GRAINGER
FOR THE ONES WHO GET IT DONE

3Q14 Earnings Podcast Script
October 16, 2014

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 2014 third quarter results. To supplement this podcast, please also reference our 2014 third quarter earnings release issued today, October 16th, in addition to other information available on our Investor Relations website.

Before we begin, please remember that certain statements and projections of future results made in the press release and in this podcast 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

Today we reported solid results for the 2014 third quarter driven by the strong performance of our U.S. business. Over the next 20 minutes or so, Bill and I will provide you with some additional insight relative to the quarter. Admittedly, there are many moving parts, so we thought it would make sense to start with the highlights from the quarter before we cover the details:

- Our U.S. business posted strong results reflected by the 90 basis point improvement to operating margins, fueled by 6 percent volume growth and solid expense leverage.
- In Canada, sales are now growing but margins are being pressured, as expected, due to unfavorable foreign exchange and increased investments in supply chain and IT.

- Earnings declined for our Other Businesses due to start-up costs for our single channel business in Europe and softer results from Fabory tied to a weaker economy in Europe.
- Our single channel businesses in Japan and the United States continue to perform well with strong top-line growth.
- We delivered 12 percent earnings per share growth despite absorbing $0.09 in the quarter related to a higher tax rate.

With that context, let's review the 2014 third quarter. Company sales increased 7 percent. Operating earnings increased 11 percent and net earnings increased 9 percent, reflecting the higher tax rate. Earnings per share were $3.30 for the quarter, an increase of 12 percent versus the 2013 third quarter.

Now, let's walk down the operating section of the income statement in more detail. Gross profit margins decreased 80 basis points to 43.0 percent versus 43.8 percent in 2013, primarily driven by the acquired businesses, faster growth from lower gross margin customers and lower gross profit margins in most of the international businesses. Company operating margin increased 50 basis points to 15.0 percent versus 14.5 percent in the prior year.

Operating expenses increased 2 percent including $17 million in incremental growth and infrastructure-related spending versus the 2013 third quarter. The lighter spending in the quarter was primarily related to timing of projects in distribution centers and IT. In addition, we also invested in our single channel start-up in Europe, which has accelerated in recent months. In the fourth quarter, growth spending is expected to accelerate including investments in sales force expansion and a new CRM, existing distribution center upgrades, eCommerce and the new single channel model. We are currently forecasting approximately $32 million in incremental growth and infrastructure spending in the 2014 fourth quarter, which brings our full year forecast to $100 million. (Please see Exhibit 4 for more detail.)

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 September;
- Second, operating performance by segment;
- Third, cash generation and capital deployment;
- And finally, we'll wrap up with a discussion of our 2014 guidance and other key items.

<u>Quarterly Sales</u>

As I previously mentioned, total company sales for the quarter increased 7 percent. The 7 percent growth included 2 percentage points from acquisitions, net of dispositions, and a 1 percentage point reduction from unfavorable foreign exchange. (Please see Exhibit 5 at the end of this podcast for more detail regarding acquisitions and divestitures.) Excluding acquisitions and foreign exchange, organic sales increased 6 percent driven by 6 percentage points from volume and 1 percentage point from price, partially offset by a 1 percentage point decline from lower sales of seasonal products. We realized 1 percentage point in price in the quarter and expect a rounded contribution of 1 percentage point for the year given better pricing compliance in the United States and a small price increase in Canada to compensate for COGS inflation tied to products imported from the United States. By month, daily sales increased 6 percent in July, 7 percent in August and 7 percent in September.

Let's move on to sales by segment. We report two business segments, the United States and Canada. Our remaining operations, located primarily in Asia, Europe and Latin America, are reported under a grouping titled Other Businesses, and also include results for the single channel businesses in Japan, the United States and Europe.

Sales in the United States, which accounted for 78 percent of total company revenues in the quarter, increased 7 percent. This sales growth included 2 percentage points from acquisitions, net of dispositions. These acquisitions are performing well and are delivering synergies in excess of our original expectations. (Please see Exhibit 5 for more detail on recent acquisitions.) Excluding acquisitions, organic sales increased 5 percent driven by 6 percentage points from volume, partially offset by a 1 percentage point decline from lower sales of seasonal products. Daily sales increased 7 percent in July, 8 percent in August and 8 percent in September.

Let's review U.S. sales performance by customer end market for the quarter:

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

Now let's turn our attention to our Canadian business. Sales in Canada represented 11 percent of total company revenues in the quarter and increased 3 percent, 8 percent in local currency. The 8 percent sales growth consisted of 5 percentage points from volume, 2 percentage points from acquisitions and 1 percentage point from price. Sales performance in Canada was led by solid growth to customers in the Commercial, Transportation, Government, and Heavy and Light Manufacturing end markets. By month, daily sales in local currency increased 1 percent in July, 6 percent in August and 15 percent in September, with the WFS Enterprises, Inc. (WFS) acquisition contributing 7 percentage points in the month. WFS expands our presence in Ontario and provides value through a broader product offering, additional solutions and technical expertise relevant to the manufacturing sector.

Let's wrap up our discussion of sales for the quarter by looking at the Other Businesses. The Other Businesses represented 11 percent of total company sales in the quarter. Sales for this group were up 16 percent and consisted of 18 percentage points from volume and price, partially offset by a 2 percentage points decline from unfavorable foreign exchange. The sales increase was primarily driven by the single channel businesses in Japan and the United States, and from the business in Mexico.

September Sales

Earlier in the quarter, we reported sales results for July and August and shared some information regarding performance in those months. Let's now take a look at September. There were 21 selling days in September of 2014 versus 20 days in the same month of 2013. Company sales increased 7 percent on a daily basis in September of 2014 versus September of 2013. The daily sales growth included 3 percentage points from acquisitions, net of dispositions, and a 1 percentage point reduction from foreign exchange. September was the first month to include sales from WFS. Excluding acquisitions and foreign exchange, organic sales increased 5 percent, primarily driven by volume.

In the United States, September daily sales increased 8 percent, which included 2 percentage points from acquisitions, net of dispositions. Excluding acquisitions, organic sales increased 6 percent on a daily basis driven by volume. Let's review sales performance by customer end market in the United States for the month of September:

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

Daily sales in Canada for September increased 9 percent in U.S. dollars and 15 percent in local currency. The 15 percent increase consisted of 7 percentage points from volume, 7 percentage points from the WFS acquisition and 1 percentage point from price. On an organic basis, all customer end markets contributed to the volume growth with the exception of Mining. Mining in Canada continues to be pressured by softness in the coal and potash sectors.

Daily sales for our Other Businesses increased 13 percent in September, consisting of 16 percentage points from volume and price, partially offset by a 3 percentage points drag from unfavorable foreign exchange. Similar to the quarter, daily sales growth in September was driven by the single channel businesses in Japan and the United States and the business in Mexico.

<u>October Sales</u>

Sales growth in the month of October is currently trending in line with the organic sales growth of 5 percent reported for September. Keep in mind that we are up against a difficult comparison as we anniversary the date we began reporting sales for E&R Industrial. As a reminder, our daily sales growth in October 2013 included 3 percentage points from acquisitions.

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

<u>Operating Performance</u>

Thanks Laura. Since we have already analyzed company operating performance, let's jump right into performance by reportable segment. Operating earnings in the United States increased 13 percent versus the 2013 third quarter. This performance was driven by the 7 percent sales growth and positive operating expense leverage. Gross profit margins for the quarter decreased 80 basis points versus the prior year. About half of the decline was driven by share gain among large customers, which carry lower margins, with the remaining half coming from lower gross margins from the recently acquired businesses. Operating expenses were essentially flat versus prior year and included incremental growth and infrastructure related spending of $12 million on areas such as new sales representatives, eCommerce and advertising. The operating margin for the U.S. segment increased 90 basis points to 18.9 percent versus 18.0 percent in the prior year.

Let's move on to our business in Canada. As expected, operating earnings were down versus the prior year, decreasing 14 percent in U.S. dollars. The lower operating performance was primarily the result of a lower gross profit margin and negative operating expense leverage. Gross profit margins declined 150 basis points primarily due to unfavorable foreign exchange from products sourced from the United States, lower supplier rebates and higher freight costs. The operating margin in Canada declined 180 basis points to 9.9 percent versus the prior year.

The Other Businesses generated $5 million in operating earnings in the 2014 third quarter versus $6 million in the 2013 third quarter. The earnings decline versus prior year was primarily driven by incremental expenses associated with the start-up of the single channel business in Europe and continued soft performance by Fabory in Europe. This decline was partially offset by improved performance in Mexico and the single channel models of Zoro in the United States and MonotaRO in Japan, along with reduced losses in China.

Other

Other income and expense of $3 million in the 2014 third quarter was flat versus the 2013 third quarter. The tax rate in the quarter was 39.1 percent versus 38.0 percent in the 2013 quarter. The increase was primarily due to a higher proportion of earnings from the U.S. segment with higher tax rates. As a result of the higher than expected tax rate, the quarter included approximately $0.09 per share in higher tax expense, consisting of $0.03 per share related to the third quarter and $0.06 per share for the first half of 2014. We now project an effective tax rate for the year 2014 of approximately 38.3 percent, excluding the effect of the $0.15 per share charge related to the Fabory retirement plan transition in the second quarter of 2014. The higher tax rate is expected to result in a $0.03 per share reduction in the fourth quarter, totaling $0.12 per share reduction for the full year 2014.

Cash Flow

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $329 million versus $354 million in 2013. Cash flow in the 2014 third quarter was lower primarily due to higher inventory purchases and higher accounts receivable. The company used the cash generated to invest in the business and return cash to shareholders through share repurchases and dividends. Capital expenditures for the quarter were $84 million versus $65 million in 2013. We paid dividends of $74 million, reflecting the 16 percent increase in the quarterly dividend announced in April of 2014. In addition, we bought back 336,000 shares of stock for $82 million and ended the quarter with 9.4 million shares remaining on our share repurchase authorization. In total, we returned $156 million to shareholders in the quarter.

2014 Guidance

As reported in our 2014 third quarter earnings release, we lowered the top end of our sales and earnings guidance for the year 2014. With nine months under our belt, we have better visibility and are able to narrow our ranges and reflect the higher effective tax rate for the year. We now expect 2014 earnings per share of $12.20 to $12.30, excluding the $0.15 per share charge for the Fabory retirement plan transition. With that as a backdrop, let's take a look at our current expectations. All comparisons are to prior year unless otherwise noted:

1. We'll begin with sales.
    a. For the full year, we now expect sales growth of 5.0 to 5.5 percent. We have also revised our full year price inflation estimate to 0.5 percent given better pricing compliance in the United States and a small price increase in Canada to compensate for COGS

inflation tied to products imported from the United States. (Details are provided in Exhibit 1.)

   b. For the fourth quarter, the new guidance implies roughly 4.0 to 5.5 percent reported daily sales growth. It is very important to note that the 2013 fourth quarter included a bit more than four months of sales for E&R Industrial, which we acquired on August 23, 2013. Adjusting for E&R and the other relevant acquisition and divestiture activity, we expect organic daily sales growth of 6.0 to 7.0 percent in the quarter.

2. Let's move on to gross profit margins.
   a. For the full year, we are forecasting gross margin contraction of about 20 basis points on a reported basis and expansion of about 10 basis points on an organic basis.
   b. For the fourth quarter, we are expecting gross profit margins to increase 90 basis points on a reported basis. The increase is primarily due to easy comparisons to the previous year driven by the acquired and international businesses.

3. Let's take a look at operating margins.
   a. For the full year, we expect operating margin expansion of 10 to 20 basis points on a reported basis. This includes $100 million in incremental growth and infrastructure spending for the year as detailed in Exhibit 3.
   b. For the fourth quarter, we are expecting operating margin expansion of about 80 to 100 basis points on a reported basis. This includes approximately $32 million in incremental growth and infrastructure spending. We also anticipate additional spending for productivity work, which is expected to drive better expense leverage in the future.

4. Finally, tax rate.
    a. We are forecasting an effective tax rate of 38.3 percent for the full year and for the 2014 fourth quarter. Again, this excludes the effect of the Fabory pension transition reported in the 2014 second quarter.
    b. The higher tax rate is expected to represent a $0.12 per share headwind for the full year, including $0.03 per share for the 2014 fourth quarter.

<u>Conclusion</u>

Please mark your calendar for the following important dates:

- On Wednesday, November 12th, we plan to release October sales, and we will host our Annual Analyst Meeting at our headquarters in Lake Forest, IL.
- On Thursday, November 13th, we will host a tour of our national distribution center in Minooka, IL. If you would like to register or have questions, please contact Linda D'Agostino at 847.535.4280 or email linda.d'agostino@grainger.com.

Thank you for your interest in Grainger. If you have any questions, please do not hesitate to contact Laura Brown at 847.535.0409, Casey Darby at 847.535.0099 or me at 847.535.0881.

Exhibit 1
Sales Guidance

	October 16, 2014	July 17, 2014	April 16, 2014	January 24, 2014	November 13, 2013
Economy/Volume	4.5% - 5%	5% - 7%	5% - 8%	4% - 8%	4% - 8%
Price	0.5%	0%	0% - 1%	1%	1%
Organic Sales	5% - 5.5%	5% - 7%	5% - 9%	5% - 9%	5% - 9%
F/X	-1%	-1%	-1%	-1%	0%
Acquisitions	1%	1%	1%	1%	1%
Company Sales	5% - 5.5%	5% - 7%	5% - 9%	5% - 9%	6% - 10%

Note: As of October 16, 2014.

Exhibit 2
2014 EPS Guidance
Total Company Reported

	October 16, 2014 (1)	July 17, 2014	January 24, 2014	November 13, 2013
Sales ($B)	$9.9 - $10.0	$9.9 - $10.1	$9.9 - $10.3	$10.1 - $10.4
V% vs. prior yr.	5% - 5.5%	5% - 7%	5% - 9%	6% - 10%
Op. Margin	14.3% - 14.3%	14.2% - 14.4%	14.2% - 14.6%	14.3% - 14.6%
bps vs. prior yr.	10 - 20	10 - 30	10 - 40	0 - 30
EPS	$12.20 - $12.30(2)	$12.20 – $12.60(2)	$12.10 - $12.85	$12.25 - $13.00

Notes: (1) As of October 16, 2014.
(2) Earnings per share guidance excludes $0.15 per share charge from the 2014 second quarter.
(3) Reiterated and did not change 2014 EPS guidance on April 16, 2014.

Exhibit 3
Q4 2014 EPS Guidance
Total Company Reported

	October 16, 2014
Sales ($B)	$2.5 - $2.5
V% vs. prior yr.	4% - 5.5%
Op. Margin	13.1% - 13.3%
bps vs. prior yr.	80 – 100
EPS	$2.75 - $2.85

Note: As of October 16, 2014.

Exhibit 4
Incremental Growth Spending
($ in Millions)

	2014 Incremental vs. 2013 (1)	2013 Incremental vs. 2012	2012 Incremental vs. 2011	2011 Incremental vs. 2010
1Q	$31	$22	$27	$7
2Q	$20	37	24	11
3Q	$17	40	19	19
4Q	$32E	31	1	30
FY	$100E (2)	$132	$71	$67

Notes:(1) As of October 16, 2014.
(2) The company expects 2014 incremental growth spending of $90-110 million. The $100 million estimate represents the mid-point of the range.

GRAINGER®
FOR THE ONES WHO GET IT DONE

Exhibit 5
Acquisition / Divestiture Schedule

Action	Segment	Date	Pre-acquisition Revenue
Acquired Techni-Tool	U.S.	December 31, 2012	$88 Million
Acquired E&R Industrial, Inc.	U.S.	August 23, 2013	$180 Million
Acquired Safety Solutions, Inc.	U.S.	December 3, 2013	$63 Million
Divested Specialty Brands	U.S.	December 31, 2013	$96 Million
Acquired WFS Enterprises, Inc.	Canada	September 2, 2014	$90 Million

Note: E&R results were first consolidated in the fourth quarter of 2013.

Exhibit 6
Selling Days: 2014 vs. 2013

Month	2014	2013	Difference
January	22	22	0
February	20	20	0
March	21	21	0
1Q	**63**	**63**	**0**
April	22	22	0
May	21	22	-1
June	21	20	1
2Q	**64**	**64**	**0**
July	22	22	0
August	21	22	-1
September	21	20	1
3Q	**64**	**64**	**0**
October	23	23	0
November	19	20	-1
December	22	21	1
4Q	**64**	**64**	**0**
Full Year	**255**	**255**	