Q3 2018 Earnings Call

W.W. Grainger, Inc.

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October 16, 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 net sales growth, adjusted gross profit, adjusted gross profit margin, adjusted operating earnings, adjusted operating margin, adjusted net earnings, adjusted diluted earnings per share and adjusted tax rate, is available in the appendix to this presentation and our most recent earnings release.

DG Macpherson

Chairman and Chief Executive Officer

Tom Okray

Senior Vice President and Chief Financial Officer

Q3 Highlights

- Another solid quarter across the business
- **U.S.**: Strong share gains with U.S. Large and U.S. Medium customers even though we lapped 2017 price changes. Normalized gross margin and operating margin were favorable to prior year
- **Canada**: turnaround progressing on schedule
- **Single Channel**: continuing growth and profitability in MonotaRO and Zoro
- **International businesses**: growing and profitable; impairment for Cromwell reflects slower growth than planned at acquisition
- **Tariffs:** exposure is well understood and effectively managed

Q3 2018 Reported Results – Total Company

($ in millions)	Q3 2018	Q3 2017	% vs. PY Fav/(Unfav)
Sales	$ 2,831	$ 2,636	7%
GP	1,079	1,017	6%
Op Expense	890	739	(20%)
Op Earnings	$ 189	$ 278	(32%)
EPS	**$ 1.82**	**$ 2.79**	**(35%)**

(% of sales)	Q3 2018	Q3 2017	bps vs. prior Fav/(Unfav)
GP Margin	38.1%	38.6%	(50)
Op Expense	31.4%	28.1%	(330)
Op Margin	6.7%	10.5%	(380)

- Reported results included restructuring items that resulted in a $142 million charge to operating earnings; $2.37 impact to EPS
- Non-cash $139 million Cromwell impairment
- The remaining slides reference adjusted results, which exclude items outlined in the earnings release

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Sales days were the same in Q3 2018 and Q3 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.

Q3 2018 Adjusted Results – Total Company

($ in millions)	Q3 2018	Q3 2017	% vs. PY Fav/(Unfav)
Sales	$ 2,831	$ 2,636	7%
GP	1,079	1,018	6%
Op Expense	747	730	(2%)
Op Earnings	$ 332	$ 287	15%
EPS	**$ 4.19**	**$ 2.90**	**44%**

(% of sales)	Q3 2018	Q3 2017	bps vs. prior Fav/(Unfav)
GP Margin	38.1%	38.6%	(50)
Op Expense	26.4%	27.7%	130
Op Margin	11.7%	10.9%	80

- Sales up 7% vs. prior year
  - Volume up 7%
  - Price up 1%
  - Foreign exchange and hurricanes each had -40 bps impact
- Normalized GP rate of 38.6%, flat to prior year *(adjusted for revenue recognition change, see appendix)*
- Strong expense leverage continues
- EPS growth driven by both operating performance and below-the-line items

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Note: Reference slides 20 and 21 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.

Q3 2018 Adjusted Results – Other Businesses

($ in millions)	**Q3 2018**	**Q3 2017**	**% vs. PY** Fav/(Unfav)
Sales	$ 609	$ 537	13%
Op Earnings	$ 40	$ 27	50%

(% of sales)	**Q3 2018**	**Q3 2017**	**bps vs. prior** Fav/(Unfav)
Op Margin	6.6%	5.0%	160

- Sales up 13% vs. prior year
  - Price and volume up 14%
  - Foreign exchange down 1%
- Single channel revenue continues to grow at 23%
- International businesses were profitable, led by Mexico

Note: Single channel businesses include all Zoro businesses and MonotaRO in Japan. International portfolio includes Cromwell, Fabory, Mexico, Puerto Rico and China. Reference slides 19 and 20 for GAAP vs. non-GAAP reconciliation.

Q3 2018 Adjusted Results – Canada

(USD in millions)	**Q3 2018**	**Q3 2017**	**% vs. PY** Fav/(Unfav)
Sales	$ 150	$ 188	(20%)
Op Earnings	$ (5)	$ (10)	51%

(% of sales)	**Q3 2018**	**Q3 2017**	**bps vs. prior** Fav/(Unfav)
Op Margin	(3.3%)	(5.3%)	200

- Sales down 20% vs. prior year, down 17% in local currency
  - Price up 10%
  - Volume down 27%
- Gross profit margin up 430 basis points excluding non-recurring adjustments and normalizing for the revenue recognition adjustment
- Expect to exit Q4 with a positive operating margin run rate

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Note: Reference slides 19 and 20 for GAAP vs. non-GAAP reconciliation.

Q3 2018 Adjusted Results – United States

($ in millions)	Q3 2018	Q3 2017	% vs. PY Fav/(Unfav)
Sales	$ 2,188	$ 2,016	9%
Op Earnings	$ 330	$ 300	10%

(% of sales)	Q3 2018	Q3 2017	bps vs. PY Fav/(Unfav)
Op Margin	15.1%	14.9%	20

- Sales up 9% vs. prior year
  - Total volume up 8%
  - Price up 1%
  - Hurricanes had a -50 bps impact
- September sales normalized for the impact of the hurricanes grew at 8%
- Normalized GP rate of 39.4%, up 20 bps *(adjusted for revenue recognition change, see appendix)*

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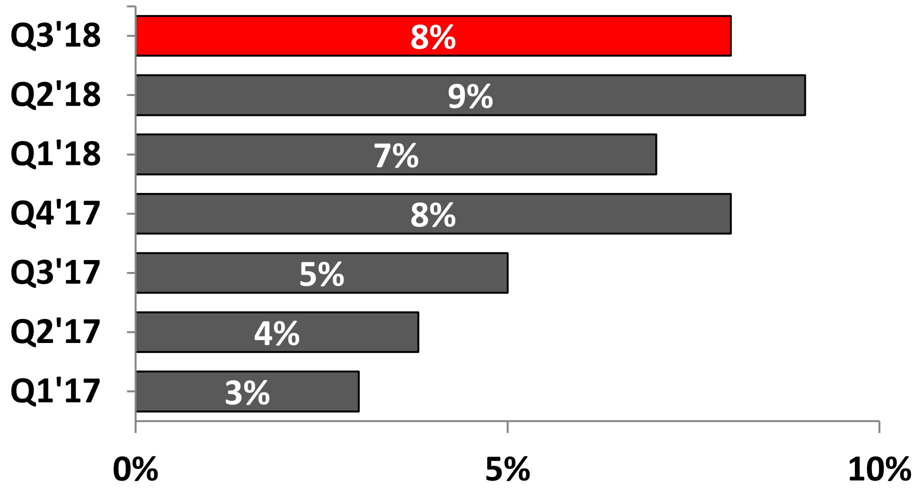
Note: Reference slides 19 and 20 for GAAP vs. non-GAAP reconciliation.

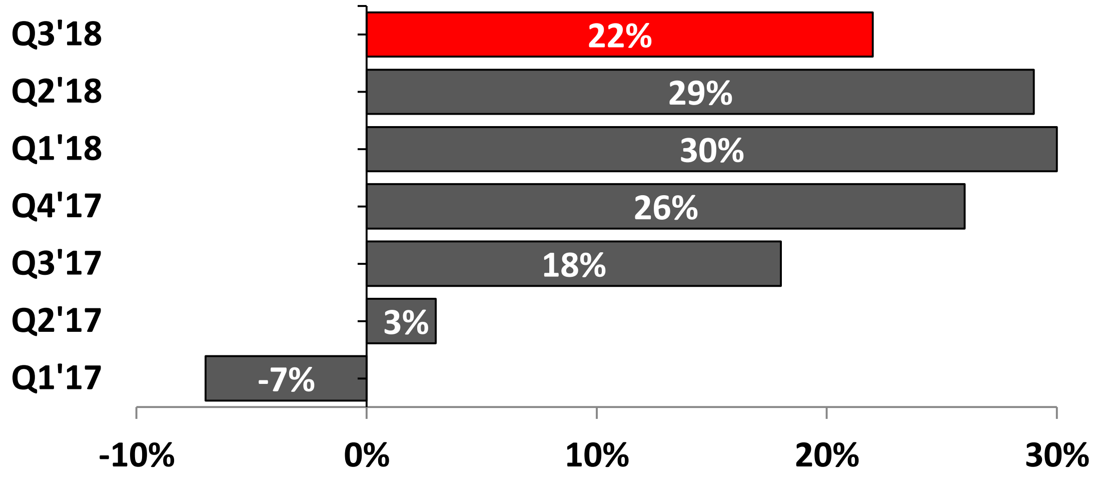
Customer Response to Pricing Reset Remains Strong

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



- Strong performance with Large non-contract customers; increasing spot buy purchases with contract customers
- Hurricane impact minimal in 2018 and 2017

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



- Continuing to add new customers at a steady pace
- Hurricane sales contributed 3% to growth in Q3 2017; 1% contribution in Q3 2018

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.

Estimated Tariff Exposure

Directly sourced from China:
~20% of U.S. Segment COGS

- National brands (majority)
- Internally sourced private label product

Subject to tariffs:
~50% of China product

- Roughly half of all Chinese imports covered by tariffs

Incremental tariffs of ~25%,
Increase in U.S. cost of ~2%

- Mitigating actions include:
  - Alternate sources
  - Pricing actions

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FOR THE ONES WHO GET IT DONE

Appendix

Quarterly Daily Sales

Q3 2018 Daily Sales by Month

Month	Company
July	9%
August	8%
September	6%*
Q3	**7%**

Selling Days – 2017 and 2018

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

Q3 2018 Daily Sales vs. Q3 2017

Drivers	Company	United States	Canada	Other Businesses
Volume	7%	8%	(27%)	14%
Price	1%	1%	10%	
Foreign Exchange/Hurricane	(1%)	n/a	(3%)	(1%)
Seasonal Sales/Holiday Timing	0%	0%	0%	
Change vs. Prior	**7%**	**9%**	**(20%)**	**13%**
% of Company Revenue	*100%*	*73%*	*5%*	*22%*

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* Note: September sales slowed sequentially due to impact of hurricanes and foreign exchange.

Company: Revenue Recognition Change

Total Company Q3 2018

	Q3 Actuals		Excl. Rev. Rec. Change	
($ billions)	**Q3 2018**	**% vs. PY** Fav/(Unfav)	**Q3 2018**	**% vs. PY** Fav/(Unfav)
Sales	**$2.8**	**7%**	**$2.8**	**7%**
Gross Profit	1.1	6%	1.1	8%
Expenses	0.7	(2%)	0.8	(5%)
Op. Earnings	0.3	15%	0.3	15%
	% of Sales	**bps vs. PY** Fav/(Unfav)	**% of Sales**	**bps vs. PY** Fav/(Unfav)
GP	38.1%	(50)	38.6%	0

- 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 was flat versus prior year.

Note: Numbers may not foot due to rounding.

U.S.: Revenue Recognition Change

U.S. Segment Q3 2018

($ billions)	Q3 Actuals: Q3 2018	Q3 Actuals: % vs. PY Fav/(Unfav)	Excl. Rev. Rec. Change: Q3 2018	Excl. Rev. Rec. Change: % vs. PY Fav/(Unfav)
Sales	**$2.2**	**9%**	**$2.2**	**9%**
Gross Profit	0.9	8%	0.9	9%
Expenses	0.5	(6%)	0.5	(9%)
Op. Earnings	0.3	10%	0.3	10%
	% of Sales	**bps vs. PY** Fav/(Unfav)	**% of Sales**	**bps vs. PY** Fav/(Unfav)
GP	38.9%	(35)	39.4%	20

- 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 was up 20 bps.
- Operating expense growth of 9% includes a variable compensation YTD true-up. Normalized operating expense growth is 5%.

Note: Numbers may not foot due to rounding.

Q3 2018 U.S. Sales By Customer End Market

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

Reported Segment Results

(in thousands of dollars)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Sales				
United States	$ 2,188,324	$ 2,015,968	$ 6,471,116	$ 5,968,565
Canada	149,782	188,216	508,414	563,470
Other Businesses	609,317	536,927	1,819,562	1,560,894
Intersegment sales	(115,994)	(105,112)	(341,050)	(300,532)
Net sales to external customers	$ 2,831,429	$ 2,635,999	$ 8,458,042	$ 7,792,397
Operating earnings				
United States	$ 326,273	$ 294,603	$ 1,032,491	$ 913,705
Canada	(4,051)	(14,972)	(37,875)	(59,428)
Other Businesses	(99,831)	26,892	(22,509)	44,177
Unallocated expense	(33,269)	(28,785)	(104,169)	(99,135)
Operating earnings	$ 189,122	$ 277,738	$ 867,938	$ 799,319
Company operating margin	6.7%	10.5%	10.3%	10.3%
ROIC* for Company			24.5%	22.3%
ROIC* for United States			44.7%	39.7%
ROIC* for Canada			-10.7%	-14.7%

*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 4-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 (4-point average of $141.0 million), deferred taxes, and investments in unconsolidated entities, plus the LIFO reserve (4-point average of $384.8 million). Working liabilities are the sum of trade payables, accrued compensation and benefits, accrued contributions to employees' profit sharing plans, and accrued expenses.

Q3 2017 and 2018 GAAP to Non-GAAP Reconciliations

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2018	Gross Profit %	2017	Gross Profit %	2018	Gross Profit %	2017	Gross Profit %
Gross profit reported	$ 1,079,235	38.1%	$ 1,017,180	38.6%	$3,281,935	38.8%	$ 3,076,328	39.5%
Restructuring, net (1)	(141)	—	481	—	820	—	3,055	—
Gross profit adjusted	$ 1,079,094	38.1%	$ 1,017,661	38.6%	$3,282,755	38.8%	$ 3,079,383	39.5%

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2018	Operating Margin %	2017	Operating Margin %	2018	Operating Margin %	2017	Operating Margin %
Operating earnings reported	$ 189,122	6.7%	$ 277,738	10.5%	$ 867,938	10.3%	$ 799,319	10.3%
Restructuring and other charges, net (1)	142,484	5.0	9,648	0.4	165,818	1.9	66,511	0.8
Operating earnings adjusted	$ 331,606	11.7%	$ 287,386	10.9%	$1,033,756	12.2%	$ 865,830	11.1%

(1) Third quarter 2018 charges related to restructuring actions in the United States, restructuring actions in Canada, restructuring actions and the impairment of goodwill and an intangible relating to Cromwell in Other Businesses. Third quarter 2017 charges related to restructuring actions and sales of branches in the United States and branch closures and other restructuring in Canada.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	%	2018	2017	%
Segment operating earnings adjusted						
United States	329,773	299,524		1,037,528	912,407	
Canada	(4,932)	(10,035)		(15,818)	(32,919)	
Other Businesses	40,034	26,682		120,903	85,477	
Unallocated expense	(33,269)	(28,785)		(108,857)	(99,135)	
Segment operating earnings adjusted	$ 331,606	$ 287,386	15 %	$ 1,033,756	$ 865,830	19 %
ROIC* for Company				29.1 %	24.2 %	
ROIC* for United States				44.9%	39.7 %	
ROIC* for Canada				-4.5%	-8.2 %	

*Adjusted ROIC is calculated as defined on slide 19 of this presentation, excluding the items adjusting operating earnings as noted above.

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Q3 2017 and 2018 GAAP to Non-GAAP Reconciliations

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	%	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017	%
Net earnings reported	$ 104,377	$ 162,006	(36%)	$ 572,893	$ 434,671	32%
Restructuring and other charges, net (1)	136,029	6,519		154,066	66,576	
Net earnings adjusted	$ 240,406	$ 168,525	43 %	$ 726,959	$ 501,247	45%

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	%	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017	%
Diluted earnings per share reported	$ 1.82	$ 2.79	(35%)	$ 10.04	$ 7.39	36%
Restructuring (United States)	0.06	0.23		0.25	$ 0.51	
Branch gains (United States)	-	(0.09)		(0.16)	(0.48)	
Other charges (United States)	-	(0.05)		-	(0.05)	
Restructuring (Canada)	(0.02)	0.08		0.39	0.45	
Restructuring (Other Businesses)	0.02	-		0.07	0.70	
Other Charges (Other Businesses)	2.42	-		2.43	-	
Restructuring (Unallocated expense)	-	-		(0.08)	-	
Intangible Impairment Tax (Cromwell)	-	-		-	-	
Total pretax adjustments	2.48	0.17		2.90	1.13	
Tax effect (2)	(0.11)	(0.06)		(0.20)	-	
Total, net of tax	2.37	0.11		2.70	1.13	
Diluted earnings per share adjusted	$ 4.19	$ 2.90	44%	$ 12.74	$ 8.52	50%

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Net cash provided by operating activities	$ 367,091	$ 348,700	$ 743,004	$ 720,878
Less:				
Additions to property, building and equipment	65,813	60,036	168,896	191,183
Add:				
Proceeds from the sale of assets	32,278	40,663	75,558	110,421
Free Cash Flow	$ 333,556	$ 329,327	$ 649,666	$ 640,116

(1) Third quarter 2018 charges related to restructuring actions in the United States, restructuring actions in Canada, restructuring actions and the impairment of goodwill and an intangible relating to Cromwell in Other Businesses. Third quarter 2017 charges related to restructuring actions and sales of branches in the United States and branch closures and other restructuring in Canada.

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(2) 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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