor Relations website. Forward-looking statements are given only as of the date of this release and we disclaim any obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as required by law.