1Q12 Earnings Release Podcast Script
April 17, 2012

Introduction

Hello, this is Laura Brown, Senior Vice President of Communications and Investor Relations. With me is Bill Chapman, Senior Director of Investor Relations. We are pleased to share with you some information regarding Grainger's first quarter 2012 results via this audio web cast. Please also reference our 2012 first quarter earnings release issued today, April 17th, in addition to other information available on our Investor Relations website, to supplement this web cast.

Before we begin, please remember that certain statements and projections of future results made in the press release and in this web cast constitute forward-looking information. These statements are based on current market conditions and competitive and regulatory expectations and involve risk and uncertainty. Please see our Form 10-K for a discussion of factors that relate to forward-looking statements.

Company Results Summary

Strong sales growth and consistent execution was the story for the quarter. This performance was largely driven by continued enhancements to the foundation of our business and aggressive investment in our growth programs. As a result of the strong start to 2012, we have increased and narrowed the ranges for our sales and EPS guidance as referenced in today's earnings release. We now expect sales to grow 12 to 14 percent and are forecasting EPS of $10.40 to $10.80 for the full year 2012. At the end of this recording we'll talk more about our revised guidance and our assumptions.

We'll start with total company results, and then take a closer look at our segments. Company sales increased 16 percent versus the 2011 first quarter. We had 64 selling days in both quarters. Operating earnings increased 16 percent, while net earnings increased 19 percent. As highlighted in our release, earnings per share of $2.57 for the quarter is an all-time company record and represents an 18 percent increase versus 2011.

In a few moments we'll take a closer look at sales results for the quarter; let's now walk down the operating section of the income statement. Gross profit margins increased 40 basis points to 44.4 percent, as we successfully expanded gross margins across the business. Due to our size and scale, we were able to increase prices with the market and ahead of product cost inflation. We'll provide more detail when we review the business by segment.

It is important to note that our gross profit margin follows a fairly consistent annual pattern, with generally highest gross margins in the first quarter. This is primarily driven by supplier funding for our annual customer trade shows in the quarter.

Company operating margins were essentially flat with the prior year at 13.9 percent. This was a function of strong sales growth and gross margin expansion, offset by higher operating expenses driven by Fabory's incremental expenses, growth-related spending and higher corporate expenses including stock-based compensation and expenses related to M&A activity and other corporate support expenses.

.

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 revised 2012 guidance.

Quarterly Sales

As mentioned earlier, company sales increased 16 percent for the quarter. Daily sales growth by month was as follows: 17 percent in January, 18 percent in February, and 15 percent in March. Of the 16 percent sales growth for the quarter, volume contributed 10 percentage points, acquisitions added 5 percentage points and price added 3 percentage points. Foreign exchange and lower sales of seasonal products each represented a 1 percentage point drag on daily sales growth for the quarter.

Let’s move on to sales by segment. We report two segments, the United States and Canada. Our remaining operations in Asia, Europe and Latin America are reported under a grouping titled Other Businesses.

Sales in the United States, which account for about 77 percent of total company revenue, increased 11 percent in the quarter, consisting of 9 percent volume growth and 3 percent from price, partially offset by a drag of 1 percentage point due to lower sales of seasonal products. By month, daily sales in the United States were up 11 percent in January, up 12 percent in February and up 9 percent in March.

Now we'll cover sales performance by customer end market in the United States. We believe that increasing our product line, expanding customer sales coverage and increasing our eCommerce capabilities is enabling the company to grow faster than the economy and gain additional market share. As a result, sales to every customer end market we serve in the United States, including Government, were positive in the quarter as follows:

- Natural Resources (formerly Agriculture and Mining) and Heavy Manufacturing were up mid-teens;
- Commercial, Retail and Light Manufacturing were up in the low double digits;
- Reseller was up in the high single digits; and
- Government and Contractors were up in the mid-single digits.

In the fourth quarter of 2010, we announced the possible divestiture of our Specialty Brands. Since that time, we have not received an acceptable offer. We plan to continue to operate the businesses and evaluate future options.

Now let's turn our attention to the Canadian business. Sales in Canada represent about 12 percent of total company revenues. For the quarter, sales in Canada increased 13 percent in U.S. dollars and 14 percent in local currency. On a daily basis in Canadian dollars, sales were up 19 percent in January, up 14 percent in February and up 11 percent in March. The 14 percent local currency sales growth in the quarter consisted of 13 percent volume growth and 1 percentage point from price. From a customer standpoint, sales growth in Canada was driven by strength in the construction, agriculture and mining, transportation, retail/wholesale and heavy manufacturing customer end markets.

Let's conclude our review of sales for the quarter by looking at the Other Businesses. Again, this group includes our operations in Asia, Europe and Latin America and currently represents about 11 percent of total company sales. Sales for this group increased 104 percent, the result of strong growth in Japan and Mexico, coupled with the incremental sales from Fabory, our business in Europe acquired in August of 2011. Excluding Fabory, sales for our Other Businesses increased 33 percent.

Beginning in the second quarter, our Other Businesses will include the results of our newly acquired business in Brazil. This business, formerly known as AnFreixo S.A., is a leading broad line distributor of maintenance, repair and operating (MRO) supplies and had 2011 sales of approximately $37 million USD. The acquisition provides us with a solid entry point for physical operations in Brazil, the largest MRO market in Latin America.

March Sales

Earlier in the quarter, we reported sales results for January and February and shared some information regarding sales performance in the month. Let's now take a closer look at March. There were 22 selling days in March of 2012, one less than 2011. Total company sales were up 15 percent on a daily basis in March of 2012 versus March of 2011. The 15 percent growth consisted of 8 percent volume growth, 3 percentage points from price inflation and 5 percentage points from acquisitions, partially offset by a 1 percentage point drag from foreign exchange.

In the United States, March daily sales were up 9 percent. This growth consisted of 6 percentage points of volume and 3 percentage points from price. Sales trends in March are more representative of our expectation for revenue growth going forward. Conversely, sales growth in January and February was unusually strong due to the following factors:

1. Customer pre-buying in advance of our February price increase, particularly in our lighting product line;
2. A higher advertising spend, and
3. Easier comparisons in January and February versus March.

Consistent with the quarter, we saw positive daily sales growth in March to each of our U.S. customer end markets as follows:

- Natural Resources increased in the low 20s;
- Heavy Manufacturing and Commercial increased in the low double digits;
- Light Manufacturing, Reseller and Retail were up in the high single digits;
- Government was up in the mid-single digits; and
- Contractor was up in the low single digits.

Daily sales in Canada for March increased 10 percent in U.S. dollars, up 11 percent in local currency. The 11 percent local currency daily sales growth consisted of 11 percent volume and 1 percentage point from price, partially offset by a 1 percentage point decline attributable to lower sales of seasonal products. Similar to the quarter, customers in the construction, agriculture and mining, transportation, retail/wholesale and heavy manufacturing customer end markets accounted for the largest increases in sales growth. The growth rate in March was influenced by difficult comparisons, particularly in the government sector, where spending reached record levels in 2011.

Daily sales for our Other Businesses increased 110 percent in March, the result of strong growth in Japan and Mexico, along with sales for our business in Europe. Excluding Fabory, sales for the Other Businesses increased 38 percent in March.

April Sales

Sales growth in the month of April started a bit slowly, primarily due to the religious holidays, but is expected to be roughly in line with the growth in March.

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

Operating Performance:

Thanks Laura.

Since we have already covered company operating performance, let's jump right into performance by segment. Operating earnings in the United States increased 17 percent versus the 2011 first quarter and operating margin increased 90 basis points to 17.6 percent. This performance was driven by 11 percent sales growth, higher gross margins and positive expense leverage. Gross profit margins for the quarter increased 10 basis points driven by price increases exceeding cost inflation, partially offset by higher freight costs and unfavorable mix as lower sales of seasonal products slowed the sales growth of private label products. Expense leverage in the United States was positive despite higher growth-related spending on new sales representatives, eCommerce and advertising.

Let's move on to our business in Canada. Operating earnings increased 24 percent versus the prior year, 26 percent in local currency. Strong sales growth, coupled with higher gross margins and effective cost management, contributed to operating margins increasing 100 basis points to 10.9 percent. Gross margins increased 60 basis points, primarily driven by improved customer mix and higher prices.

Operating performance for our Other Businesses improved versus a year ago, the result of our focus on improving growth and operating results. This group posted operating earnings of $11 million for the quarter versus $6 million a year ago. Strong operating performance in Japan and Mexico, coupled with $1 million in operating earnings from Fabory, drove the improved results for this group.

Other

Below the operating line, interest expense, net of interest income, was $2.5 million in the 2012 first quarter versus $1.4 million in the 2011 first quarter. The increase was primarily attributable to interest on the debt of €120 million used to finance a portion of the Fabory acquisition.

As mentioned at our November analyst meeting and in the 2011 Form 10-K, we were originally forecasting an effective tax rate of 37.9 percent for the full year 2012. In the 2012 first quarter, the effective tax rate was 37.4 percent, primarily due to higher earnings in foreign jurisdictions with lower tax rates and a lower blended state tax rate. The difference between the actual effective rate and the forecasted rate resulted in a $0.02 per share benefit for the quarter. We are now expecting the full year 2012 effective tax rate to be in the range of 37.4 to 37.7 percent.

Cash Flow

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $106 million versus $118 million in 2011. The year-over-year reduction in cash flow was driven by lower trade accounts payable balances due to the timing of inventory purchases and a higher contribution to the company's retirement plan tied to strong company performance and higher payroll expense in the prior year. We used the cash generated during the quarter to invest in the business and return $109 million to shareholders through share repurchase and dividends. Capital expenditures for the quarter were $41 million. We paid dividends of $47 million and bought back 291,000 shares of stock. As of quarter end, the company has approximately 6.8 million shares remaining on its share repurchase authorization.

2012 Guidance

As reported in our 2012 first quarter earnings release, we raised and narrowed both sales and earnings guidance for the full year 2012. We now expect sales growth in the range of 12 to 14 percent and EPS in the range of $10.40 to $10.80.

While our sales guidance is below our first quarter 2012 performance, we expect EPS to expand over the prior year at an increasing rate for the remainder of 2012. Let's look more closely at the underlying elements of our revised expectations:

- First, sales growth in the first quarter, particularly January and February, was stronger than we had forecasted.
- Second, unlike the first quarter, we are forecasting operating margin expansion, over prior year, in each remaining quarter in 2012. This expansion should come from a more even contribution from both gross margin expansion and better expense leverage. Gross profit margins in the second quarter should be higher than the prior year, but below the 2012 first quarter, which includes supplier support provided for the annual customer trade shows. Year-over-year, gross profit margins for the remaining quarters should exceed 2011, but will remain relatively consistent with second quarter 2012. Again, better expense and earnings leverage should come in the back half of the year as we lap our growth investments, such as new sales representatives and eCommerce.
- Third, our international businesses have posted improved performance, which we expect to continue. We believe Fabory will continue to deliver 3 to 6 cents of earnings accretion in 2012, while our newly acquired business in Brazil should be 3 to 5 cents dilutive this year.
- Finally, the lower tax rate of 37.4 to 37.7 percent forecasted for 2012 should contribute 4 to 9 cents per share for the full year. As noted earlier, the first quarter included about a 2 cent benefit from the lower tax rate versus our forecasted rate.

Conclusion

Thank you for your interest in Grainger. Please mark your calendar for our shareholders' meeting on Wednesday, April 25th and the release of April sales on Friday, May 11th.   If you have any questions, please do not hesitate to contact Laura Brown at 847.535.0409 or me at 847.535.0881.

Thank you.