

Q4 2019 Earnings Call

W.W. Grainger, Inc.

Safe Harbor Statement and Non-GAAP Financial Measures

All statements in this communication, other than those relating to historical facts, are “forward-looking statements.” Forward-looking statements can generally be identified by their use of terms such as “anticipate,” “estimate,” “believe,” “expect,” “could,” “forecast,” “may,” “intend,” “plan,” “predict,” “project” “will” or “would” and similar terms and phrases, including references to assumptions. 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. 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 those in the forward-looking statements 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 technology initiatives; the implementation, timing and results 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; failure to comply with laws, regulations and standards; disruption of information technology or data security systems involving us or third parties on which we depend; general industry, economic, market or political conditions; general global economic conditions, including tariffs and trade issues and policies; currency exchange rate fluctuations; market volatility; commodity price volatility; labor shortages; facilities disruptions or shutdowns; higher fuel costs or disruptions in transportation services; pandemic diseases and natural and other catastrophes; unanticipated and/or extreme weather conditions; loss of key members of management; our ability to operate, integrate and leverage acquired businesses; changes in effective tax rates; our common stock, including volatility in our stock price; 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 daily sales in constant currency, 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.



GRAINGER

DG Macpherson
Chairman and Chief Executive Officer

The Grainger Edge

Our Purpose

We Keep the World Working

Our Aspiration

We relentlessly expand our leadership position by being the go-to partner for people who build and run safe, sustainable, and productive operations.

Our Strategy

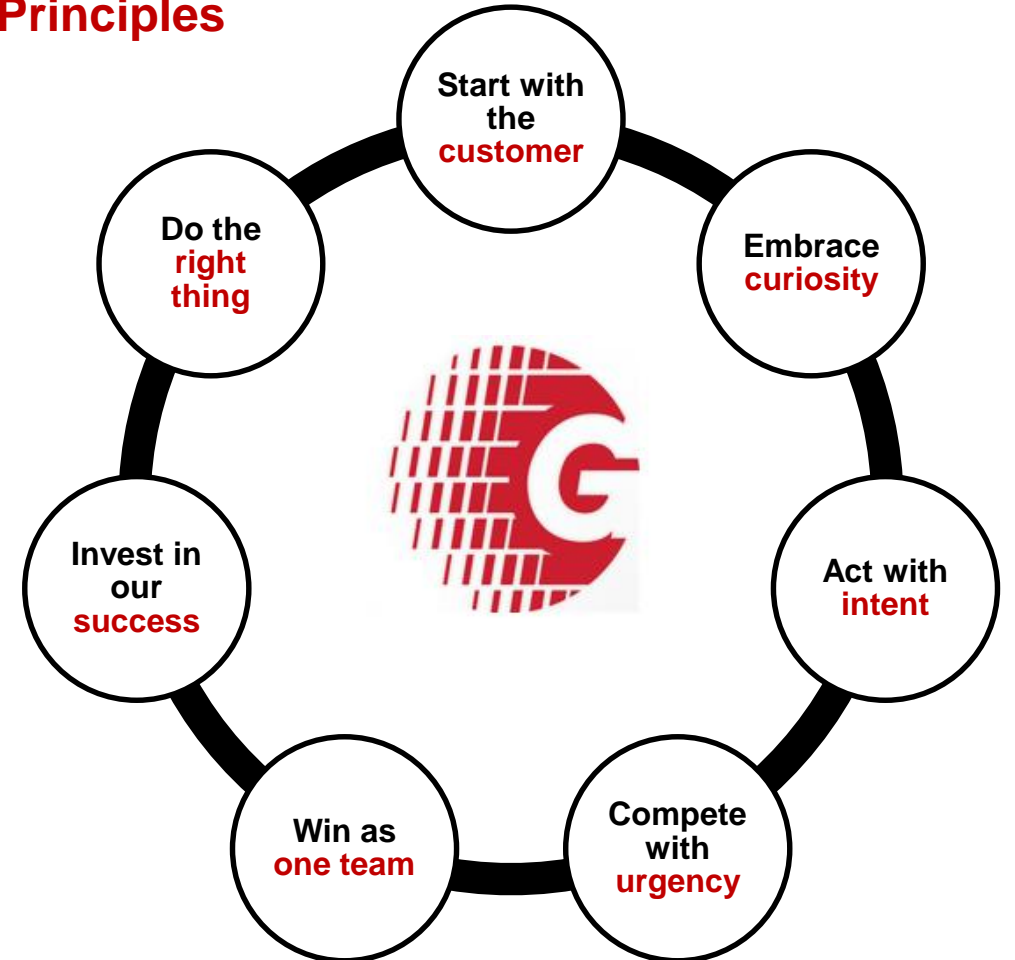
High-Touch Solutions Model

- Advantaged MRO solutions
- Differentiated sales and services
- Unparalleled customer service

Endless Assortment Model

- Expansive product assortment
- Innovative customer acquisition and retention capabilities

Our Principles



Setting the Foundation for Growth

Consistent investment strategy has strengthened market-leading position

✓ **Enhanced core U.S. Grainger business**

- Executed pricing reset
- Verticalized sales force
- Centralized call centers
- Restructured KeepStock® solution
- Added supply chain capacity
- Enhanced website
- Improved cost structure

✓ **Restructured Canadian business**

✓ **Implemented strategic investments at Zoro**

✓ **Improved MonotaRO delivery capabilities**

✓ **Shed unprofitable, non-core businesses abroad**

2019 Highlights

Delivered solid operating results despite challenging market conditions

- **Achieved sales, gross profit margin and EPS targets in line with guidance**
- **3% daily sales growth** (total company, on a constant currency basis)
- **Maintained flat SG&A**
- **Expanded operating margin by 10bps**
- **Returned over \$1 billion to shareholders** through dividends and buy backs
- Outgrew U.S. MRO market by 150bps - 200bps in FY'19; **gained momentum in 2H'19 including ~ 300 bps of outgrowth in Q4'19**
- Accomplished 2019 goal of **remerchandising \$1.2 billion of products in US**
- Delivered **19% growth in endless assortment** businesses
- **Added 1.5 million SKUs at Zoro**; developed new product information and analytics capabilities

Growth Priorities for 2020 & Beyond: *High-Touch Solution Model*

Near-term Priorities

- Remerchandise the assortment with strategic SKU adds
- Execute targeted, relevant, high return marketing
- Build advantaged digital and technology solutions
- Improve customer experience through enhanced network capacity and utilization
- Expand seller coverage; equip with better tools
- Deepen relationships through onsite services, KeepStock®
- Improve service and profitability of Cromwell and Grainger Canada

Expect to drive consistent outgrowth to MRO market

(including target of 300-400 bps annual outgrowth in U.S.)

Growth Priorities for 2020 & Beyond: *Endless Assortment*

Near-term Priorities

Return Zoro US to profitable growth

- Expect 10+ million SKUs in next 3-to-5 years
- Improve marketing capabilities
- Build deeper small business relationships

Continue Zoro UK path to profitability

- Customer acquisition
- Website enhancements
- Expand assortment

Ensure sustained MonotaRO growth – network enhancements, continued assortment growth

***Expect to
continue
producing
annual
growth of
~20%***



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Tom Okray

Senior Vice President and Chief Financial Officer



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Full Year & Fourth Quarter 2019 Results

FY 2019 Adjusted Results: *Total Company*

(\$ in millions)

	FY 2019	FY 2018	% vs. PY Fav/(Unfav)
Sales	\$ 11,486	\$ 11,221	2%
GP	4,397	4,348	1%
SG&A	3,009	3,004	—
Op Earnings	\$ 1,388	\$ 1,344	3%
EPS	\$ 17.29	\$ 16.70	4%

(% of sales)

	FY 2019	FY 2018	bps vs. PY Fav/(Unfav)
GP Margin	38.3%	38.7%	(50)
SG&A Margin	26.2%	26.8%	60
Op Margin	12.1%	12.0%	10

Daily sales increased 2.5%, 3% on a constant currency basis

- Volume up 2.5%
- Price up 0.5%
- Foreign exchange impact of negative 0.5%

Gross profit margin reflects impact of:

- Business unit mix
- Decline in endless assortment margins

SG&A dollars flat to prior year

Generated over \$1 billion of operating cash flow

Q4 2019 Adjusted Results: *Total Company*

(\$ in millions)

	Q4 2019	Q4 2018	% vs. PY Fav/(Unfav)
Sales	\$ 2,847	\$ 2,763	3%
GP	1,081	1,065	2%
SG&A	774	755	(3)%
Op Earnings	\$ 307	\$ 310	(1)%
EPS	\$ 3.88	\$ 3.96	(2)%

(% of sales)

	Q4 2019	Q4 2018	bps vs. PY Fav/(Unfav)
GP Margin	38.0%	38.5%	(50)
SG&A Margin	27.2%	27.3%	10
Op Margin	10.8%	11.2%	(40)

Daily sales increased 3.0%, no foreign exchange impact

- Volume up 3.5%
- Price down 0.5%

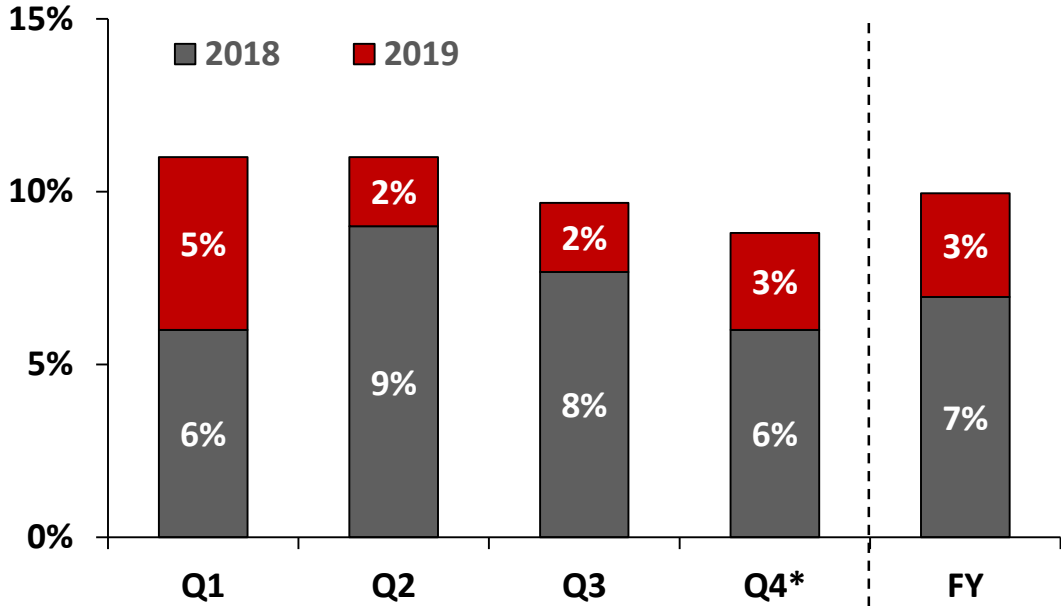
Gross profit margin declined 50 basis points vs. the prior year driven by

- Unfavorable business unit mix impact
- Mix shift within U.S. large customer group
- Partially offset by supply chain efficiencies in Canada

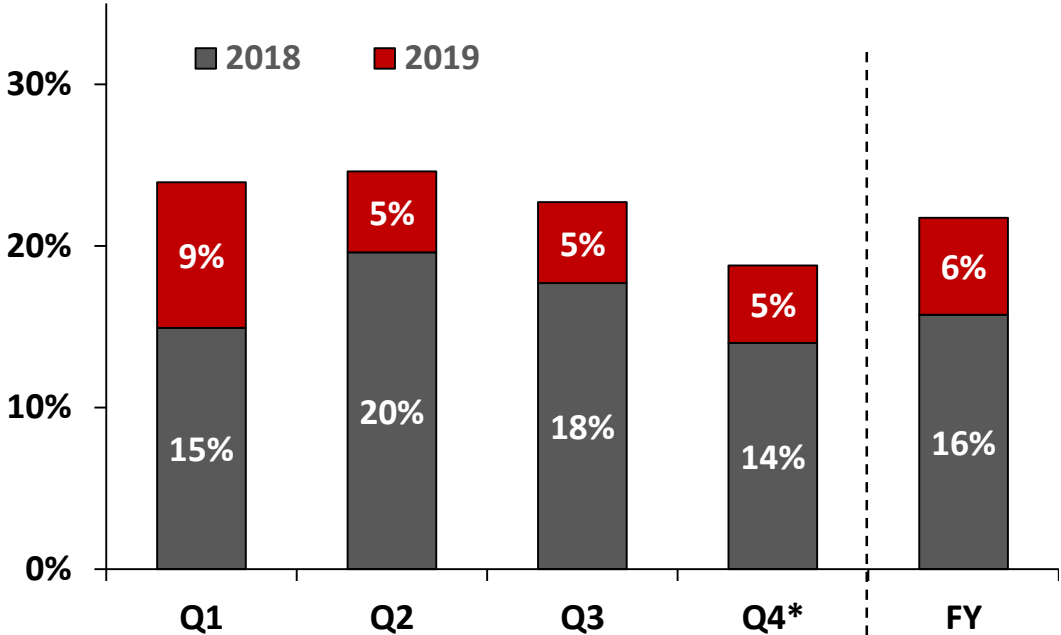
EPS unfavorable to Q4 2018 on slightly lower operating earnings and a higher tax rate in the current year period

U.S. Large and Midsize Sales Performance

U.S. Large: Daily sales growth on \$7.0 billion of revenue



U.S. Midsize: Daily sales growth on \$1.1 billion of revenue



U.S. MRO Market 2019

2-2.5% ~1% ~0% (1)-0% 0.5-1%

2-2.5% ~1% ~0% (1)-0% 0.5-1%

*Q4'18 sales are normalized for a negative 1 ppt. impact from Christmas/New Years timing. U.S. Large revenue of \$7.0 billion and U.S. Midsize revenue of \$1.1 billion is for the full-year ended 12/31/2019.

Q4 2019 Adjusted Results: *United States*

(\$ in millions)

	Q4 2019	Q4 2018	% vs. PY Fav/(Unfav)
Sales	\$ 2,167	\$ 2,117	2%
GP	835	837	—
SG&A	529	528	—
Op Earnings	\$ 306	\$ 309	(1)%

(% of sales)

	Q4 2019	Q4 2018	bps vs. PY Fav/(Unfav)
GP Margin	38.5%	39.5%	(100)
SG&A Margin	24.4%	25.0%	60
Op Margin	14.1%	14.6%	(40)

Daily sales increased 2.5%

- Volume up 3.0%
- Price down 1.0%
- Intercompany sales up 0.5%

Gross profit margin decline driven by:

- Mix shift within large customer subgroup
- Impact of intercompany sales
- Higher supplier rebates in prior year

Operating margin declined 40 bps vs. PY driven by lower gross profit margin, offset by SG&A leverage

Q4 2019 Adjusted Results: *Other Businesses*

(\$ in millions)

	Q4 2019		Q4 2018		% vs. PY Fav/(Unfav)
Sales	\$	682	\$	621	10%
GP		194		178	9%
SG&A		168		146	(16)%
Op Earnings	\$	26	\$	32	(20)%

(% of sales)

	Q4 2019		Q4 2018		bps vs. PY Fav/(Unfav)
GP Margin		28.6%		28.6%	(10)
SG&A Margin		24.8%		23.4%	(130)
Op Margin		3.8%		5.2%	(140)

Daily sales increased 9.5%, 7.5% on a constant currency basis

- Foreign exchange impact of positive 2.0%

Endless assortment sales growth of 18%

Operating margin declined 140 basis points driven primarily by investments in Zoro and performance at Cromwell

Note: In Q4'19, the company recorded a \$120 million write-down of substantially all of the remaining intangible assets of the Cromwell business. This write-down is excluded from Adjusted Results.

Q4 2019 Adjusted Results: *Canada*

(\$ in millions)

	Q4 2019		Q4 2018		% vs. PY Fav/(Unfav)
Sales	\$	129	\$	145	(11)%
GP		52		51	4%
SG&A		44		49	10%
Op Earnings	\$	8	\$	1	466%

(% of sales)

	Q4 2019		Q4 2018		bps vs. PY Fav/(Unfav)
GP Margin		41.2%		35.2%	595
SG&A Margin		34.7%		34.2%	(50)
Op Margin		6.4%		1.0%	545

Daily sales down 11.5%

- Price down 1.5%
- Volume down 10.0%
- No foreign exchange impact

Gross profit margin up 595 basis points vs. PY driven by supply chain efficiencies

Operating expenses down 10% vs. prior year quarter on continued cost take out



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2020 Guidance

2020 Guidance (Adjusted Results)

Expect solid sales and EPS growth in FY'20 despite a modest deceleration of U.S. MRO market

	2019A	2020 Guidance
Sales (\$ billions)	\$11.5	\$11.9 – \$12.2
<i>% vs. prior year (daily)*</i>	2.5%	3.5% – 6.5%
U.S. Market (price + volume)	0.5% – 1%	(1.5%) – 0.5%
U.S. Segment	2.5%	1% – 4%
Gross Profit Margin	38.3%	37.2% – 37.8%
<i>bps vs. prior year</i>	(50)	(110) – (50)
Op Margin	12.1%	11.7% – 12.5%
<i>bps vs. prior year</i>	10	(40) – 40
Tax Rate	24.8%	24.5% – 25.5%
EPS	\$17.29	\$17.75 – \$19.25
<i>% vs. prior year</i>	3.5%	3% – 11%

Sales

- Anticipate U.S. revenue to grow ~300bps faster than market
- Targeting endless assortment growth of ~20%
- Expect volumes to stabilize in Canada

Profitability

- Gross profit margin pressure from mix related to business unit and large customer headwinds
- Expect continued SG&A leverage to stabilize operating margin
- Continued pace of share repurchases accelerating EPS growth

2020 Guidance (Adjusted Results)

2020 operating margins expected to remain relatively stable

	2019A	2020 Guidance
U.S.	15.8%	15.6% – 16.0%
Other Businesses	4.2%	4% – 6%
Canada	0.6%	(2%) – 2%
Total Company	12.1%	11.7% – 12.5%

Expect operating cash flow to fund balanced capital allocation strategy

(\$ millions)	2019A	2020 Guidance
Op Cash Flow	\$1,042	\$1,100 – \$1,200
CapEx (accrued)	\$248	~ \$250
Share Repurchases	\$700	\$600 – \$700
Dividends	\$328	\$310 – \$320

Closing Remarks / Q&A

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Appendix

FY 2019 Reported Results: *Total Company*

(\$ in millions)

	FY 2019	FY 2018	% vs. PY Fav/(Unfav)
Sales	\$ 11,486	\$ 11,221	2%
GP	4,397	4,348	1%
SG&A	3,135	3,190	2%
Op Earnings	\$ 1,262	\$ 1,158	9%
EPS	\$ 15.32	\$ 13.73	12%

(% of sales)

	FY 2019	FY 2018	bps vs. PY Fav/(Unfav)
GP Margin	38.3%	38.7%	(50)
SG&A Margin	27.3%	28.4%	115
Op Margin	11.0%	10.3%	65

- 2019 reported results include adjustments that had a \$126 million impact to operating earnings and a \$1.97 impact to EPS
- The remaining slides reference adjusted results, which exclude items outlined in our Q4 press release

Q4 2019 U.S. Sales By Customer End Market

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

Quarterly Daily Sales

Company Q4 2019 Daily Sales	
Month	Reported Sales ⁽¹⁾
October	2.0%
November	5.0%
December	2.5%
Q4 Daily Sales	3.0%

Selling Days			
	2020	2019	2018
1Q	64	63	64
2Q	64	64	64
3Q	64	64	63
4Q	64	64	64
Full Year	256	255	255

Q4 2019 Daily Sales vs. Q4 2018

Drivers	Company	United States	Canada	Other Businesses
Volume	3.5%	3.0%	(10.0)%	7.5%
Price	(0.5)	(1.0)	(1.5)	—
Intercompany	—	0.5	—	—
Foreign Exchange	—	—	—	2.0
Change vs. Prior	3.0%	2.5%	(11.5)%	9.5%
<i>% of Company Revenue</i>	<i>100%</i>	<i>72%</i>	<i>4%</i>	<i>24%</i>

(1) Total company monthly sales performance is based on U.S. sales days. No foreign exchange impact in the quarter.

Q4 2019 GAAP to Non-GAAP Reconciliations

(in millions of dollars)

	Three Months Ended December 31,			
	2019	Gross Profit %	2018	Gross Profit %
Gross profit reported	\$ 1,082	38.0%	\$ 1,066	38.6%
Restructuring (United States)	—	—	(1)	(0.1)
Restructuring (Canada)	(1)	—	—	—
Gross profit adjusted	\$ 1,081	38.0%	\$ 1,065	38.5%

(in millions of dollars)

	Twelve Months Ended December 31,			
	2019	Gross Profit %	2018	Gross Profit %
Gross profit reported	\$ 4,397	38.3%	\$ 4,348	38.7%
Restructuring (United States)	—	—	(1)	—
Restructuring (Other businesses)	—	—	1	—
Gross profit adjusted	\$ 4,397	38.3%	\$ 4,348	38.7%

(in millions of dollars)

	Three Months Ended December 31,		%
	2019	2018	
Operating earnings reported	\$ 181	\$ 290	(37)%
Restructuring, net branch gains (United States)	3	3	
Restructuring (Canada)	1	12	
Restructuring (Other businesses)	2	2	
Impairment charges (Other businesses)	120	—	
Restructuring (Unallocated expense)	—	3	
Subtotal	126	20	
Operating earnings adjusted	\$ 307	\$ 310	(1)%

(in millions of dollars)

	Twelve Months Ended December 31,		%
	2019	2018	
Operating earnings reported	\$ 1,262	\$ 1,158	9%
Restructuring, net branch gains (United States)	4	8	
Restructuring (Canada)	—	35	
Restructuring (Other businesses)	2	6	
Impairment charges (Other businesses)	120	139	
Restructuring (Unallocated expense)	—	(2)	
Subtotal	126	186	
Operating earnings adjusted	\$ 1,388	\$ 1,344	3%

Note: The reconciliations above provide the information necessary to reconcile reported SG&A to adjusted SG&A, therefore no separate reconciliation is provided.

Q4 2019 GAAP to Non-GAAP Reconciliations

(in millions of dollars)

	Three Months Ended December 31,		%
	2019	2018	
Net earnings reported	\$ 103	\$ 209	(51)%
Restructuring, net of branch gains (United States)	2	2	
Restructuring (Canada)	1	10	
Restructuring (Other Businesses)	2	2	
Impairment charges (Other businesses)	104	—	
Restructuring (Unallocated expense)	—	2	
Subtotal	109	16	
Net earnings adjusted	\$ 212	\$ 225	(6)%

(in millions of dollars)

	Twelve Months Ended December 31,		%
	2019	2018	
Net earnings reported	\$ 849	\$ 782	8%
Restructuring, net of branch gains (United States)	3	6	
Restructuring (Canada)	—	26	
Restructuring (Other Businesses)	2	6	
Impairment charges (Other businesses)	104	133	
Restructuring (Unallocated expense)	—	(1)	
Subtotal	109	170	
Net earnings adjusted	\$ 958	\$ 952	1%

(in dollars per share)

	Three Months Ended December 31,		%
	2019	2018	
Diluted earnings per share reported	\$ 1.88	\$ 3.68	(49)%
Restructuring, net of branch gains (United States)	0.05	0.06	
Restructuring (Canada)	0.02	0.22	
Restructuring (Other businesses)	0.04	0.03	
Impairment charges (Other businesses)	2.19	—	
Total pretax adjustments	2.30	0.36	
Tax effect (1)	(0.30)	(0.08)	
Total, net of tax	2.00	0.28	
Diluted earnings per share adjusted	\$ 3.88	\$ 3.96	(2)%

(in dollars per share)

	Twelve Months Ended December 31,		%
	2019	2018	
Diluted earnings per share reported	\$ 15.32	\$ 13.73	12%
Restructuring, net of branch gains (United States)	0.08	0.15	
Restructuring (Canada)	—	0.6	
Restructuring (Other businesses)	0.04	0.11	
Impairment charges (Other businesses)	2.15	2.43	
Restructuring (Unallocated expense)	(0.01)	(0.03)	
Total pretax adjustments	2.26	3.26	
Tax effect (1)	(0.29)	(0.29)	
Total, net of tax	1.97	2.97	
Diluted earnings per share adjusted	\$ 17.29	\$ 16.70	4%

(1) The tax impact of adjustments and impairments are 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.

Q4 2019 GAAP to Non-GAAP Reconciliations

	Three Months Ended		Twelve Months Ended	
	December 31,		December 31,	
	2019	2018	2019	2018
<i>(in millions of dollars)</i>				
Sales				
United States	\$ 2,167	\$ 2,117	\$ 8,815	\$ 8,588
Canada	129	145	529	653
Other Businesses	682	621	2,651	2,441
Intersegment sales	(131)	(120)	(509)	(461)
Net sales to external customers	<u>\$ 2,847</u>	<u>\$ 2,763</u>	<u>\$ 11,486</u>	<u>\$ 11,221</u>
Operating earnings reported				
United States	\$ 303	\$ 306	\$ 1,391	\$ 1,338
Canada	7	(11)	3	(49)
Other Businesses	(96)	30	(9)	8
Unallocated expense	(33)	(35)	(123)	(139)
Operating earnings reported	<u>\$ 181</u>	<u>\$ 290</u>	<u>\$ 1,262</u>	<u>\$ 1,158</u>
Company operating margin reported	6.4%	10.5%	11.0%	10.3%
ROIC* for Company			26.6%	24.6%
ROIC* for United States			42.0%	43.2%
ROIC* for Canada			0.9%	(10.8)%

	Three Months Ended December 31,			
	2019	Operating Margin %	2018	Operating Margin %
	<i>(in millions of dollars)</i>			
Segment operating earnings adjusted				
United States	\$ 306	14.1%	\$ 309	14.6%
Canada	8	6.4%	1	1.0%
Other Businesses	26	3.8%	32	5.2%
Unallocated expense	(33)	N/A	(32)	N/A
Segment operating earnings adjusted	<u>\$ 307</u>	10.8%	<u>\$ 310</u>	11.2%

	Twelve Months Ended December 31,			
	2019	Operating Margin %	2018	Operating Margin %
	<i>(in millions of dollars)</i>			
Segment operating earnings adjusted				
United States	\$ 1,396	15.8%	\$ 1,346	15.7%
Canada	3	0.6%	(14)	(2.2)%
Other Businesses	113	4.2%	153	6.3%
Unallocated expense	(124)	N/A	(141)	N/A
Segment operating earnings adjusted	<u>\$ 1,388</u>	12.1%	<u>\$ 1,344</u>	12.0%
ROIC* for Company	29.3%		28.5%	
ROIC* for United States	42.1%		43.4%	
ROIC* for Canada	0.8%		(3.2)%	

*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 5-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 (5-point average of \$150.2 million), deferred taxes, and investments in unconsolidated entities, plus the LIFO reserve (5-point average of \$414.1 million). Working liabilities are the sum of trade payables, accrued compensation and benefits, accrued contributions to employees' profit sharing plans, and accrued expenses.

Q4 2019 GAAP to Non-GAAP Reconciliations

(in millions of dollars)

	<u>December 31,</u> <u>2019</u>
Condensed Consolidated Balance Sheet	
Short-term debt	\$ 55
Current maturities of long term debt	246
Long-term debt	<u>1,914</u>
Debt	<u>\$ 2,215</u>
Condensed Consolidated Statement of Earnings	
Net earnings	\$ 895
Income taxes	314
Other expense, net	53
Condensed Consolidated Statement of Cash Flows	
Depreciation and amortization	<u>229</u>
EBITDA	\$ 1,491
Restructuring, net and impairment charges	<u>126</u>
Adjusted EBITDA	<u>\$ 1,617</u>
Debt to Adjusted EBITDA	1.4

Note: Management believes the presentation of Debt to EBITDA ratio provides useful information regarding the Company's liquidity and leverage.

Non-GAAP Forward Looking Information

This communication also includes certain non-GAAP forward-looking information. The company believes that a quantitative reconciliation of such forward-looking information to the most comparable financial measure calculated and presented in accordance with GAAP cannot be made available without unreasonable efforts. A reconciliation of these non-GAAP financial measures would require the company to predict the timing and likelihood of future restructurings, asset impairments, and other charges. Neither of these forward-looking measures, nor their probable significance, can be quantified with a reasonable degree of accuracy. Accordingly, the most directly comparable forward-looking GAAP measures are not provided.

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