Q1 2017 Earnings Call

W.W. Grainger, Inc.

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April 18, 2017

Safe Harbor Statement and Non-GAAP Financial Measures

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; the implementation, timing and success of our strategic pricing initiatives; 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; changes in credit ratings; changes in effective tax rates 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 communication 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.

Additional information relating to certain non-GAAP financial measures referred to in this presentation, including adjusted operating earnings, adjusted segment operating earnings, adjusted net earnings and adjusted diluted earnings per share, is available in the appendix to this presentation and our most recent earnings release.

DG Macpherson

Chief Executive Officer

Ron Jadin

Senior Vice President and Chief Financial Officer

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Q1 2017 Reported Results – Total Company

($ in millions)	**Q1 2017**	**Q1 2016**	**% vs. PY**
Sales	$ 2,541	$ 2,507	1%
GP	1,019	1,045	-2%
Op Expense	724	728	-1%
Op Earnings	$ 295	$ 317	-7%
EPS	**$ 2.93**	**$ 2.98**	**-2%**

(% of sales)	**Q1 2017**	**Q1 2016**	**bps vs. PY**
GP Margin	40.1%	41.7%	(160)
Op Expense	28.5%	29.0%	(50)
Op Margin	11.6%	12.7%	(110)

The remaining slides reference adjusted results, which exclude items that the company believes are not indicative of ongoing operations, providing better comparability to prior and future periods.

Q1 2017 Adjusted Results – Total Company

($ in millions)	Q1 2017	Q1 2016	% vs. PY
Sales	$ 2,541	$ 2,507	1%
GP	1,019	1,048	-3%
Op Expense	729	711	3%
Op Earnings	$ 290	$ 337	-14%
EPS	**$ 2.88**	**$ 3.18**	**-9%**

(% of sales)	Q1 2017	Q1 2016	bps vs. PY
GP Margin	40.1%	41.8%	(170)
Op Expense	28.7%	28.4%	30
Expense/COGS	47.9%	48.8%	(90)
Op Margin	11.4%	13.4%	(200)

- Sales up 1% vs. prior year
  - Volume up 5%
  - Price down 3%
  - Seasonal down 1%
- GP margin decline driven by customer response to U.S. pricing actions
- Operating cash flow up 13% driven by working capital and timing of payments

Q1 2017 Adjusted Results – Other Businesses

($ in millions)	**Q1 2017**	**Q1 2016**	**% vs. PY**
Sales	$ 497	$ 445	12%
Op Earnings	$ 32	$ 22	45%

(% of sales)	**Q1 2017**	**Q1 2016**	**bps vs. PY**
Op Margin	6.3%	4.9%	140

- Price and volume up 15%
- FX headwind 3%, primarily due to British pound
- Online businesses delivered 23% sales growth
- Operating margin improved by 140 bps

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Reported results equal adjusted results for Other Businesses in Q1'17 and Q1'16.

Q1 2017 Adjusted Results – Canada

($ in millions)	**Q1 2017**	**Q1 2016**	**% vs. PY**
Sales	$ 186	$ 179	4%
Op Earnings	$ -16	$ -9	-69%

(% of sales)	**Q1 2017**	**Q1 2016**	**bps vs. PY**
Op Margin	-8.4%	-5.2%	(320)

- Revenue growth in local currency of 1%
- Service levels have stabilized
- Pricing actions underway will be realized throughout 2017
- More aggressive cost reductions in development

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Q1 2017 Adjusted Results – United States

($ in millions)	**Q1 2017**	**Q1 2016**	**% vs. PY**
Sales	$ 1,953	$ 1,966	-1%
Op Earnings	$ 306	348	-12%

(% of sales)	**Q1 2017**	**Q1 2016**	**bps vs. PY**
Op Margin	15.7%	17.7%	(200)

- Q1 2017 performance driven by pricing actions
- Volume response faster and stronger than anticipated
- Sales down 1%:
    - Volume up 4%
    - Price down 4%
    - Seasonal down 1%
- Expenses essentially flat

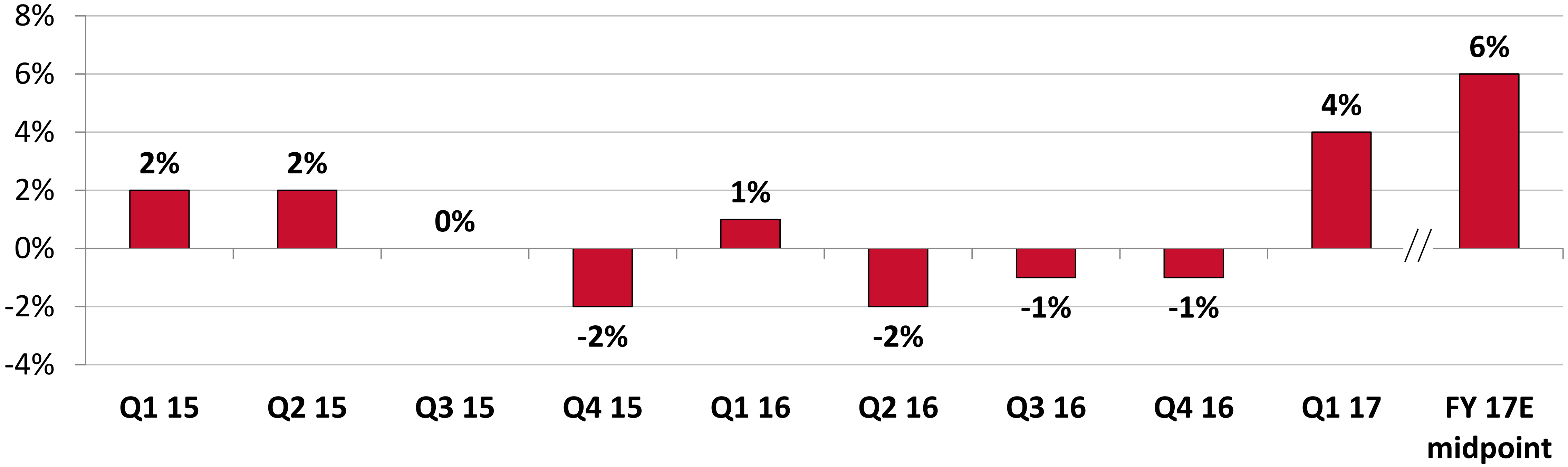
Pricing Actions – Initial Results

Pricing structure was impeding growth and profitability

Actions in Q1 2017	What we saw in Q1 2017
1. Adjusted list prices to support large customers consolidating their purchases (January)	Stronger than anticipated volume response on both frequent and infrequent purchases
2. Introduced new web prices on ~450K SKUs to drive Medium and Large noncontract customer acquisition and growth (February)	Prior to web pricing, volume was declining at double digits and is now up in the mid-single digits for those who opted in (without marketing)
3. Negotiate Large customer contracts to reverse the decline in spot buy business (ongoing)	Prior to contract modifications, customer volume was growing 4%. Post implementation, volume grew 9% for those customers where we have implemented pricing changes

More relevant pricing makes Grainger easier to do business with

U.S. Volume Trend



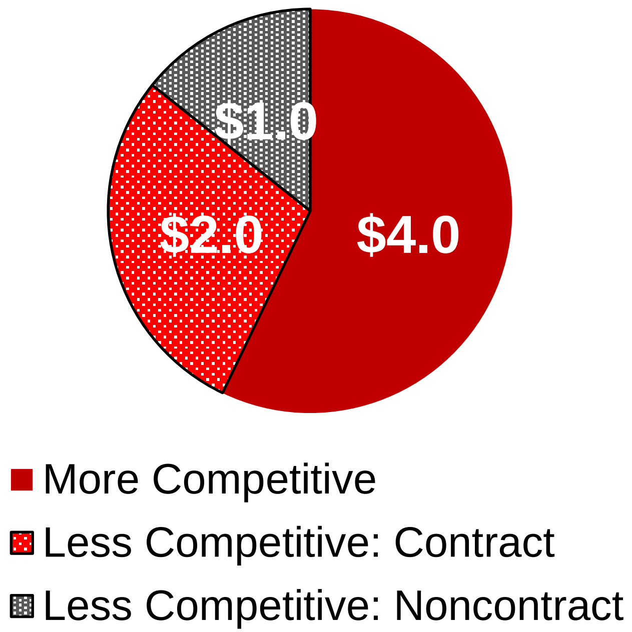
Next Steps

Introduce web prices on entire assortment beginning in Q3 2017, accelerate large contract customer negotiations and begin marketing more aggressively to:

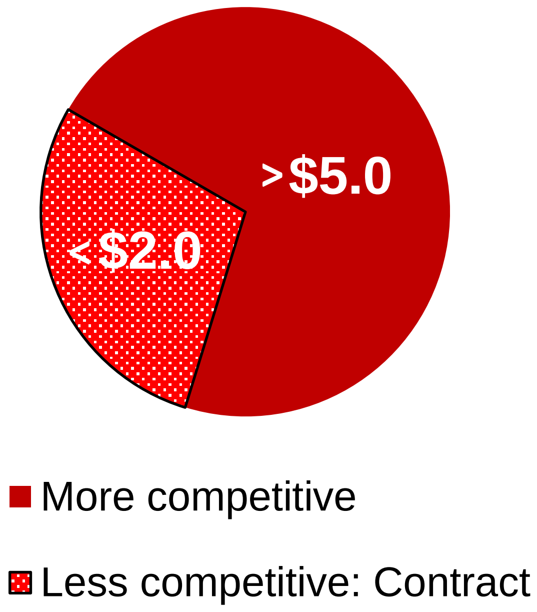
- Speed up customer retention efforts, accelerate growth and gain back the spot buy volume
- Simplify our pricing structure and accelerate the ability to lower expenses tied to our price complexity
- Put the pricing change behind us faster, enabling stronger sales growth and improved operating margins
- Back on track to hit 2019 long-term operating margin guidance of 12% to 13%

U.S. Large and Medium Pricing Actions – Effective Date

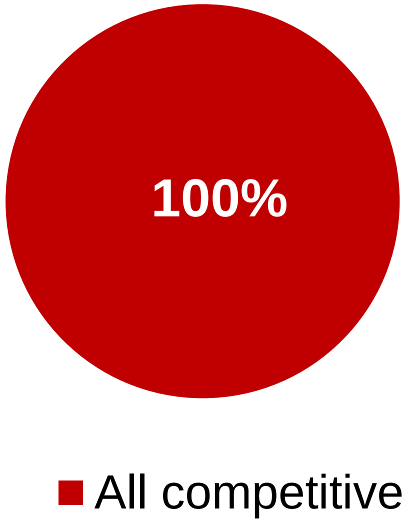
Today



FY 2017



FY 2018



Q1 2017 – U.S. Segment

- Price deflation: 4%
- GP margin decline: 190 bps

FY 2017 – U.S. Segment

- Price deflation: 5%
- GP margin decline: 210 bps

FY 2018 – U.S. Segment

- Price deflation: 2%
- GP margin decline: 120 bps

Note: U.S. Segment includes specialty brands and intercompany sales to Zoro.

All figures in billions of dollars. Price deflation and GP declines driven by 2017 and 2018 price changes and 2018 carryover and completion of contract negotiations. GP margin also reflects favorable customer/product mix and price increases on more competitively priced products in line with inflation.

2017 Guidance at Midpoint

	January 25, 2017	**Illustrative*** (excludes pricing acceleration)	**April 18, 2017** (with pricing acceleration)
Sales *($ billions)*	**$10.6**	**$10.5**	**$10.4**
% vs. prior year	4%	3%	2.5%
GP Margin	**40.2%**	**39.6%**	**39.1%**
bps vs. prior year	(55)	(115)	(160)
Op. Margin	**11.9%**	**11.4%**	**10.7%**
bps vs. prior year	(55)	(115)	(170)
EPS	**$11.85**	**$11.45**	**$10.65**
	$11.30[a]	**$11.32**[b]	

- Q1 results reflected higher customer volume response to pricing actions vs. expectations.
- Q1 guidance updated based on customer response and decision to accelerate pricing actions.

*Middle column illustrates full year impact of learnings from Q1 pricing programs due to higher customer volume response.
Note: 2017 guidance ranges included in Q1 earnings supplement.
a. Low end of January guidance range b. Excludes $0.13 benefit from accounting change noted in release

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2017 and 2019 Operating Margin Guidance

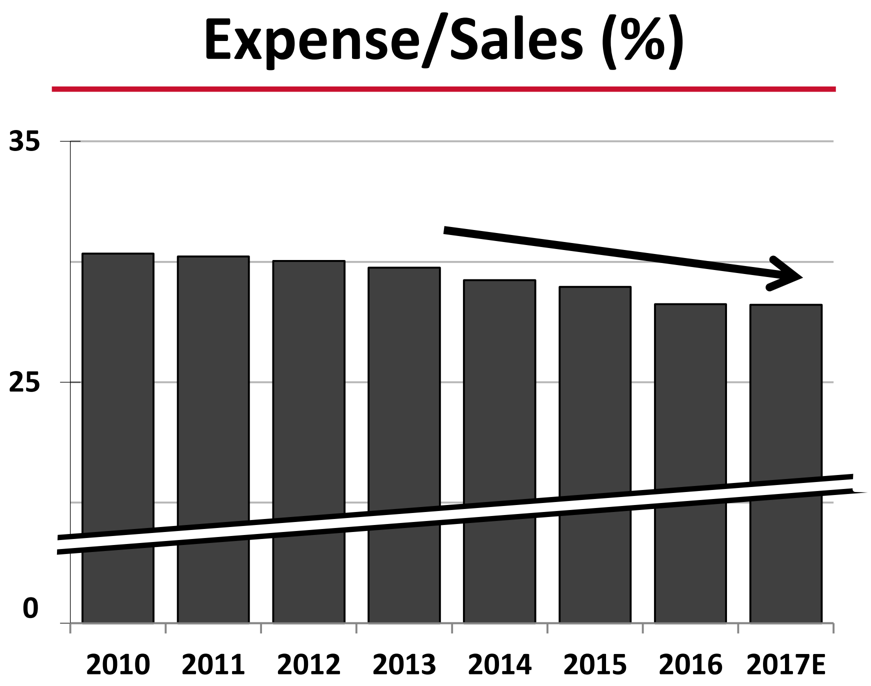
	2017E	2019E
U.S.	14% - 15%	15% - 16%
Canada	(6)% - (4)%	2% - 4%
Other	6% - 7%	8 - 10%
Company	**10% - 11%**	**12% - 13%**

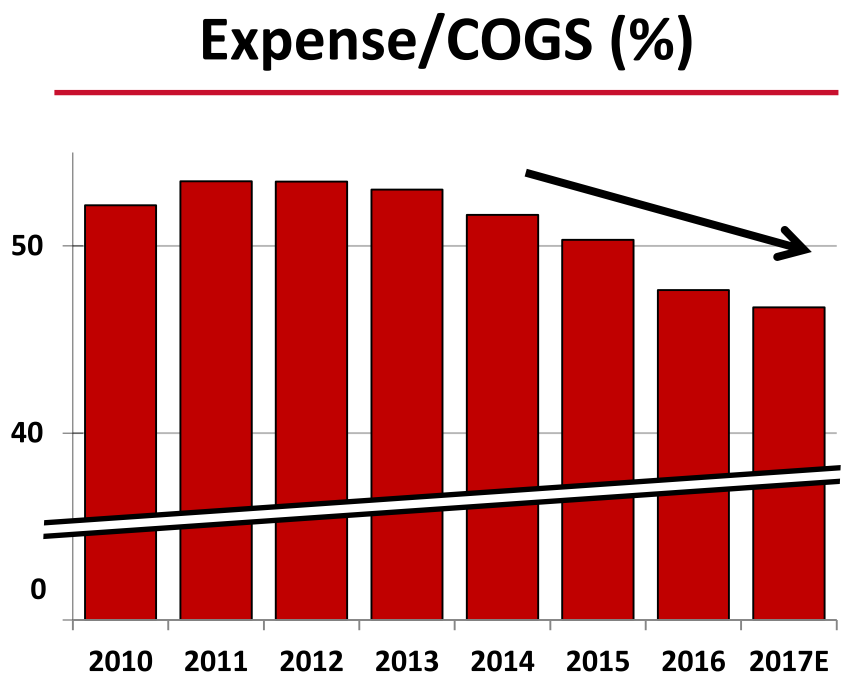
2019 Outlook:

- Total company operating earnings and operating margin guidance unchanged from November 2016 Analyst Meeting
- U.S. price deflation offset by better mix and continued cost productivity
- Canada volume and pricing improves along with significant cost productivity

Note: Company includes unallocated expenses and eliminations.

Cost productivity





Demonstrated ability to manage operating expenses and drive productivity

Closing Remarks

- We continue to be encouraged by the growth and profit improvement of our online businesses.
- We've stabilized service levels in Canada but need to do more to improve price realization and the cost structure of the business.
- In the U.S., the pricing acceleration will allow us to be more aggressive in our marketing efforts and will drive market share gains and allow new customer acquisition with the Grainger brand.
- While a strategic change of this nature is challenging and complex, we know this is the right thing to do for the long-term health of the business.

Q&A

Appendix

GAAP to Non-GAAP Reconciliations

	Three Months Ended March 31, 2017	2016	%
Operating earnings reported	$ 295,488	$ 317,092	(7)%
Restructuring (United States)	(6,322)	16,407	
Restructuring (Canada)	1,087	3,077	
Subtotal	(5,235)	19,484	
Operating earnings adjusted	$ 290,253	$ 336,576	(14)%

	Three Months Ended March 31, 2017	2016	%
Segment operating earnings adjusted			
United States	306,148	348,264	
Canada	(15,642)	(9,270)	
Other Businesses	31,507	21,783	
Unallocated expense	(31,760)	(24,201)	
Segment operating earnings adjusted	$ 290,253	$ 336,576	(14)%
Company operating margin adjusted	11.4 %	13.4 %	
ROIC* for Company	24.2 %	27.1 %	
ROIC* for United States	39.2 %	44.4 %	
ROIC* for Canada	(11.5)%	(6.2)%	

*Adjusted ROIC is calculated as defined on page 8 of the earnings release, excluding the items adjusting operating earnings as noted above

	Three Months Ended March 31, 2017	2016	%
Net earnings reported	$ 174,744	$ 186,713	(6)%
Restructuring (United States)	(3,959)	10,268	
Restructuring (Canada)	803	2,262	
Subtotal	(3,156)	12,530	
Net earnings adjusted	$ 171,588	$ 199,243	(14)%
Diluted earnings per share reported	$ 2.93	$ 2.98	(2)%
Pretax adjustments:			
Restructuring (United Sates)	(0.11)	0.26	
Restructuring (Canada)	0.02	0.05	
Total pretax adjustments	(0.09)	0.31	
Tax effect (1)	0.04	(0.11)	
Total, net of tax	(0.05)	0.20	
Diluted earnings per share adjusted	$ 2.88	$ 3.18	(9)%

(1) The tax impact of adjustments is calculated based on the income tax rate in each applicable jurisdiction.

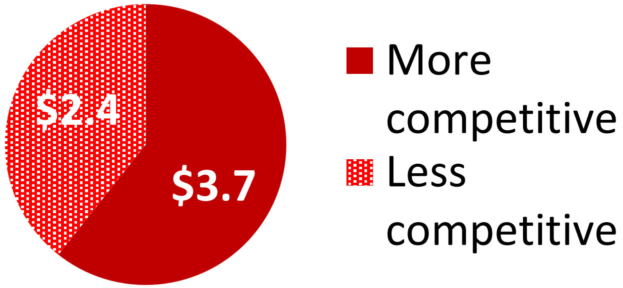
Pricing Actions – U.S. Business

2016 Revenue *(MRO potential in $ / year)*

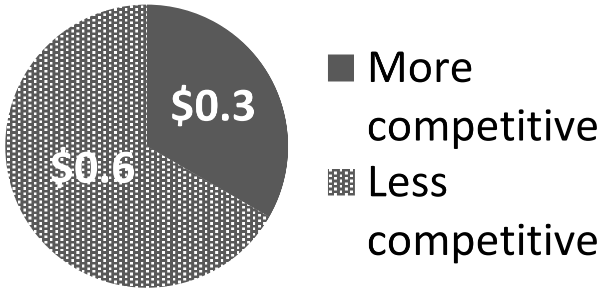
	Part of a multisite contract	Single-site/ local	Total
Large *(>$60K)*	*$4.3B*	*$1.1B*	*~$5.4B*
Medium *($10-60K)*	*$0.7B*	*$0.6B*	*~$1.3B*
Small *(<$10K)*	*$0.1B*	*$0.3B*	*~$0.4B*

By customer type

U.S. Large Customers 2016 Revenue $6.1B



U.S. Medium Customers 2016 Revenue $0.9B



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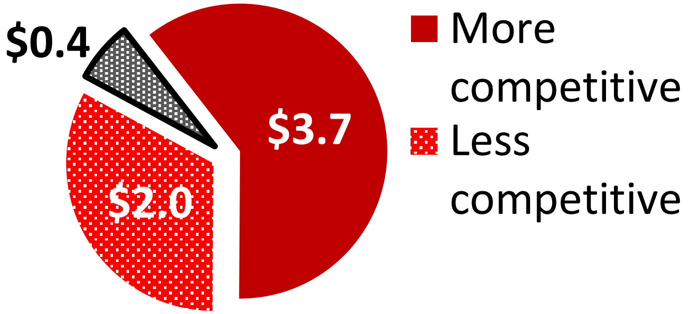
Note: Multichannel only. Does not include Zoro and Specialty Brands.

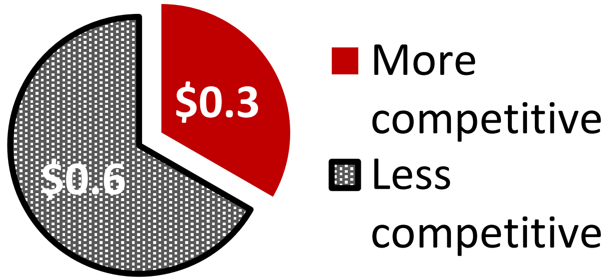
Pricing Actions – Deployment

By customer type

U.S. Large Customers
2016 Revenue $6.1B



U.S. Medium Customers
2016 Revenue $0.9B



By pricing strategy

$7B U.S. Business (Large and Medium)

$4B **More competitively priced – Large and Medium:**
- Continued volume growth, GP margin below average
- Increase prices as appropriate with inflation and other market factors

$2B **Less competitively priced – Large contract:**
- Declining volume, GP margin above average
- Recapture business with lower prices during contract negotiations

$1B **Less competitively priced – Large and Medium noncontract:**
- Declining volume, GP margin significantly above average
- Deploy web prices on all SKUs in Q3 and add marketing to acquire new customers

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2017 Guidance Ranges

	January 25, 2017	April 18, 2017 (with pricing acceleration)
Sales (% vs. prior year)	2% – 6%	1% – 4%
GP Margin (bps vs. prior year)	(70) – (40)	(190) – (130)
Op. Margin (bps vs. prior year)	(80) – (30)	(210) – (130)
EPS	$11.30 – $12.40	$10.00 – $11.30

2017 guidance updated to include the effect of the pricing acceleration and a 1 percent reduction in sales from foreign exchange

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