Q4 2017 Earnings Call

W.W. Grainger, Inc.

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January 24, 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 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

Chairman and Chief Executive Officer

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FY 2017 Results – Total Company

	Reported		Adjusted	
($ in millions)	**FY 2017**	**% vs. PY**	**FY 2017**	**% vs. PY**
Sales	$ 10,425	3%	$ 10,425	3%
GP	4,098	0%	4,111	0%
Op Expense	3,049	2%	2,951	3%
Op Earnings	$ 1,049	-6%	$ 1,160	-8%
EPS	**$ 10.02**	**2%**	**$ 11.46**	**-1%**

(% of sales)	**FY 2017**	**bps vs. PY**	**FY 2017**	**bps vs. PY**
GP Margin	39.3%	(130)	39.4%	(130)
Op Expense	29.2%	(30)	28.3%	10
Op Margin	10.1%	(90)	11.1%	(140)

- 2017 reported results included adjustments that had a $112 million impact to operating earnings and a $1.44 impact to EPS
- The remaining slides reference adjusted results, which exclude items outlined in our Q4 press release

Note: Guidance as of 1/24/2018. Reference slides 25 and 26 for GAAP vs. non-GAAP reconciliation.

Q4 2017 Adjusted Results – Total Company

($ in millions)	**Q4 2017**	**Q4 2016**	**% vs. PY**
Sales	$ 2,632	$ 2,471	7%
GP	1,032	990	4%
Op Expense	747	715	4%
Op Earnings	$ 285	$ 275	4%
EPS	**$ 2.94**	**$ 2.45**	**20%**

(% of sales)	**Q4 2017**	**Q4 2016**	**bps vs. PY**
GP Margin	39.2%	40.1%	(90)
Op Expense	28.4%	28.9%	(50)
Expense/COGS	46.6%	48.3%	(170)
Op Margin	10.8%	11.1%	(30)

- Sales up 7% vs. prior year
  - Volume up 11%
  - Price down 3%
  - U.S. specialty divestiture down 1%
- GP dollars increased 4% as volume growth outpaced price deflation
- GP margin better than expected due to strong performance in the U.S. and Canada price increases
- Improved operating expense leverage on higher volume (Expense/COGS)

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Note: Sales days were the same in Q4 2017 and Q4 2016.

Q4 2017 Adjusted Results – Other Businesses

($ in millions)	Q4 2017	Q4 2016	% vs. PY
Sales	$ 559	$ 484	16%
Op Earnings	$ 25	$ 17	51%

(% of sales)	Q4 2017	Q4 2016	bps vs. PY
Op Margin	4.5%	3.4%	110

- Sales up 16% vs. prior year on a daily basis based on price and volume
- Single channel model continues to be a profitable growth driver
- International portfolio improving margins

Note: Single channel businesses include all Zoro businesses and MonotaRO in Japan. International portfolio includes Cromwell, Fabory, Mexico, other Latin America businesses and China.

Q4 2017 Adjusted Results – Canada

(USD in millions)	Q4 2017	Q4 2016	% vs. PY
Sales	$ 189	$ 181	5%
Op Earnings	$ -4	$ -11	59%

(% of sales)	Q4 2017	Q4 2016	bps vs. PY
Op Margin	-2.3%	-5.9%	360

- Sales up 5% vs. prior year, flat in local currency
  - Volume down 4%
  - Price up 4%
- Local currency operating expenses up 2% vs. prior year
- Operating margin better than expected due primarily to a higher GP rate as a result of price increases and a benefit from year-end inventory adjustments

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Q4 2017 Adjusted Results – United States

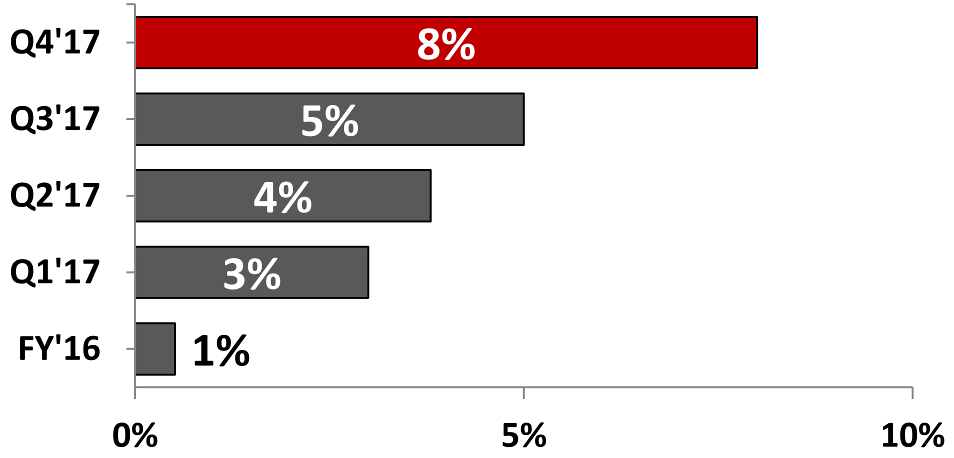
($ in millions)	Q4 2017	Q4 2016	% vs. PY
Sales	$ 1,992	$ 1,897	5%
Op Earnings	$ 299	300	-1%

(% of sales)	Q4 2017	Q4 2016	bps vs. PY
Op Margin	15.0%	15.8%	(80)

- Sales up 5% vs. prior year
  - Volume up 11%
  - Price down 5%
  - Specialty divestiture down 1%
- Operating expenses up only 2% on 11% volume growth
- Operating margin better than expected as expense leverage partially offset GP rate decline of 170 basis points

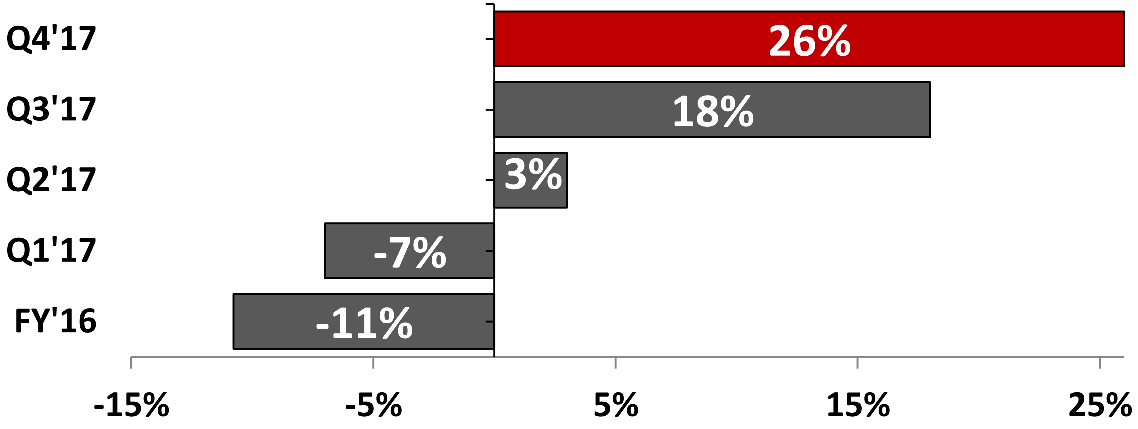
U.S. Volume Growth Exceeding Expectations

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



- Majority of Large customer contract negotiations completed
- Pricing changes allowing for better customer mix

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



- After historical declines, pricing and marketing actions enable significant share growth
- Increasing penetration with existing customers and acquiring new customers

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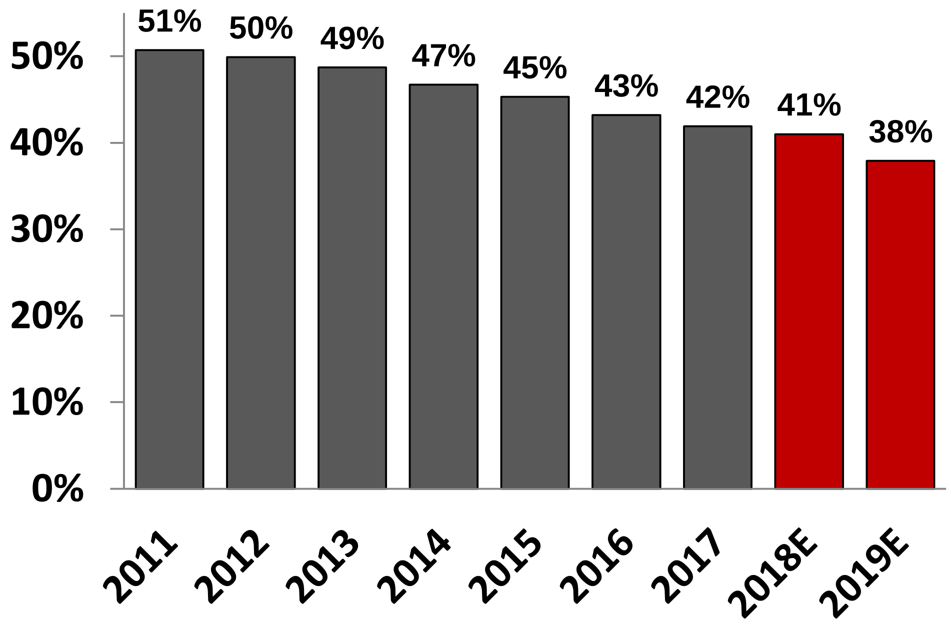
Note: Total product COGS dollars (excludes freight, rebates and other adjustments) used as a proxy for volume.

Expense Leverage and Productivity Improving

U.S. Expense to COGS (%)



Cost Takeout/Productivity

Expectations for 2018 and 2019 unchanged

- **U.S.: $90 - $120 million**
- **Canada: $50 - $70 million**
- **All other: $10 - $20 million**

Continue to expect $150–$210 million of cost takeout through 2019, net of digital investments

Note: Guidance as of 1/24/2018. Reference slides 25 and 26 for GAAP vs. non-GAAP reconciliation. U.S. expense to COGS expectations for 2018 and 2019 exclude revenue recognition accounting standard for comparability purposes.

2018 Guidance at the Midpoint

	As of 11/10/2017		As of 1/24/2018	
	2017E	**2018E**	**2017A**	**2018E**
Sales *($ billions)*	**$10.4**	**$10.9**	**$10.4**	**$10.9**
% vs. prior year	2%	5%	3%	5%
Op. Earnings growth (% vs. prior year)	**-13%**	**5%**	**-8%**	**2%**
Op. Margin	**10.7%**	**10.7%**	**11.1%**	**10.8%**
bps vs. prior year	(170)	0	(140)	(30)
EPS	**$10.65**	**$11.20**	**$11.46**	**$13.55**
% vs. prior year	-8%	5%	-1%	18%

- 2018 revenue still expected to grow 5% on better 2017 sales performance
- Raised operating margin expectations to 10.8% while investing additional 20 basis points in digital
- Holding Canada plan consistent to analyst meeting expectations
- Expect both higher sales and earnings dollars and a higher operating margin in 2018 given Q4 performance

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Note: Guidance as of 1/24/2018. Reference slides 25 and 26 for GAAP vs. non-GAAP reconciliation.
2018E sales growth guidance range is 3% to 7% and 2018E EPS guidance range is $12.95 to $14.15.

2018 Guidance vs. Analyst Meeting (at the Midpoint)

	Op. Margin	EPS
2018E (as of 11/10/2017)	**10.7%**	**$11.20**
2017 Performance:		
+ 2017 Op. Margin performance	0.4%	0.59
- Maintain Canada's 2018 Op. Margin at -2.5%	(0.1)%	(0.09)
Subtotal	**11.0%**	**$11.70**
2018 Incremental:		
- Lower tax benefit from clean energy		(0.10)
+ Lower corporate tax rate		2.15
- Incremental investment in digital	(0.2)%	(0.26)
+ Share repurchases		0.06
2018E (as of 1/24/2018)	**10.8%**	**$13.55**

- Operating margin guide improves to 10.8% even with incremental investment in digital
- Strong Q4 2017 operating performance flows into 2018 guidance, with exception of Canada
- Clean energy EPS benefit reduced to range of $0.05 to $0.10 due to coal plant closure
- Expected 2018 tax rate of 23% - 26%

Note: Guidance as of 1/24/2018. Reference slides 25 and 26 for GAAP vs. non-GAAP reconciliation.

Sources and Uses of Cash

	2017A	2018E	
		Low	High
Op. Cash Flow	$1,057	$1,100	$1,180
LT Debt	372	--	--
Asset Proceeds	120	30	30
Sources	**$1,549**	**$1,130**	**$1,210**
CapEx (gross)	$237	$290	$330
Share Repurchases	605	280	310
Dividends	304	310	320
ST Debt & Other	403	250	250
Uses	**$1,549**	**$1,130**	**$1,210**

2017:

- Generated $1.1 billion in operating cash flow vs. $1.0 billion in 2016; 3% increase
- CapEx was $237 million vs. $284 million in 2016
- Returned $910 million to shareholders through share repurchases and dividends

2018:

- Expect to generate strong operating cash flow, supplemented by cash benefit from tax reform. As a result:
  - Increasing investments in digital (CapEx)
  - Increasing share repurchases vs. November 2017 guide reflecting our confidence in the business

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Note: As of 1/24/2018. Financials are based on GAAP numbers.

Closing Remarks

Q&A

Appendix

2018 Guidance

	LOW	MID-PT	HIGH
Sales ($B)	$10.7	$10.9	$11.2
EPS	$12.95	$13.55	$14.15
Sales growth	3%	5%	7%
Op. Earnings growth	-2%	2%	6%
EPS growth	13%	18%	24%
Op. Margin	10.5%	10.8%	11.1%
Op. Margin bps vs. PY	(60) bps	(30) bps	0 bps

- Mid-single digit revenue growth on share gains and strong demand environment
- Gross profit rate expected to decline -130 bps *(-70 bps excluding accounting change)*
- Operating expense to sales expected to improve 100 bps *(40 bps excluding accounting change)* as productivity is partially offset by incremental digital investment
- Expected to result in operating margin decline of 30 bps vs. 2017 actuals

Note: As of 1/24/2018. See reconciliations on slides 25 and 26.

2018 Guidance Midpoint with Revenue Recognition Change

No impact to operating margin. Reclassification lowers operating expenses and increases cost of goods sold.

Total Company 2018E

	Before change		After change	
($ billions)	**FY 2018E**	**% vs. PY**	**FY 2018E**	**% vs. PY**
Sales	**$10.9**	**5%**	**$10.9**	**5%**
Gross Profit	4.2	3%	4.2	1%
Expenses	3.0	3%	3.0	1%
Op. Earnings	1.2	2%	1.2	2%
% of Sales	**FY 2018E**	**bps vs. PY**	**FY 2018E**	**bps vs. PY**
GP	38.7%	(70)	38.1%	(130)
EXP	27.9%	(40)	27.3%	(100)
OM	10.8%	(30)	10.8%	(30)

- New revenue recognition accounting standard requires a reclassification of certain service costs from operating expense to cost of goods sold
- Change lowers GP rate and operating expenses as a percent of sales by 60 bps. No impact to operating margin

Note: Guidance as of 1/24/2018. Reference slides 25 and 26 for GAAP vs. non-GAAP reconciliation.

2018 Guidance Midpoint with Accounting Changes – U.S.

No impact to operating margin. Reclassification lowers operating expenses and increases cost of goods sold.

U.S. Segment 2018E

	Before change		After change	
($ billions)	**FY 2018E**	**% vs. PY**	**FY 2018E**	**% vs. PY**
Sales	**$8.2**	**3%**	**$8.2**	**3%**
Gross Profit	3.2	1%	3.2	-1%
Expenses	2.0	2%	2.0	-1%
Op. Earnings	1.2	-1%	1.2	-2%
% of Sales	**FY 2018E**	**bps vs. PY**	**FY 2018E**	**bps vs. PY**
GP	39.4%	(90)	38.7%	(160)
EXP	24.8%	(20)	24.1%	(90)
OM	14.7%	(70)	14.7%	(70)

- New revenue recognition accounting standard requires a reclassification of certain service costs from operating expense to cost of goods sold
- Change lowers GP rate and operating expenses as a percent of sales by 70 bps. No impact to operating margin.

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Note: Guidance as of 1/24/2018. Reference slides 25 and 26 for GAAP vs. non-GAAP reconciliation.
Percentages reflect actual vs. rounded numbers.

Restructuring Costs and Benefits

($Millions)	Cost		Savings		
	'17	'18E	'17	'18E	'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**
- **Approximately 60% of 2017 and 40% of 2018E costs are non-cash**

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Note: As of 1/24/2018.

Quarterly Daily Sales

Q4 2017 Daily Sales vs. Q4 2016	Company	United States	Canada	Other Businesses
Volume	11%	11%	-4%	16%
Price	-3%	-5%	4%	
Foreign exchange	0%	n/a	5%	0%
Divestiture	-1%	-1%	0%	
Change vs. Prior	**7%**	**5%**	**5%**	**16%**
% of Company Revenue	*100%*	*72%*	*7%*	*21%*

Q4 2017 Daily Sales by Month	Company	United States	Canada	Other Businesses
October	6%	5%	6%	15%
November	8%	6%	9%	15%
December	5%	4%	-2%	17%
Q4	**7%**	**5%**	**5%**	**16%**

Note: 63 selling days in 2017; 63 selling days in 2016

Q4 2017 U.S. Sales By Customer End Market

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

Other Notes

Selling Days – 2016, 2017 and 2018

Month	2018	2017	2016
1Q	64	64	64
2Q	64	64	64
3Q	63	63	64
4Q	64	63	63
Full Year	255	254	255

2018 Earnings Dates

Quarter	Date
Q1	April 19, 2018
Q2	July 18, 2018
Q3	October 16, 2018
Q4	January 24, 2019

Q4 2017 Branch Summary

	Fourth Quarter 2017 Branch Summary				
	Branches 9/30/2017	Opened	Closed	Branches 12/31/2017	Distribution Centers 12/31/2017
United States	286	0	2	284	16
Canada	109	0	18	91	5
Other Businesses					
Fabory	69	0	25	44	2
Mexico	18	1	0	19	2
Cromwell	62	0	7	55	1
Colombia	4	0	4	0	1
China	0	0	0	0	1
Puerto Rico	5	0	0	5	0
Dominican Republic	1	0	0	1	0
Japan	0	0	0	0	2
Brazil	0	0	0	0	1
Peru	1	0	0	1	0
Total Other Businesses	160	1	36	125	10
Total	555	1	56	500	31

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2016 and 2017 GAAP to Non-GAAP Reconciliations

	Three Months Ended December 31, 2017	Three Months Ended December 31, 2016	%	Twelve Months Ended December 31, 2017	Twelve Months Ended December 31, 2016	%
Operating earnings reported	$ 239,939	$ 174,229	38%	$ 1,048,662	$ 1,119,497	(6)%
Restructuring (United States)	14,364	4,869		44,121	33,904	
Branch gains (United States)	(4,831)	(1,693)		(32,863)	(18,236)	
Other (gains)/charges (United States)	(1,487)	45,555		(4,510)	45,555	
Restructuring (Canada)	12,778	(501)		39,287	14,998	
Inventory reserve adjustment (Canada)	—	—		—	9,847	
Restructuring (Other Businesses)	13,720	—		55,020	—	
Other charges (Other Businesses)	—	52,318		—	52,318	
Restructuring (Unallocated expense)	10,593	—		10,593	8,947	
Subtotal	45,137	100,548		111,648	147,333	
Operating earnings adjusted	$ 285,076	$ 274,777	4%	$ 1,160,310	$ 1,266,830	(8)%

Note: The $45.1 million of restructuring and other (gains)/charges is composed of the following: United States: $1.5 million of cost of merchandise sold expense and $6.5 million of operating expense; Canada: $5.7 million of cost of merchandise sold expense and $7.1 million of operating expense; Other Businesses: $3.3 million of cost of merchandise sold expense and $10.4 million of operating expense; Unallocated expense: $10.6 million of operating expense.

	Three Months Ended December 31, 2017	Three Months Ended December 31, 2016	%	Twelve Months Ended December 31, 2017	Twelve Months Ended December 31, 2016	%
Segment operating earnings adjusted						
United States	298,570	300,263		1,219,886	1,336,074	
Canada	(4,332)	(10,657)		(37,251)	(40,517)	
Other Businesses	25,176	16,660		110,653	93,002	
Unallocated expense	(34,338)	(31,489)		(132,978)	(121,729)	
Segment operating earnings adjusted	$ 285,076	$ 274,777	4%	$ 1,160,310	$ 1,266,830	(8)%
Company operating margin adjusted	10.8%	11.1%		11.1 %	12.5 %	
ROIC* for Company				24.6 %	25.8 %	
ROIC* for United States				40.3 %	42.6 %	
ROIC* for Canada				(7.0)%	(7.1)%	

*Adjusted ROIC is calculated as defined on page 9, excluding the items adjusting operating earnings as noted above.

2016 and 2017 GAAP to Non-GAAP Reconciliations

	Three Months Ended December 31, 2017	Three Months Ended December 31, 2016	%	Twelve Months Ended December 31, 2017	Twelve Months Ended December 31, 2016	%
Net earnings reported	$ 151,059	$ 60,666	149%	$ 585,730	$ 605,928	(3)%
Restructuring (United States)	9,013	3,049		30,352	21,234	
Branch gains (United States)	(3,031)	(1,060)		(20,620)	(11,421)	
Other (gains)/charges (United States)	(933)	28,531		(2,830)	28,531	
Restructuring (Canada)	9,441	(370)		30,390	11,085	
Inventory reserve adjustment (Canada)	—	—		—	7,278	
Restructuring (Other Businesses	11,580	—		55,324	—	
Other charges (Other Businesses)	—	52,318		—	52,318	
Restructuring (Unallocated expense)	6,647	—		6,647	5,603	
U.S. tax legislation	(3,250)	—		(3,250)	—	
Discrete tax items	(12,123)	3,784		(12,123)	(9,378)	
Subtotal	17,344	86,252		83,890	105,250	
Net earnings adjusted	$ 168,403	$ 146,918	15%	$ 669,620	$ 711,178	(6)%

	Three Months Ended December 31, 2017	Three Months Ended December 31, 2016	%	Three Months Ended December 31, 2017	Three Months Ended December 31, 2016	
Diluted earnings per share reported	$ 2.63	$ 1.01	160%	$ 10.02	$ 9.87	2 %
Pretax adjustments:						
Restructuring (United States)	0.25	0.10		0.76	0.56	
Branch gains (United States)	(0.08)	(0.03)		(0.56)	(0.30)	
Other (gains)/charges (United States)	(0.03)	0.75		(0.08)	0.74	
Restructuring (Canada)	0.22	(0.01)		0.67	0.25	
Inventory reserve adjustment (Canada)	—	—		—	0.16	
Restructuring (Other Businesses)	0.24	—		0.94	—	
Other charges (Other Businesses)	—	0.87		—	0.85	
Restructuring (Unallocated expense)	0.18	—		0.18	0.15	
Total pretax adjustments	0.78	1.68		1.91	2.41	
Tax effect (1)	(0.21)	(0.30)		(0.21)	(0.55)	
U.S. tax legislation (2)	(0.06)	—		(0.06)		
Discrete tax items	(0.20)	0.06		(0.20)	(0.15)	
Total, net of tax	0.31	1.44		1.44	1.71	
Diluted earnings per share adjusted	$ 2.94	$ 2.45	20%	$ 11.46	$ 11.58	(1)%

(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.
(2) U.S. tax legislation reflects 2017 impact of the benefit of re-measurement of deferred taxes, partially offset by one-time deemed repatriation tax.

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