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2Q16 Earnings Podcast Script
July 19, 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 2016 second quarter results.

This podcast supplements our 2016 second quarter earnings release issued today, July 19th, 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.

Company Results Summary

Today we reported results for the 2016 second quarter and updated our sales and earnings per share guidance for the full year to reflect our performance to date and the challenging industrial economy. I also wanted to report on our progress on key initiatives since we're at the midpoint of the year. We've made many important investments in this business despite the current economic challenges.

- We're investing in our supply chain, our eCommerce capability, our onsite services and tools to make our sales force more efficient.
- In the United States, in the quarter we launched a new inside sales team, which has 275 representatives calling on our medium-sized customers.
- We closed 27 branches in the quarter in the United States as part of our previously announced plan to adjust the U.S. branch network.

- In Canada, we installed SAP to allow for better visibility to our data and our inventory at a North American level. We also increased direct-to-customer shipping to improve service and efficiency. As of the end of the quarter 24 percent of shipments were going direct to the customer.
- eCommerce represented 46 percent of sales in the first half of the year, up from 40 percent in first half 2015, illustrating our strength in helping customers using the tools and channels they prefer.
- And the single channel online businesses increased revenue 34 percent on a daily basis over the 2015 second quarter.

Overall, we remain confident in our U.S. performance for the year despite the tough environment we're operating in. Canada's results were lower than anticipated and significantly contributed to the earnings shortfall versus our expectations, but we believe in the long-term prospects of the business and are executing a plan to improve performance. Finally, our single channel online businesses continued their rapid growth, serving mostly small customers in the United States and Japan.

Before we begin our review of results, I'd like to remind you of the adjustments to reported results in the second quarters of 2016 and 2015. In general, we will adjust the reported results to exclude items that are unrelated to the ongoing operations of the business. We believe this gives investors a better view of our core operational performance. Tables reconciling reported to adjusted results and other non-GAAP measures accompany today's earnings release and the transcript of this podcast, both of which are available on our Investor Relations website.

In the quarter, we took several actions to restructure the business for long-term success.

- We initiated $6 million of restructuring costs in the United States. Those costs were more than offset by gains on sales of branch real estate of

$15 million. Overall, we realized a net savings of $0.09 earnings per share.

- We had restructuring costs of $8 million in Canada, primarily related to severance, or $0.09 per share.
- Also in Canada, we reported a $10 million, or $0.12 per share, negative adjustment to inventory as a result of revisions to the reserves methodology based on additional visibility of inventory performance provided by the recent conversion to the U.S. SAP system.
- We wrote down the value of a plane we are selling as part of eliminating aviation operations, which had a $0.09 impact to earnings per share.
- Lastly, the quarter also included a benefit of $0.11 per share from the effective settlement of certain federal income tax issues under audit for the years 2009 through 2012.

These actions had a net effect of $0.10 of charges to earnings per share.
In 2015, we took $0.02 per share in charges related to restructuring at Fabory and the shutdown of the Brazil business.

With that as a backdrop, let's look at our results for the 2016 second quarter. **All figures below reflect adjusted results unless specifically noted.**

Company sales for the quarter increased 2 percent versus the 2015 second quarter. Excluding acquisitions, organic sales decreased 2 percent. There were 64 selling days in both quarters. Operating earnings decreased 10 percent, and net earnings decreased 20 percent. Earnings per share were $2.89, down 12 percent versus the prior year.

Bill will cover our revised guidance in detail at the end of the podcast. We now expect 2016 sales growth of 1 to 4 percent and earnings per share of $11.20 to $12.20. Our 2016 guidance issued on April 18, 2016, included 0 to 6 percent sales growth and earnings per share of $11.00 to $12.80.

Let's now walk down the operating section of the income statement in more detail. Gross profit margins in the second quarter decreased 160 basis points to 41.0 percent versus 42.6 percent in 2015, due to unfavorable price-cost mix in the United States and Canada. Operating expenses for the company increased 2 percent primarily due to the addition of Cromwell expenses not recorded in last year's results. Operating expenses as a percent of sales were 28.4 percent, up 10 basis points versus the prior year. Total company operating earnings were $323 million, a decrease of 10 percent versus the prior year. The operating margin was 12.6 percent, a decrease of 160 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 2016 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 2 percent. Sales growth by month was as follows: up 4 percent in April, up 1 percent in May and flat in June. Results for the quarter included 4 percentage points from the Cromwell acquisition. Excluding acquisitions, organic sales decreased 2 percent driven by a 1 percentage point decline in volume and 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 74 percent of total company revenue in the quarter, decreased 3 percent. Results for the quarter included a 2 percentage point decline from volume and a 2 percentage point decline from price, partially offset by 1 percentage point from intercompany sales, primarily to Zoro.

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

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

As we announced previously, we realigned our sales force on May 1 to better serve government, manufacturing, commercial and healthcare customers. We are currently experiencing some sales disruption due to the transition, but we expect the new structure to drive increased growth, share gain and better efficiency.

Now let's turn our attention to the Canadian business. Sales in Canada represented 8 percent of total company revenues. Reflecting the tough Canadian economy and particularly the energy sector, sales for the quarter decreased 19 percent in U.S. dollars and declined 16 percent in local currency versus the prior year. The 16 percent sales decrease consisted of a 14 percentage point decline in volume and a 2 percentage point decline from the wildfires in Alberta. All end markets except Government and Forestry were down for the quarter. From a geographic standpoint, sales in oil-producing Alberta were down 28 percent, compared to all other provinces which were down 11 percent in aggregate.

Let's conclude our discussion of sales for the quarter by looking at the Other Businesses, which represented 18 percent of total company sales. Sales for the Other Businesses increased 49 percent, consisting of 31 percentage points from the Cromwell acquisition, 17 percentage points of growth from volume and price and 1 percentage point from foreign exchange. The organic sales increase was primarily due to growth from the single channel online businesses of Zoro U.S. and MonotaRO, partially offset by lower sales in Latin America.

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 2016, the same as 2015. Company sales were flat in June versus the prior year. The sales performance included 4 percentage points from acquisitions, offset by a 3 percentage point decline from volume and a 1 percentage point decline from price.

In the United States, June daily sales decreased 3 percent, driven by a 4 percentage point decline from volume and a 1 percentage point decline from price, partially offset by 2 percentage points from intercompany sales, primarily to Zoro. June customer end market performance in the United States was as follows*:*

- Retail was flat;
- Light Manufacturing, Government and Commercial were down in the low single digits;
- Heavy Manufacturing was down in the mid-single digits;
- Contractor was down in the high single digits;

- Reseller was down in the mid-teens and
- Natural Resources was down in the high teens.

The performance of the Government end market was affected by softer sales to state and local customers at the June fiscal year-end compared to 2015. Given that 2015 was exceptionally strong, the low single digit decline was within our expectations. Similar to the quarter, sluggish demand and sales force changes contributed to the lower sales performance in June.

Sales in Canada for June were down 23 percent in U.S. dollars and 18 percent in local currency. The 18 percent decrease was driven by a 17 percentage point decline in volume and a 2 percentage point decline from the wildfires in Alberta, partially offset by 1 percentage point from price. All end markets were negative. From a geographic standpoint, sales in Alberta were down 30 percent, compared to all other provinces which were down 11 percent in aggregate.

Sales for our Other Businesses increased 46 percent in June, consisting of 31 percentage points from the Cromwell acquisition, 14 percentage points from volume and price and 1 percentage point from foreign exchange. The organic sales increase was primarily due to strong revenue growth from Zoro U.S. and Japan, partially offset by lower sales for Fabory in Europe and Latin America. As a reminder, we will anniversary the Cromwell acquisition on September 1, 2016.

July Sales

Sales growth in the month of July to date is in line with the sales performance in June.

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

Operating Performance

Thanks Laura. Let's talk about performance by reportable segment since we have already analyzed company operating performance. As a reminder, all figures below represent adjusted results.

In the United States, operating earnings decreased 8 percent in the quarter driven by lower sales and lower gross profit margins. The operating margin for the U.S. segment was 17.2 percent versus 18.2 percent in the 2015 quarter. Gross profit margins for the quarter declined 90 basis points primarily driven by negative customer selling mix and price deflation greater than product cost deflation. Operating expenses were down 2 percent due to lower advertising costs.

Let's move on to our business in Canada, which had an operating loss of $10 million in the quarter versus operating earnings of $9 million in the 2015 second quarter, driven by lower sales and lower gross profit. The gross profit margin in Canada declined 640 basis points versus the prior year, driven by the combination of price deflation and cost of goods sold inflation and unfavorable foreign exchange from products sourced from the United States. Operating expenses were down 12 percent versus the 2015 quarter driven by lower SAP costs versus the prior year and lower advertising costs. The Canadian business is undergoing significant change management as a result of the SAP conversion, though we have confidence in our leadership team and the plan to return the business to long-term profitable growth.

Operating earnings for the Other Businesses were $30 million in the 2016 second quarter. Operating earnings in the 2015 second quarter were $17 million, representing an earnings increase of $13 million or 73 percent versus the prior year. Results included strong performance from Zoro U.S. and Japan and the earnings contribution from Cromwell.

Other

Below the operating line, other income and expense was a net $23 million expense in the 2016 second quarter versus a net $8 million expense in the 2015 second quarter. The increase was driven by higher interest expense from the company's debt offerings in 2015 and 2016. Operating losses from the clean energy investments were lower than expected in the quarter as a result of lower demand for refined coal given relatively mild weather.

Income Tax

For the quarter, the reported effective tax rate in 2016 was 36.6 percent versus 35.4 percent in 2015. The 2016 second quarter included a $0.11 per share benefit from the effective settlement of certain federal income tax issues under audit for the years 2009 through 2012. Excluding this discrete benefit, the company's effective tax rate was 39.1 percent. The effective tax rate for the 2015 second quarter, excluding a year-to-date adjustment for the benefit from the company's first clean energy investment, was 36.9 percent. The year-over-year increase in the tax rate, excluding the settlement benefit, was primarily due to a larger proportion of earnings from higher tax rate jurisdictions and lower benefit from the clean energy investments in the quarter. We currently project an effective tax rate, excluding discrete items, of 36.8 to 37.8 percent for the full year 2016 versus 35.2 to 36.2 percent provided on April 18, 2016. The increase since April is driven by the expectation of continued earnings concentration in higher tax rate jurisdictions and lower benefit from the clean energy investments.

Cash Flow

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $173 million versus $213 million in 2015 as a result of lower earnings. We used the cash generated during the quarter along with borrowings to invest in the business and return cash to shareholders through share repurchase and dividends. We bought back 1,033,000 shares of stock for $241 million in the second quarter. Grainger returned a total of $315 million to shareholders in the quarter including $75 million in dividends, reflecting the 4 percent increase in the quarterly dividend announced in April of 2016. Capital expenditures were $54 million in the quarter versus $71 million in the second quarter of 2015. We have revised our full year guidance for capital expenditures to $300 to $325 million, from $300 to $350 million announced in November 2015.

2016 Guidance

As reported in our 2016 second quarter earnings release, we revised our 2016 sales and earnings per share guidance. For the full year 2016, we now expect 1 to 4 percent sales growth and earnings per share of $11.20 to $12.20. Let's look more closely at our current expectations:

1. We'll begin with sales:
    a. For the full year, the midpoint of guidance is now 2.5 percent growth, reflecting lower than expected volume in the United States and Canada.
    b. We now expect foreign exchange to have no net impact on sales for the full year due to the strengthening of the Japanese yen.
    c. As a reminder, we anniversary the Cromwell acquisition at the beginning of September.

2. Moving on to gross profit margins:
    a. For the full year, we still expect gross profit margins to be down 130 to 150 basis points versus 2015.
    b. Gross profit margins for the third quarter are forecasted to be down 100 to 140 basis points versus the prior year.

3. Let's take a closer look at operating margin expectations:
    a. For the full year, we now expect operating margin compression of 60 to 130 basis points.

b. The midpoint of operating margin guidance remains unchanged as gross profit improvements over April guidance offset expense deleveraging on lower sales.
c. The full year guidance implies modest improvement in the second half of the year versus previous guidance. This is due to continued strong expense management and better than expected gross profit margin in the United States.
d. For the third quarter, we expect operating margins to be down 80 to 170 basis points versus the prior year.

4. Next, other income and expense:
    a. We issued $400 million of new debt in mid-May, so there was about a half a quarter's worth of increased interest expense in the second quarter. The third and fourth quarters will contain the full three months of the higher interest expense.

5. Finally, earnings per share:
    a. As noted in our revised guidance, we now expect EPS of $11.20 to $12.20.
    b. We now expect a $0.07 benefit to earnings per share in 2016 from the two clean energy investments, compared to the prior projection of a $0.15 benefit on April 18, 2016. Please see Exhibit 4 for more detail.
    c. The EPS guidance includes the projected tax rate of 36.8 to 37.8 percent for 2016 reflecting a higher proportion of earnings from higher-tax jurisdictions.

Important Dates

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

- On August 11th we plan to release July sales.

- And we will host our Annual Analyst Meeting on the morning of Friday, November 11th, 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, Michael Ferreter at 847.535.1439 or me at 847.535.0881. Thank you for your interest in Grainger.

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Exhibit 1
2016 Reported and Adjusted Reconciliations

The company supplemented the reporting of financial information determined under U.S. generally accepted accounting principles (GAAP) with certain non-GAAP financial measures, which the company refers to as "adjusted" measures, including adjusted operating earnings, adjusted segment operating earnings, adjusted net earnings and adjusted diluted earnings per share. Adjusted measures exclude items that may not be indicative of core operating results. The company believes that these non-GAAP measures provide meaningful information to assist shareholders in understanding financial results and assessing prospects for future performance. Management believes adjusted operating earnings, adjusted net earnings and adjusted diluted earnings per share are important indicators of operations because they exclude items that may not be indicative of our core operating results, and provide a better baseline for analyzing trends in our underlying businesses. Because non-GAAP financial measures are not standardized, it may not be possible to compare these financial measures with other companies' non-GAAP financial measures having the same or similar names. These adjusted financial measures should not be considered in isolation or as a substitute for reported results. These non-GAAP financial measures reflect an additional way of viewing aspects of operations that, when viewed with GAAP results, provide a more complete understanding of the business. The company strongly encourages investors and shareholders to review company financial statements and publicly-filed reports in their entirety and not to rely on any single financial measure.

The reconciliations provided below reconcile the non-GAAP financial measures adjusted net earnings, adjusted diluted earnings per share, adjusted operating earnings and adjusted segment operating earnings with GAAP financial measures:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2016	2015	%	2016	2015	%
Operating earnings reported	$ 305,589	$ 356,717	(14%)	$ 622,681	$ 707,965	(12%)
Restructuring (United States)	(9,352)	—		7,055	—	
Inventory reserve adjustment (Canada)	9,847	—		9,487	—	
Restructuring (Canada)	8,055	—		11,132	—	
Restructuring (Unallocated expense)	8,947	—		8,947	—	
Restructuring (Other Businesses)	—	2,066		—	4,086	
Subtotal	17,497	2,066		36,981	4,086	
Operating earnings adjusted	$ 323,086	$ 358,783	(10%)	$ 659,662	$ 712,051	(7%)

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	Three Months Ended June 30,			Six Months Ended June 30,		
	2016	2015	%	2016	2015	%
Segment operating earnings adjusted						
United States	339,586	369,533		687,850	735,622	
Canada	(9,839)	9,499		(19,109)	18,886	
Other Businesses	29,724	17,224		51,508	28,770	
Unallocated expense	(36,385)	(37,473)		(60,587)	(71,227)	
Segment operating earnings adjusted	$ 323,086	$ 358,783	(10%)	$ 659,662	$ 712,051	(7%)
Company operating margin adjusted	12.6%	14.2%		13.0%	14.3%	
ROIC* for Company				26.5%	32.5%	
ROIC* for United States				43.6%	48.7%	
ROIC* for Canada				(6.3%)	5.8%	

*Adjusted ROIC is calculated as defined below, excluding the items noted above. The GAAP financial statements are the source for all amounts used in the Return on Invested Capital (ROIC) calculation. ROIC is calculated using operating earnings divided by net working assets (a 3-point average for the year). Net working assets are working assets minus working liabilities defined as follows: working assets equal total assets less cash equivalents (3-point average of $95.4 million), deferred taxes, and investments in unconsolidated entities, plus the LIFO reserve (3-point average of $388.0 million). Working liabilities are the sum of trade payables, accrued compensation and benefits, accrued contributions to employees' profit sharing plans, and accrued expenses.

	Three Months Ended June 30,			Six Months Ended June 30,		
	2016	2015	%	2016	2015	%
Net earnings reported	$ 172,676	$ 220,548	(22%)	$ 359,389	$ 431,563	(17%)
Restructuring (United States)	(5,852)			4,415		
Inventory reserve adjustment (Canada)	7,240			7,240		
Restructuring (Canada)	5,922			8,184		
Restructuring (Unallocated expense)	5,599			5,599		
Discrete tax item	(7,075)			(7,075)		
Restructuring (Other Businesses)		1,676			3,504	
Subtotal	5,834	1,676		18,363	3,504	
Net earnings adjusted	$ 178,510	$ 222,224	(20%)	$ 377,752	$ 435,067	(13%)
Diluted earnings per share reported	$ 2.79	$ 3.25	(14%)	$ 5.77	$ 6.32	(9%)
Restructuring (United States)	(0.09)			0.07		
Inventory reserve adjustment (Canada)	0.12			0.12		
Restructuring (Canada)	0.09			0.13		
Restructuring (Unallocated expense)	0.09			0.09		
Discrete tax item	(0.11)			(0.11)		
Restructuring (Other Businesses)		0.02			0.05	
Subtotal	0.10	0.02		0.30	0.05	
Diluted earnings per share adjusted	$ 2.89	$ 3.27	(12%)	$ 6.07	$ 6.37	(5%)

Exhibit 2
2016 Sales Guidance

	July 19, 2016	April 18, 2016
Economy/Volume	0% - 3%	0% - 6%
Price	(2)%	(2)%
Organic Sales	(2)% - 1%	(2)% - 4%
Acquisitions	3%	3%
F/X	0%	(1)%
Company Sales	1% - 4%	0% - 6%

Note: As of July 19, 2016.

Exhibit 3
2016 EPS Guidance

	July 19, 2016	April 18, 2016
Sales ($B)	$10.1 - $10.4	$9.9 - $10.6
V% vs. prior yr.	1% - 4%	0% - 6%
Op. Margin	12.2% - 12.9%	12.0% - 13.1%
bps vs. prior yr.	(130) - (60)	(150) – (40)
EPS	$11.20 - $12.20	$11.00 - $12.80

Note: As of July 19, 2016. Excludes special items that the company believes are not indicative of ongoing operations and have been removed to make the results more comparable to prior periods. See the tables reconciling reported to adjusted results included in the earnings release and this transcript.

Exhibit 4

2016E Financials for Grainger's Clean Energy Investments

	July 19, 2016	April 18, 2016
Other Income and Expense	($22 million)	($30 million)
Tax Benefit	$8 million	$11 million
Clean Energy Tax Credits	$18 million	$28 million
Net Earnings	$4 million	$9 million
Earnings Per Share (rounded)	$0.07	$0.15

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" based on our current view of the competitive market and the overall environment. Factors that could cause our actual results to differ materially from those statements include, among other risks and uncertainties, a major loss of customers or suppliers, competitive pressures, legal proceedings, changes in laws and regulations, general economic, industry or market conditions, technological or operational disruptions, natural and other catastrophes and other factors that can be found in our filings with the Securities and Exchange Commission, including our most recent Forms 10-K and 10-Q, which are available on our Investor Relations website. We disclaim any obligation to update or revise any forward-looking statement, except as required by law.