Q2 2018 Earnings Call

W.W. Grainger, Inc.

July 18, 2018

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 forward-looking 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 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

Chairman and Chief Executive Officer

Q2 Key Messages

- Sales and volume growth significantly outpaced the market
- **U.S.:** both the volume response to our pricing actions and the demand environment were strong
- **Canada:** the execution of our turnaround is progressing as planned
- **Other Businesses:** our single channel online and international businesses both expanded operating earnings in the quarter
- Second quarter performance exceeded expectations and we are raising 2018 guidance

Q2 2018 Reported Results – Total Company

($ in millions)	Q2 2018	Q2 2017	% vs. PY Fav/(Unfav)
Sales	$ 2,860	$ 2,615	9%
GP	1,111	1,040	7%
Op Expense	767	811	5%
Op Earnings	$ 344	$ 229	50%
EPS	**$ 4.16**	**$ 1.67**	**149%**

(% of sales)	Q2 2018	Q2 2017	bps vs. prior Fav/(Unfav)
GP Margin	38.8%	39.8%	(100)
Op Expense	26.8%	31.0%	420
Op Margin	12.0%	8.8%	320

- Reported results included restructuring items that resulted in a $15 million charge to operating earnings and had a $0.21 impact to EPS
- The remaining slides reference adjusted results, which exclude items outlined in the earnings release

Sales days were the same in Q2 2018 and Q2 2017. Results for 2017 have been restated due to adoption of *Accounting Standards Update (ASU) 2017-07, Compensation Retirement Benefits (Topic 715)*. See supplement on IR website.

Q2 2018 Adjusted Results – Total Company

($ in millions)		Q2 2018		Q2 2017	% vs. PY Fav/(Unfav)
Sales	$	2,860	$	2,615	9%
GP		1,112		1,043	7%
Op Expense		753		751	0%
Op Earnings	$	359	$	291	23%
EPS	**$**	**4.37**	**$**	**2.74**	**59%**

(% of sales)	Q2 2018	Q2 2017	bps vs. prior Fav/(Unfav)
GP Margin	38.9%	39.9%	(100)
Op Expense	26.3%	28.7%	240
Op Margin	12.6%	11.1%	150

- Sales up 9% vs. prior year
  - Volume up 9%
  - Price flat
  - FX favorability of 1%
  - Techni-Tool divestiture -1%
- Normalized GP rate of 39.2% declined 30 bps *(adjusted for revenue recognition change and annual sales meeting timing, see appendix)*
- GP rate better than expected driven by U.S. volume mix, price/cost spread and Canada price increases
- OpEx rate declined 190 bps *(adjusted for revenue recognition change, see appendix)*

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Note: Reference slides 26 and 27 for GAAP vs. non-GAAP reconciliation. Results for 2017 have been restated due to adoption of Accounting Standards Update (ASU) 2017-07, Compensation Retirement Benefits (Topic 715). See supplement on IR website. Numbers may not sum due to rounding.

Q2 2018 Adjusted Results – Other Businesses

($ in millions)	**Q2 2018**	**Q2 2017**	**% vs. PY** Fav/(Unfav)
Sales	$ 622	$ 527	18%
Op Earnings	$ 43	$ 27	59%

(% of sales)	**Q2 2018**	**Q2 2017**	**bps vs. prior** Fav/(Unfav)
Op Margin	7.0%	5.2%	180

- Sales up 18% vs. prior year
  - Price and volume up 14%
  - FX favorability of 4%
- Performance driven by 25% sales growth for single channel businesses, which continue to be a profitable growth driver
- International portfolio delivered solid organic growth with improving operating margin

Note: Single channel businesses include all Zoro businesses and MonotaRO in Japan. International portfolio includes Cromwell, Fabory, Mexico, Puerto Rico and China. Reference slide 26 and 27 for GAAP vs. non-GAAP reconciliation.

Q2 2018 Adjusted Results – Canada

(USD in millions)	Q2 2018	Q2 2017	% vs. PY Fav/(Unfav)
Sales	$ 177	$ 189	(6%)
Op Earnings	$ (2)	$ (7)	77%

(% of sales)	Q2 2018	Q2 2017	bps vs. prior Fav/(Unfav)
Op Margin	(0.9%)	(3.8%)	290

- Sales down 6% vs. prior year, down 10% in local currency
  - Price up 10%
  - Volume down 20%
- Normalized GP rate increased 455 bps *(adjusted for revenue recognition change)*
- Local currency operating expenses down 6% due to branch closures and cost reductions *(adjusted for revenue recognition change)*
- Operating margin better than expected due primarily to a higher GP rate as a result of market-based price increases and cost management

Q2 2018 Adjusted Results – United States

($ in millions)	**Q2 2018**	**Q2 2017**	**% vs. PY** Fav/(Unfav)
Sales	$ 2,175	$ 1,999	9%
Op Earnings	$ 356	$ 310	15%

(% of sales)	**Q2 2018**	**Q2 2017**	**bps vs. PY** Fav/(Unfav)
Op Margin	16.4%	15.5%	90

- Sales up 9% vs. prior year
  - Total volume up 11% including a 1% benefit from seasonal sales/holiday timing
  - Price -1%
  - Techni-Tool divestiture -1%
- Normalized GP rate of 39.8% declined 65 bps *(adjusted for revenue recognition change and annual sales meeting timing, see appendix)*
- Operating expenses were up 2% on 11% total volume growth *(adjusted for revenue recognition change, see appendix)*
- Operating margin better than expected as expense leverage more than offset GP rate decline

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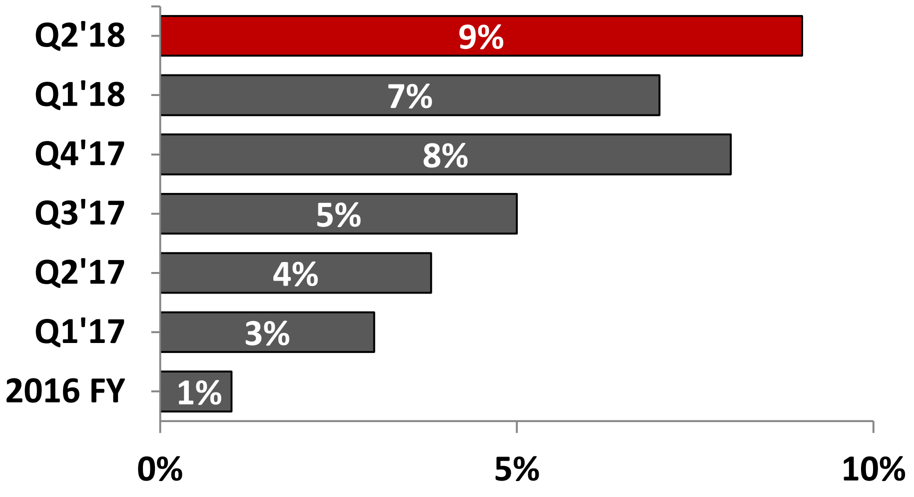
Note: Reference slide 26 and 27 for GAAP vs. non-GAAP reconciliation.

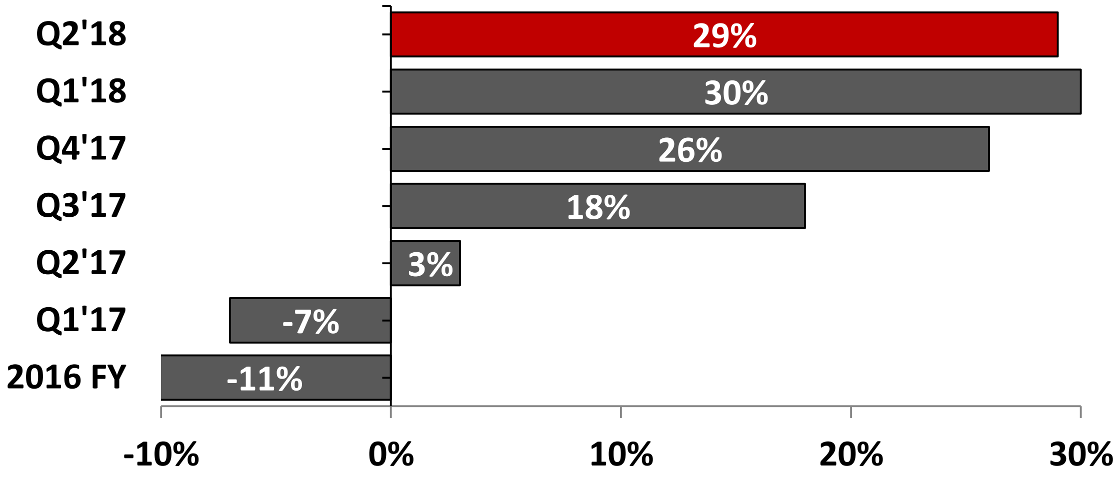
Customer Response to Pricing Reset Remains Strong

U.S. Large: daily volume growth on $6.2 billion of revenue



- U.S. Large volume growth of 9% in the quarter exceeded expectations
- Large customer share gains driven by strong value proposition, relevant pricing and digital marketing

U.S. Medium: daily volume growth on $0.9 billion of revenue



- U.S. Medium volume growth of 29% in the quarter exceeded expectations
- Increasing penetration with existing/lapsed customers and acquiring new customers

Note: U.S. Large revenue of $6.2 billion and U.S. Medium revenue of $0.9 billion as of 12/31/2017.
Total product COGS dollars (excludes freight, rebates and other adjustments) used as a proxy for volume.

Tom Okray

Senior Vice President and Chief Financial Officer

Q2 Financial Commentary

- **GP Rate:** Total company normalized GP rate of 39.2% declined 30 basis points
  - U.S. normalized GP rate declined 65 basis points
  - Canada normalized GP rate increased 455 basis points
- **Operating Margin:** Total company operating margin was 12.6%, up 150 basis points, driven by operating expense leverage on strong sales performance
- **EPS:** Total company EPS of $4.37 was up 59% versus the prior year driven by higher operating earnings and a lower tax rate
- **Cash Flow:**
  - Operating cash flow of $248 million was up 30% versus the prior year
  - Free cash flow of $211 million was up 32% versus the prior year

Note: Reference slide 27 for Free Cash Flow definition.

Raised 2018 Guidance Ranges

	As of 4/19/2018 2018E	As of 7/18/2018 2018E
Sales *($ billions)*	**$10.9 - $11.3**	**$11.0 - $11.3**
% vs. prior year	5% to 8%	5.5% to 8.5%
Op. Earnings *($ billions)*	**$1.2 - $1.3**	**$1.3 - $1.4**
% vs. prior year	6% to 14%	10% to 18%
Op. Margin	**11.1% - 11.5%**	**11.5% - 11.9%**
bps vs. prior year	10 to 50	50 to 90
EPS	**$14.30 - $15.30**	**$15.05 - $16.05**
% vs. prior year	25% to 33%	32% to 40%

- 2018 revenue now expected to grow 5.5% to 8.5% on strong Q2 performance and lower expected price deflation in the U.S. in the second half
- After normalizing for 50 bps related to revenue recognition, GP rate expected to decline between 50 bps and 20 bps
- Operating margin now expected to be 11.5% to 11.9% on improved GP rate and expense productivity

Note: Guidance as of 7/18/2018. Reference slide 26 and 27 for GAAP vs. non-GAAP reconciliation. Results for 2017 have been restated due to adoption of *Accounting Standards Update (ASU) 2017-07, Compensation Retirement Benefits (Topic 715)*. See supplement on IR website.

2018 U.S. Segment Price/Cost

	As of 4/19/2018 2018E	As of 7/18/2018 2018E
Total Price	**(1.5%)**	**(1.0%)**
Price Reset	(3.0%)	(2.5%)
Price Increases/Mix	1.5%	1.5%
COGS	(0.5%)	(0.5%)
Total	**(1.0%)**	**(0.5%)**

- Impact of pricing reset expected to improve
- Expectation of COGS deflation of -0.5% for 2018 remains consistent

Note: As of 7/18/2018.

Closing Remarks

Q&A

Appendix

Company: Revenue Recognition Change and National Sales Meeting

Total Company Q2 2018

($ billions)	Q2 Actuals		Excl. Rev. Rec. Change	
	Q2 2018	% vs. PY Fav/(Unfav)	Q2 2018	% vs. PY Fav/(Unfav)
Sales	**$2.9**	**9%**	**$2.9**	**10%**
Gross Profit	1.1	7%	1.1	8%
Expenses	0.8	0%	0.8	(2%)
Op. Earnings	0.4	23%	0.4	23%
	% of Sales	**bps vs. PY** Fav/(Unfav)	**% of Sales**	**bps vs. PY** Fav/(Unfav)
GP	38.9%	(100)	39.4%	(50)

- New revenue recognition accounting standard reclassifies certain service costs from operating expense to cost of goods sold. There is a slight impact to revenue.
- Revenue recognition had a 50 bps impact on GP rate.
- GP rate normalized for revenue recognition and national sales meeting timing was down ~30 bps

% of Sales	2018 GP	2017 GP	bps vs. PY
Q2 Actual	38.9%	39.9%	(100)
Excl. Rev. Rec	39.4%	39.9%	(50)
Excl. Sales Meeting	39.2%	39.5%	(30)

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U.S.: Revenue Recognition Change and National Sales Meeting

U.S. Segment Q2 2018

	Q2 Actuals		Excl. Rev. Rec. Change	
($ billions)	**Q2 2018**	**% vs. PY** Fav/(Unfav)	**Q2 2018**	**% vs. PY** Fav/(Unfav)
Sales	**$2.2**	**9%**	**$2.2**	**9%**
Gross Profit	0.9	5%	0.9	7%
Expenses	0.5	1%	0.5	(2%)
Op. Earnings	0.4	15%	0.4	15%

% of Sales	**% of Sales**	**bps vs. PY** Fav/(Unfav)	**% of Sales**	**bps vs. PY** Fav/(Unfav)
GP	39.5%	(150)	40.0%	(95)

- New revenue recognition accounting standard requires a reclassification of certain service costs from operating expense to cost of goods sold. There is a slight impact to revenue.
- Revenue recognition had a 55 bps impact on GP rate.
- GP rate normalized for revenue recognition and national sales meeting timing was down ~65 bps.

% of Sales	**2018 GP**	**2017 GP**	**bps vs. PY**
Q2 Actual	39.5%	41.0%	(150)
Excl. Rev. Rec	40.0%	41.0%	(95)
Excl. Sales Meeting	39.8%	40.5%	(65)

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2018 Guidance: Sales Bridge

	Company 2018E	U.S. Segment 2018E
	7/18/2018	**7/18/2018**
Volume	6% to 8%	6.5% to 9.5%
Price	(1%) to 0%	(1.5%) to (0.5%)
Organic *(Daily)*	**5% to 8%**	**5% to 9%**
Other[1]	0.5%	(0.5%)
Total	**5.5% to 8.5%**	**4.5% to 8.5%**

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Note: As of 7/18/2018. 1. Other includes impact of sales day differences, weather/holiday timing, divestitures, FX and intercompany.

Restructuring Costs and Benefits

($Millions)	Cost '17	Cost '18E	Savings '17	Savings '18E	Savings '19E
U.S.	18	0 - 10	15	45 - 65	45 - 55
Canada	39	40 - 50	13	25 - 35	25 - 35
Colombia	37	0	2	0 - 5	0
Other Business Units	19	0 - 5	3	10 - 15	0
Total	**112**	**40 - 65**	**33**	**80 - 120**	**70 - 90**

Restructuring costs and savings averaging a 2-year payback

Note: As of 7/18/2018.

Quarterly Daily Sales

Q2 2018 Daily Sales by Month

Month	Company
April	11%
May	8%
June	9%
Q2	**9%**

Selling Days – 2017 and 2018

Month	2018	2017
1Q	64	64
2Q	64	64
3Q	63	63
4Q	64	63
Full Year	255	254

Q2 2018 Daily Sales vs. Q2 2017

Drivers	Company	United States	Canada	Other Businesses
Volume	9%	10%	(20%)	14%
Price	0%	(1%)	10%	
Foreign exchange	1%	n/a	4%	4%
Seasonal Sales/Holiday Timing	0%	1%		
Divestiture	(1%)	(1%)		
Change vs. Prior	**9%**	**9%**	**(6%)**	**18%**
% of Company Revenue	*100%*	*72%*	*6%*	*22%*

Q2 2018 U.S. Sales By Customer End Market

- Reseller: up Mid-Teens
- Government: up Mid-Teens
- Commercial: up Low Double Digits
- Heavy Manufacturing: up High Single Digits
- Natural Resources: up High Single Digits
- Retail: up High Single Digits
- Contractor: up High Single Digits
- Healthcare: up Mid-Single Digits
- Light Manufacturing: up Low Single Digits

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Note: An earlier version of the presentation said Government was up Mid-Double Digits. This has been corrected to Mid-Teens.

Q2 2018 Branch Summary

	Second Quarter 2018 Branch Summary				
	Branches 3/31/2018	Opened	Closed	Branches 6/30/2018	Distribution Centers 6/30/2018
United States	285	0	1	284	17
Canada	74	0	30	44	7
Other Businesses					
Fabory	44	0	0	44	2
Mexico	17	2	0	19	2
Cromwell	53	0	1	52	1
China	0	1	0	1	1
Puerto Rico	5	0	0	5	0
Dominican Republic	1	0	1	0	0
Japan	0	0	0	0	3
Peru	1	0	1	0	0
Total Other Businesses	121	3	3	121	9
Total	480	3	34	449	33

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Reported Segment Results

(in thousands of dollars)	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Sales				
United States	$ 2,175,106	$ 1,999,153	$ 4,282,792	$ 3,952,597
Canada	176,868	189,113	358,633	375,254
Other Businesses	622,153	526,560	1,210,245	1,023,967
Intersegment sales	(113,915)	(99,557)	(225,057)	(195,420)
Net sales to external customers	$ 2,860,212	$ 2,615,269	$ 5,626,613	$ 5,156,398
Operating earnings				
United States	$ 349,713	$ 309,460	$ 706,217	$ 619,102
Canada	(13,667)	(27,727)	(33,824)	(44,456)
Other Businesses	40,899	(14,222)	77,321	17,285
Unallocated expense	(32,959)	(38,431)	(70,898)	(70,350)
Operating earnings	$ 343,986	$ 229,080	$ 678,816	$ 521,581
Company operating margin	12.0%	8.8%	12.1%	10.1%
ROIC* for Company			28.4%	21.7%
ROIC* for United States			46.1%	39.7%
ROIC* for Canada			-13.9%	-16.4%

*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-to-date). Net working assets are working assets minus working liabilities defined as follows: working assets equal total assets less cash equivalents (3-point average of $96.7 million), deferred taxes, and investments in unconsolidated entities, plus the LIFO reserve (3-point average of $383.7 million). Working liabilities are the sum of trade payables, accrued compensation and benefits, accrued contributions to employees' profit sharing plans, and accrued expenses.

Q2 2017 and 2018 GAAP to Non-GAAP Reconciliations

	Three Months Ended June 30,			
	2018	Gross Profit %	2017	Gross Profit %
Gross profit reported	$ 1,110,941	38.8 %	$ 1,039,956	39.8 %
Restructuring (United States)	300	—	—	—
Restructuring (Canada)	(34)	—	2,574	0.1
Restructuring (Other Businesses)	1,083	0.1	—	—
Subtotal	1,349	0.1	2,574	0.1
Gross profit adjusted	$ 1,112,290	38.9 %	$ 1,042,530	39.9 %

	Three Months Ended June 30,			
	2018	Operating Margin %	2017	Operating Margin %
Operating earnings reported	$ 343,986	12.0 %	$ 229,080	8.8 %
Restructuring (United States)	7,349	0.3	13,541	0.5
Branch gains (United States)	(1,385)	—	(13,438)	(0.5)
Restructuring (Canada)	12,018	0.4	20,485	0.8
Restructuring (Other Businesses)	2,372	0.1	41,510	1.5
Restructuring (Unallocated expense)	(5,058)	(0.2)	—	—
Subtotal	15,296	0.6	62,098	2.3
Operating earnings adjusted	$ 359,282	12.6 %	$ 291,178	11.1 %

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	%	2018	2017	%
Segment operating earnings adjusted						
United States	355,677	309,563		707,754	612,883	
Canada	(1,649)	(7,242)		(10,886)	(22,884)	
Other Businesses	43,271	27,288		80,868	58,795	
Unallocated expense	(38,017)	(38,431)		(75,586)	(70,350)	
Segment operating earnings adjusted	$359,282	$291,178	23%	$702,150	$578,444	21%
ROIC* for Company				29.3%	24.0%	
ROIC* for United States				46.2%	39.3%	
ROIC* for Canada				-4.5%	-8.4%	

*Adjusted ROIC is calculated as defined on slide 25 of this presentation, excluding the items adjusting operating earnings as noted above.

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Q2 2017 and 2018 GAAP to Non-GAAP Reconciliations

	Three Months Ended June 30,			Six Months Ended June30,		
	2018	2017	%	2018	2017	%
Net earnings reported	$ 236,981	$ 97,921	142%	$ 468,516	$ 272,665	72%
Restructuring (United States)	5,589	11,161		7,948	13,081	
Branch gains (United States)	(1,053)	(8,419)		(6,778)	(14,300)	
Restructuring (Canada)	8,880	16,498		17,210	17,301	
Restructuring (Other Businesses)	2,270	43,969		3,220	43,969	
Restructuring (Unallocated expense)	(3,847)	—		(3,566)	—	
Subtotal	11,839	63,209		18,034	60,051	
Net earnings adjusted	$ 248,820	$ 161,130	54%	$ 486,550	$ 332,716	46%
Diluted earnings per share reported	$ 4.16	$ 1.67	149%	$ 8.23	$ 4.61	79%
Pretax adjustments:						
Restructuring (United Sates)	0.13	0.23		0.19	0.28	
Branch gains (United States)	(0.02)	(0.23)		(0.16)	(0.39)	
Restructuring (Canada)	0.21	0.35		0.40	0.37	
Restructuring (Other Businesses)	0.04	0.71		0.06	0.70	
Restructuring (Unallocated expense)	(0.09)	—		(0.08)	—	
Total pretax adjustments	0.27	1.06		0.41	0.96	
Tax effect (1)	(0.06)	0.01		(0.09)	0.05	
Total, net of tax	0.21	1.07		0.32	1.01	
Diluted earnings per share adjusted	$ 4.37	$ 2.74	59%	$ 8.55	$ 5.62	52%

Free Cash Flow	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net cash provided by operating activities	$247,954	$191,232	$394,839	$372,178
Less:				
Additions to property, building and equipment	53,934	52,379	103,083	131,147
Add:				
Proceeds from the sale of assets	17,293	21,452	43,280	69,758
Free Cash Flow	$211,313	$160,305	$335,036	$310,789

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(1) The tax impact of adjustments is calculated based on the income tax rate in each applicable jurisdiction, subject to deductibility limitations and the Company's ability to realize the associated tax benefits

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