1Q16 Earnings Release Podcast Script
April 18, 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 first quarter 2016 results.

This podcast is supplemented by our 2016 first quarter earnings release issued today, April 18th, 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 today's earnings release, which is available on our Investor Relations website.

Company Results Summary

Today we reported our 2016 first quarter results. While we are currently experiencing economic headwinds and our short term results are affected, we continue to manage the business for the long term. Our investments in eCommerce, KeepStock and supply chain, including the New Jersey and Toronto distribution centers, will provide and support growth for years to come. We have also invested in tools and processes that will make us more productive including a new CRM system for the sales force and SAP in Canada and Mexico. Now let's cover the specifics for the quarter.

A stronger than expected January, due to carryover spending from fourth quarter customer shutdowns and favorable holiday timing, contributed to our sales performance. The difficult economic environment and headwind from last year's strong sales of seasonal products and Ebola-related products were also considerations. Solid expense management and the timing of planned spending offset some of the gross margin pressure. In Canada, we completed the installation of SAP, which will drive better service and increased productivity over time. However, we saw a further slowdown in February and March due to the implementation, which also had an unfavorable effect on expenses. And our single channel online businesses of Zoro in the United States and MonotaRO in Japan posted continued strong performance.

Let's now look at the quarter in detail. Company sales increased 3 percent. We had 64 selling days in the quarter, one more than the previous year. On a daily basis, sales increased 1 percent. Reported operating earnings declined 10 percent and net earnings were down 12 percent. Reported earnings per share of $2.98 were down 3 percent versus $3.07 in the previous year.

The first quarter in both years contained restructuring items as noted in the press release issued today, April 18th. Please refer to the adjusted results found in the press release. All results referenced in the remainder of this podcast are adjusted unless specifically noted.

Let's now walk down the operating section of the income statement in more detail:

- Gross profit margins decreased 300 basis points versus the prior year to 41.8 percent driven by lower performance in the U.S. and Canada segments.
- Operating expenses for the company declined 4 percent driven by restructuring benefits and the timing of planned spending.
- Company operating earnings declined 5 percent versus the 2015 quarter. This decrease was primarily driven by lower gross profit margins, partially offset by lower operating expenses.

- Company operating margins were down 110 basis points versus the prior year to 13.4 percent.
- Net income was $199 million, down 6 percent.
- Adjusted earnings per share of $3.18 were up 3 percent from the 2015 first quarter.

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 2016 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. For consistency, 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 1 percent on a daily basis. The 1 percent sales growth included a 4 percentage point contribution from Cromwell, acquired on September 1, 2015, and a 1 percentage point reduction from foreign exchange. Excluding acquisitions and foreign exchange, organic sales declined 2 percent driven by a 3 percentage point reduction in price and a 1 percentage point reduction in lower sales of seasonal products, partially offset by a 2 percentage point increase from higher volume. By month, daily sales were as follows: up 4 percent in January, up 1 percent in February and down 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 Europe, Asia 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 75 percent of total company revenue in the quarter, were down 2 percent on a daily basis. The 2 percent decrease was driven by a 3 percentage point decline in price and a 1 percentage point decline from lower sales of seasonal products, partially offset by 1 percent from volume growth and a 1 percentage point contribution from increased sales to Zoro, the single channel online business in the United States.

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

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

Now let’s turn our attention to the Canadian business. Sales in Canada represented 7 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 were further affected by the strong U.S. dollar. Sales for our business in Canada declined 25 percent on a daily basis and 17 percent on a daily basis in local currency. The 17 percent decline consisted of 14 percentage points from lower volume and 6 percentage points from the SAP implementation, partially offset by 3 percentage points from price. The Canadian business installed SAP on February 1, 2016. As expected, the business experienced lower sales following implementation as team members became acclimated to the new system.

All customer end markets were lower in the quarter. On a geographic basis, daily sales in the province of Alberta, which represents about a third of the company's business in Canada, was down 26 percent in local currency. Local currency sales for all other provinces were down 10 percent.

Let's conclude our discussion of sales for the quarter by looking at the Other Businesses. This group includes our operations in Europe, Asia and Latin America and represents about 18 percent of total company sales. Sales for this group increased 47 percent on a daily basis, consisting of 33 percentage points from Cromwell, acquired on September 1, 2015, and 17 percentage points of growth from volume and price, partially offset by a 3 percentage point decline from foreign exchange. Sales growth in the Other Businesses was driven by the strong performance from the single channel online businesses in the United States and Japan, which grew 34 percent on a daily basis.

<u>March Sales</u>

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 23 selling days in March of 2016, one more than in 2015. Company daily sales declined 1 percent versus March of 2015. Sales results in March included 4 percentage points from acquisitions, and foreign exchange was essentially flat for the month. Excluding acquisitions, organic daily sales declined 5 percent driven by a 3 percentage point decline in price, a 1 percentage point reduction from the timing of the Easter holiday, a 1 percentage point reduction in lower sales of seasonal products and a 1 percentage point reduction in lower sales of Ebola related products, partially offset by a 1 percentage point contribution from volume.

In the United States, daily sales in March declined 5 percent. This decline was due to a 3 percentage point decline in price, a 1 percentage point reduction from the timing of the Easter holiday, a 1 percentage point reduction in lower sales of seasonal products and a 1 percentage point reduction in lower sales of Ebola related products, partially offset by a 1 percentage point contribution from increased sales to Zoro. March customer end market performance in the United States was as follows:

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

Daily sales in Canada for March were down 20 percent and down 18 percent in local currency. The 18 percent daily sales decline consisted of a 16 percentage point decline in volume, a 3 percentage point decline from the SAP implementation and a 1 percentage point decline from lower sales of seasonal products, partially offset by a 2 percentage point benefit from price. The volume decline was seen in all customer end markets. On a geographic basis, sales performance in Canada was driven by softness in the province of Alberta, which was down 24 percent in local currency in March. All other provinces were down about 18 percent.

Daily sales in March for our Other Businesses increased 41 percent. The daily sales growth consisted of 31 percentage points from Cromwell and 10 percentage points from volume and was primarily driven by Zoro U.S. and MonotaRO. Performance for the Other Businesses was driven by 28 percent daily sales growth for the single channel online businesses. Our businesses in

Latin America and Fabory in Europe were affected by the timing of Easter, where extended holidays are more common.

April Sales

Turning to April, daily sales growth to date has benefited from the timing of the Easter holiday; we are expecting low single digit sales growth for the full month.

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. As a reminder, all results in the podcast are adjusted to exclude restructuring unless specifically noted. Operating earnings in the United States declined 5 percent versus the 2015 first quarter, with operating margins down 90 basis points to 17.7 percent versus 18.6 percent in the prior year. Gross profit margins for the quarter declined 260 basis points, driven by greater sales to lower margin customers and price deflation greater than cost deflation. Approximately 80 basis points of the reduction was due to changes in the classification of certain funding received from vendors related to the annual trade show. Operating expenses for the U.S. segment decreased 7 percent driven by lower payroll and benefit costs and timing of planned spending and $10 million of supplier funding for the trade show.

Let's move on to our business in Canada, which had a loss of $9 million in the quarter versus a $9 million profit in the prior year. The decrease was driven by the sales decline, lower gross profit margins and unfavorable operating expense leverage. The gross profit margin in Canada was down 660 basis points, with about one-third of the decline due to not having a trade show this year in Canada and about two-thirds from product mix driven by unfavorable foreign exchange. Expenses were down 18 percent versus the prior year, but the business experienced negative expense leverage given the 24 percent decline in reported revenue. We believe our investments in supply chain and IT in Canada set the stage for improved performance for this business.

Our Other Businesses generated $22 million in operating earnings in the 2016 quarter versus $12 million in 2015. This performance was primarily driven by strong results from Zoro in the United States and MonotaRO, along with the incremental earnings from Cromwell, acquired on September 1, 2015. Operating margin for the Other Businesses in the quarter increased 100 basis points, from 3.9 percent to 4.9 percent year over year.

Other

Below the operating line, other income and expense was a net expense of $20 million in the 2016 first quarter versus $4 million in the 2015 first quarter. The increase is due to interest expense from the $1 billion of debt the company issued in 2015, as well as expected losses from the company's investment in clean energy.

For the quarter, the effective tax rate in 2016 was 35.6 percent versus 38.4 percent in 2015. The decrease was primarily due to the company's investments in clean energy. We are still projecting an effective tax rate of 35.2 to 36.2 percent for the full year 2016.

Cash Flow

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $154 million in the 2016 first quarter versus $156 million in the 2015 first quarter. The company used the cash generated, along with short term borrowings, to invest in the business and return cash to shareholders through share repurchase and dividends. Capital expenditures were $52 million in the 2016 first quarter versus $99 million in the first quarter of 2015, reflecting a lower planned spend for 2016 and timing of ongoing projects. We returned $245 million to shareholders through $73 million in dividends and $172 million to buy back 893,000 shares of stock.

Now let's take a look at guidance.

2016 Guidance

As mentioned in the press release, we have narrowed our 2016 guidance range for sales and earnings per share. Our new guidance reflects increased gross profit pressure for the year and increased operating expense favorability, although not to the same extent as the first quarter. Let's look more closely at the underlying elements of our expectations versus adjusted results in 2015:

1. We'll begin with sales:
    a. We narrowed our sales guidance range and maintained a midpoint of 3 percent reported growth.
    b. We now expect price to be a little worse, down 2 percent, and foreign exchange to be a little better, down 1 percent, both for the full year.
    c. Although price was down 3 percent in the first quarter, we expect price to improve slightly in the final three quarters. We normally issue a price increase in January, but we intend to increase prices on a selective group of items as the year progresses.
2. Moving on to gross profit margins:
    a. Given the deflationary environment, we are taking a cautious view on gross margins and are lowering our gross margin expectations by 80 basis points. For the year, we now expect gross profit margins to be down 130 to 150 basis points versus 2015 results.
    b. For the 2016 second quarter, we are expecting gross profit margins to be down 130 to 150 basis points versus the 2015 second quarter.
3. On operating expense:

a. For the year, we expect operating expense to sales to be flat to down 90 basis points.
b. For the second quarter, we expect operating expense to sales to be down 40 to 60 basis points.

4. Let's take a closer look at operating margin expectations:
    a. The gross profit and operating expense adjustments offset, resulting in unchanged operating margin guidance from January. For the full year, we continue to expect 40 to 150 basis points of operating margin compression versus the prior year.
    b. For the 2016 second quarter, operating margins are forecasted to be down 70 to 110 basis points.
5. On restructuring:
    a. In the first quarter, we closed five branches in the United States, and we expect to close 50 more in the remainder of the year.
    b. While negligible in the first quarter, we now anticipate gains on sales of restructuring related assets to be $5 to $10 million pretax over the rest of the year. Unlike the $7 million gain on the sale of the former Toronto distribution center due to relocation, the branch gains are an offset to restructuring costs and are not in our guidance. We wanted to share this detail as it drives reported results, from expenses to earnings per share and net working assets to cash flow.
6. Now on our non-operating initiatives:
    a. We anticipate our next issuance of $400 million in long term debt in the second quarter as part of our planned $800 million in share repurchases for 2016.
    b. As communicated early this year, we entered into a second clean energy investment, which generates operating losses but is also eligible for tax credits. We expect about a $0.15 benefit to earnings per share in 2016 from the two clean energy investments. Please see Exhibit 4.

7. Finally, earnings per share:
    a. We narrowed our range for earnings per share. Similar to sales, we did not adjust the midpoint due to uncertainty about the economy and the first quarter expense favorability that will not repeat to the same extent.

Conclusion

Please mark your calendar for the following upcoming events:

1. On April 27th we will host our Annual Meeting of Shareholders. The script from that meeting will be available on our website following the event.
2. We plan to report April sales information on May 13th.
3. On May 18th, Jim Ryan, Ron Jadin and DG Macpherson 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, Michael Ferreter at 847.535.1439 or me at 847.535.0881.

Exhibit 1
Reported vs. Adjusted Earnings

	Three Months Ended March 31, 2016	2015	% Change
Diluted Earnings Per Share as reported:	$2.98	$3.07	(3)%
Restructuring (United States)	0.16		
Restructuring (Canada)	0.04		
Restructuring (Other Businesses)		0.03	
Subtotal	0.20	0.03	
Diluted Earnings Per Share as adjusted:	$3.18	$3.10	3%

Exhibit 2
2016 Sales Guidance

	April 18, 2016	January 26, 2016
Economy/Share Gain	0% - 6%	0% - 6%
Price	(2)%	(2)% - (1)%
Organic Sales	(2)% - 4%	(2)% - 5%
Acquisitions	3%	3%
F/X	(1)%	(2)% - (1)%
Company Sales	0% - 6%	(1)% - 7%

Note: As of April 18, 2016.

Exhibit 3
2016 EPS Guidance

	April 18, 2016			January 26, 2016		
Sales ($B)	$ 9.9	-	$10.6	$ 9.9	-	$10.7
V% vs. prior yr.	0%	-	6%	(1)%	-	7%
Op Margin	12.0%	-	13.1%	12.0%	-	13.1%
bps vs. prior yr.	(150)	-	(40)	(150)	-	(40)
EPS	$11.00	-	$12.80	$10.80	-	$13.00

Notes:
(1) As of April 18, 2016.
(2) Excludes restructuring/non-operating items as reported by the company in its quarterly earnings releases.

Exhibit 4
2016E Financials for Grainger's Clean Energy Investments

	April 18, 2016	February 11, 2016
Other Income and Expense	($30 million)	($30 - $45 million)
Tax Benefit	$11 million	$11 - $17 million
Clean Energy Tax Credits	$28 million	$28 - $41 million
Net Earnings	$9 million	$9 - $13 million
Earnings Per Share (rounded)	$0.15	$0.15 to $0.20

Exhibit 5
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 podcast 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.