Q4 2018 Earnings Call

W.W. Grainger, Inc.

January 24, 2019

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 cyber security matters; investigations, inquiries, audits and changes in laws and regulations; disruption of information technology or data security systems; general industry, economic, market or political 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 and/or extreme 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.

FY 2018 Reported Results – Total Company

($ in millions)	FY 2018	FY 2017	% vs. PY Fav/(Unfav)
Sales	$ 11,221	$ 10,425	8%
GP	4,348	4,098	6%
Op Expense	3,190	3,063	(4%)
Op Earnings	**$ 1,158**	**$ 1,035**	**12%**
EPS	$ 13.73	$ 10.02	37%

(% of sales)	FY 2018	FY 2017	bps vs. prior Fav/(Unfav)
GP Margin	38.7%	39.3%	(60)
Op Expense	28.4%	29.4%	100
Op Margin	**10.3%**	**9.9%**	**40**

- 2018 reported results include adjustments that had a $186 million impact to operating earnings and a $2.97 impact to EPS
- The remaining slides reference adjusted results, which exclude items outlined in our Q4 press release

Note: 2018 contained one extra sales day. On daily basis, sales for the year increased 7%.

DG Macpherson

Chairman and Chief Executive Officer

2018 Accomplishments

U.S.	• Strong share gains across Large and Medium customers • Better than expected gross margin and operating expense leverage • Very strong and improving customer satisfaction
Canada	• Right-sized the business for profitable growth • Exited the year with a profitable fourth quarter
Other Businesses	• 23% daily sales growth and strong profitability for single channel businesses • Improved profitability for international businesses
Company	• Achieved $130 million in cost savings and productivity in 2018 vs. target of $80 to $120 million • Achieved 2019 operating margin target of 12% one year earlier than expected

Note: Reference slides 28 and 29 for GAAP vs. non-GAAP reconciliation.

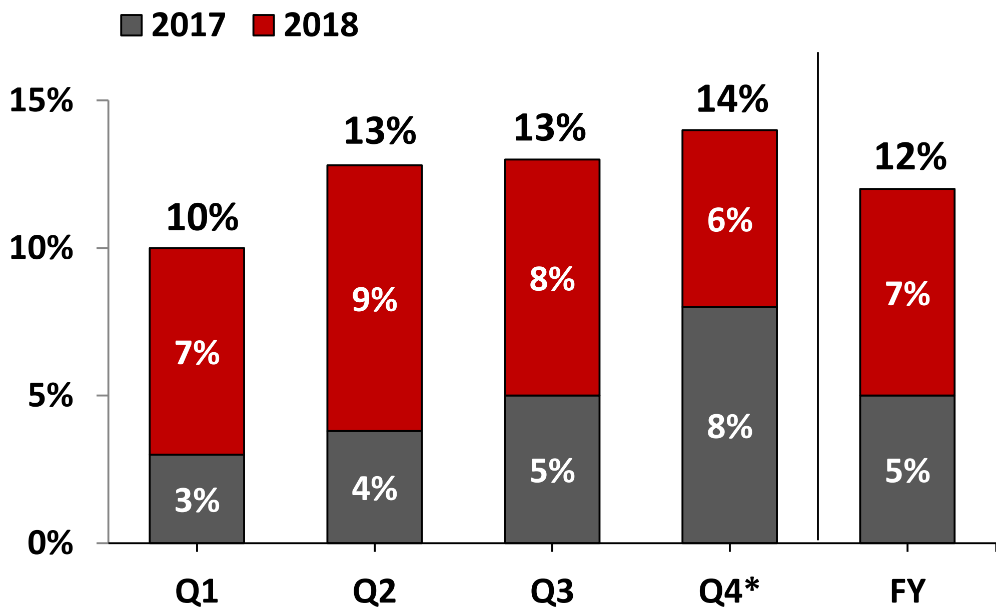
U.S. 2018 Accomplishments – Revisiting Pricing Changes

Q1 2017: What We Said	2018: What We Did
• Achieve **6-8% volume growth** with expected **market volume growth of 2% to 3**% in 2018	• **Volume growth of 8%, 450 bps faster than market volume growth at ~3.5%**
• Expected **2% price deflation** in 2018	• **Price was flat** in 2018
• Expected **gross margin decline of 120 basis points** in 2018	• **Gross margin declined 20 bps** (excluding revenue recognition accounting change)

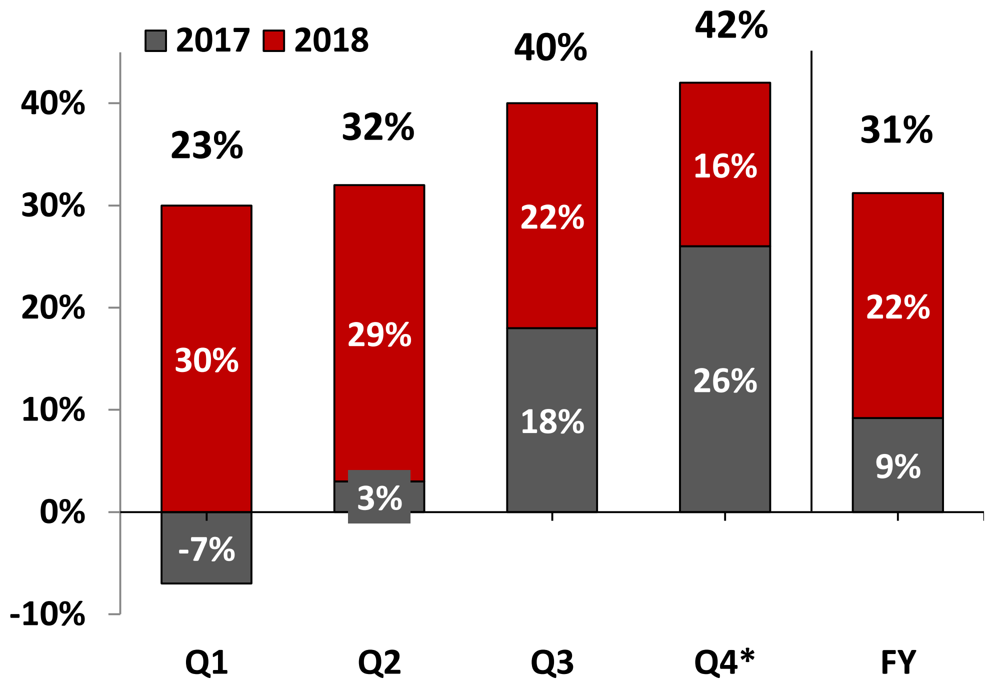
Note: Reference slides 28 and 29 for GAAP vs. non-GAAP reconciliation.

U.S. Large and Medium Volume – Q4 Performance Adjusted for Holiday Timing

U.S. Large: daily volume growth on $6.8 billion of revenue



U.S. Medium: daily volume growth on $1.0 billion of revenue



Note: U.S. Large revenue of $6.8 billion and U.S. Medium revenue of $1.0 billion as of 12/31/2018. Q4 growth rates are normalized for negative holiday impact in December of ~1%. Total product COGS dollars (excludes freight, rebates and other adjustments) used as a proxy for volume.

Strategic Imperatives

Our purpose: We help professionals keep their operations running and their people safe

Business Models	Businesses	Priorities
High-Touch, High-Service Model *Curated experience with deep relationships and value-added services for complex customer needs*	• U.S. • Canada • Mexico • Cromwell • Fabory	• Advantaged MRO Solutions • Differentiated Sales and Services • Flawless Order to Cash Process • Turnaround Canada
Endless Assortment (Single Channel Online) Model *Endless assortment at competitive prices; exceptional service on simple transactions*	• Zoro • MonotaRO	• Expand the Assortment • Build Marketing and Analytics Capabilities

Performance Expectations 2019 and Beyond

- U.S. revenue to grow 300 to 400 basis points faster than market
- Canada volume stabilization and profitable growth
- Accelerated growth of endless assortment model
- Strong operating expense leverage
- Continued operating margin improvement

Note: Guidance as of 1/24/2019.

Tom Okray

Senior Vice President and Chief Financial Officer

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FY 2018 Adjusted Results – Total Company

($ in millions)	FY 2018	FY 2017	% vs. PY Fav/(Unfav)
Sales	$ 11,221	10,425	8%
GP	4,348	4,112	6%
Op Expense	3,004	2,965	(1%)
Op Earnings	**$ 1,344**	**$ 1,147**	**17%**
EPS	$ 16.70	$ 11.46	46%

(% of sales)	FY 2018	FY 2017	bps vs. prior Fav/(Unfav)
GP Margin	38.7%	39.4%	(70)
Op Expense	26.8%	28.4%	170
Op Margin	**12.0%**	**11.0%**	**100**

- Sales up 8% vs. prior year, 7% daily, all from volume
- Normalized GP rate of 39.2%, 20 basis points lower than prior year *(adjusted for revenue recognition change, see appendix)*
- Strong expense leverage continues
- EPS growth driven by operating performance and below-the-line items, primarily tax favorability

Note: Reference slides 28 and 29 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.

Q4 2018 Adjusted Results – Total Company

($ in millions)		Q4 2018		Q4 2017	% vs. PY Fav/(Unfav)
Sales	$	2,763	$	2,633	5%
GP		1,065		1,032	3%
Op Expense		755		751	(1%)
Op Earnings	$	310	$	281	10%
EPS	**$**	**3.96**	**$**	**2.94**	**35%**

(% of sales)	Q4 2018	Q4 2017	bps vs. prior Fav/(Unfav)
GP Margin	38.5%	39.2%	(70)
Op Expense	27.3%	28.5%	120
Op Margin	11.2%	10.7%	50

- Sales increased 5%, constant currency sales up 6%, 4% daily:
  - Volume growth of 4%
  - Price inflation of 1%
  - Holiday timing of (1%)
- Normalized GP rate of 39.0%, down 20 basis points vs. the prior year *(adjusted for revenue recognition change, see appendix)*
- Strong operating performance and lower tax rate drove 35% EPS growth

Note: Reference slides 28 and 29 for GAAP vs. non-GAAP reconciliation.

Q4 2018 Adjusted Results – Other Businesses

($ in millions)	Q4 2018	Q4 2017	% vs. PY Fav/(Unfav)
Sales	$ 621	$ 559	11%
Op Earnings	$ 32	$ 25	28%

(% of sales)	Q4 2018	Q4 2017	bps vs. prior Fav/(Unfav)
Op Margin	5.2%	4.5%	70

- Sales up 11% vs. prior year, 9% daily, and 11% in constant currency driven by volume
- Single channel model grew 21% on a daily basis
- International portfolio contributed to growth and profitability

Note: Single channel businesses include all Zoro businesses and MonotaRO in Japan. International portfolio comprises Cromwell, Fabory, Mexico, other Latin America businesses and China. Reference slides 28 and 29 for GAAP vs. non-GAAP reconciliation.

Q4 2018 Adjusted Results – Canada

(USD in millions)	Q4 2018	Q4 2017	% vs. PY Fav/(Unfav)
Sales	$ 145	$ 190	(24%)
Op Earnings	$ 1	$ (4)	134%

(% of sales)	Q4 2018	Q4 2017	bps vs. prior Fav/(Unfav)
Op Margin	1.0%	-2.3%	330

- Sales down 24% vs. prior year, down 25% daily and down 22% in constant currency
  - Volume down 30%
  - Price up 8%
- Gross profit margin up 160 basis points normalized for the revenue recognition accounting change
- Operating expenses down 27% vs. prior year normalized for the revenue recognition accounting change
- Profitable fourth quarter creates foundation for operating earnings growth in 2019

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Note: Reference slides 28 and 29 for GAAP vs. non-GAAP reconciliation.

Q4 2018 Adjusted Results – United States

($ in millions)	Q4 2018	Q4 2017	% vs. PY Fav/(Unfav)
Sales	$ 2,117	$ 1,991	6%
Op Earnings	$ 309	$ 294	5%

(% of sales)	Q4 2018	Q4 2017	bps vs. PY Fav/(Unfav)
Op Margin	14.6%	14.8%	(20)

Sales growth	**6%**
Selling day adjustment	(1%)
Daily sales growth	**5%**
December holiday timing	1%
Daily sales normalized for holiday	**6%**

- Daily sales growth normalized for holiday timing included 5% volume and 1% price inflation
- Normalized GP rate of 40.0%, up 20 basis points vs. the prior year *(adjusted for revenue recognition change, see appendix)*
- Operating expenses impacted by digital investment, incentive compensation, one-time items and an additional payroll day

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Note: Reference slides 28 and 29 for GAAP vs. non-GAAP reconciliation.

Cost Takeout and Productivity Targets

	Original Targets		Updated	
($ in millions)	**2018E**	**2019E**	**2018A**	**2019E**
U.S.	$45 - $65	$45 - $55	$70	$30 - $40
Canada	$25 - $35	$25 - $35	$45	$35 - $45
Other Bus.	$10 - $20	$0	$15	$0
Total	**$80 - $120**	**$70 - $90**	**$130**	**$65 - $85**

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Note: Guidance as of 1/24/2019.

2018 Recap

	Guidance 1/24/18	Guidance 7/18/18	Actuals	vs. Guidance
Sales *($ billions)* *% vs prior year*	**$10.7 to $11.2** *3% to 7%*	**$11.0 to $11.3** *5.5% to 8.5%*	**$11.2** *8%*	**Achieved High-End**
Gross Profit Margin* *bps vs. prior year*	**38.5% to 38.9%** *(90) to (50)*	**38.9% to 39.2%** *(50) to (20)*	**39.2%** *(20)*	**Achieved High-End**
Op Margin *bps vs prior year*	**10.5% to 11.1%** *(60) to 0*	**11.5% to 11.9%** *50 to 90*	**12.0%** *100*	**Beat High-End**
EPS *% vs prior year*	**$12.95 to $14.15** *13% to 24%*	**$15.05 to $16.05** *32% to 40%*	**$16.70** *46%*	**Beat High-End**

Note: Reference slides 28 and 29 for GAAP vs. non-GAAP reconciliation.
*Normalized for revenue recognition

2019 Guidance

	2018A	2019E
Sales *($ billions)*	**$11.2**	**$11.7 – $12.2**
% vs. prior year	*8%*	*4% - 8.5%*
U.S. Market (price + volume)	*4%*	*1% - 4%*
Gross Profit Margin	**38.7%**	**38.1% - 38.7%**
bps vs. prior year	*(20)**	*(60) – 0*
Op Margin	**12.0%**	**12.2% - 13.0%**
bps vs. prior year	*100*	*20 - 100*
Tax Rate	**21.7%**	**24.5% - 27.5%**
EPS	**$16.70**	**$17.10 - $18.70**
% vs. prior year	*46%*	*2% - 12%*

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Note: Guidance as of 1/24/2019. Reference slides 28 and 29 for GAAP vs. non-GAAP reconciliation.

*Normalized for revenue recognition

2019 Operating Margin Guidance by Segment

	2018A	2019E
U.S.	15.7%	15.5% - 16.1%
Canada	(2.2%)	1% - 5%
Other Businesses	6.3%	6% - 8%
Company	**12.0%**	**12.2% - 13.0%**

Note: Guidance as of 1/24/2019. Reference slides 28 and 29 for GAAP vs. non-GAAP reconciliation.

Sources and Uses of Cash Guidance

$ in millions	2018A	2019E
Op Cash Flow	$1,057	$1,070 – $1,260
Other	73	30 – 70
Sources	**$1,130**	**$1,100 - $1,330**
CapEx (gross)	$239	$300 – $350
Share Repurchases	425	450 – 600
Dividends	316	310 – 325
Other	150	40 – 55
Uses	**$1,130**	**$1,100 - $1,330**

- Continued strong operating cash flow expected in 2019
- Expect to use cash to continue to invest in our DC network, digital platform and IT infrastructure
- Expect to continue to return cash to shareholders through share repurchases and dividends

Note: Guidance as of 1/24/2019. Based on GAAP numbers.

Closing Remarks

Q&A

Appendix

Company: Revenue Recognition Change

Total Company Q4 2018

($ billions)	Q4 Actuals: Q4 2018	Q4 Actuals: % vs. PY Fav/(Unfav)	Excl. Rev. Rec. Change: Q4 2018	Excl. Rev. Rec. Change: % vs. PY Fav/(Unfav)
Sales	**$2.8**	**5%**	**$2.8**	**5%**
Gross Profit	1.1	3%	1.1	5%
Expenses	0.8	(1%)	0.8	(3%)
Op Earnings	0.3	10%	0.3	10%
	% of Sales	**bps vs. PY** Fav/(Unfav)	**% of Sales**	**bps vs. PY** Fav/(Unfav)
GP	38.5%	(70)	39.0%	(20)

- 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 down 20 bps versus the prior year.

Note: Numbers may not foot due to rounding.

U.S.: Revenue Recognition Change

U.S. Segment Q4 2018

($ billions)	Q4 Actuals: Q4 2018	Q4 Actuals: % vs. PY Fav/(Unfav)	Excl. Rev. Rec. Change: Q4 2018	Excl. Rev. Rec. Change: % vs. PY Fav/(Unfav)
Sales	**$2.1**	**6%**	**$2.1**	**6%**
Gross Profit	0.8	6%	0.8	8%
Expenses	0.5	(6%)	0.5	(9%)*
Op Earnings	0.3	5%	0.3	5%
	% of Sales	**bps vs. PY** Fav/(Unfav)	**% of Sales**	**bps vs. PY** Fav/(Unfav)
GP	39.5%	(30)	40.0%	20

- 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 50 bps impact on GP rate.
- GP rate normalized for revenue recognition was up 20 bps.
- Normalized for revenue recognition, operating expense grew 9%. Excluding the extra payroll day, expenses grew 8%. Higher variable compensation drove 3% of the increase.

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*Operating expenses included the impact of an extra payroll day versus the 2017 fourth quarter. Numbers may not foot due to rounding.

Quarterly Daily Sales

Q4 2018 Daily Sales on a Constant Currency Basis*

Month	Company
October	5%
November	5%
December *(normalized for holiday)*	4%*
Q4 Daily Sales *(normalized for holiday)*	**5%**

Selling Days

Month	2019	2018	2017
1Q	63	64	64
2Q	64	64	64
3Q	64	63	63
4Q	64	64	63
Full Year	**255**	**255**	**254**

Q4 2018 Daily Sales vs. Q4 2017

Drivers	Company	United States	Canada	Other Businesses
Volume	4%	5%	-30%	11%
Price	1%	1%	8%	
Foreign Exchange	-1%	n/a	-3%	-2%
Seasonal Sales/Holiday Timing	-1%	-1%		
Change vs. Prior	**3%**	**5%**	**(25%)**	**9%**
% of Company Revenue	*100%*	*72%*	*5%*	*23%*

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*December included negative 1 percent impact from foreign exchange and negative 3 percent impact due to holiday timing. See daily sales bridge on slide 29.

Q4 2018 U.S. Sales By Customer End Market

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

2017 and 2018 GAAP to Non-GAAP Reconciliations

(in millions of dollars)	Three Months Ended December 31, 2018	Three Months Ended December 31, 2017	%	Twelve Months Ended December 31, 2018	Twelve Months Ended December 31, 2017	%
Operating earnings reported	$ 290	$ 236	23%	$ 1,158	$ 1,035	12%
Restructuring (United States)	4	14		18	44	
Branch gains (United States)	(1)	(5)		(10)	(33)	
Other charges (United States)	-	(2)		-	(4)	
Restructuring (Canada)	13	13		36	39	
Branch gains (Canada)	(1)	-		(1)	-	
Restructuring (Other Businesses)	2	14		6	55	
Intangible Charges (Other Businesses)	-	-		139	-	
Restructuring (Unallocated expense)	3	11		(2)	11	
Subtotal	20	45		186	112	
Operating earnings adjusted	$ 310	$ 281	10%	$ 1,344	$ 1,147	17%

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.

(in millions of dollars)	Three Months Ended December 31, 2018	Three Months Ended December 31, 2017	%	Twelve Months Ended December 31, 2018	Twelve Months Ended December 31, 2017
Segment operating earnings adjusted					
United States	$ 309	$ 294		$ 1,346	$ 1,207
Canada	1	(4)		(14)	(37)
Other Businesses	32	25		153	111
Unallocated expense	(32)	(34)		(141)	(134)
Segment operating earnings adjusted	$ 310	$ 281		$ 1,344	$ 1,147
ROIC* for Company				28.5%	24.3%
ROIC* for United States				43.4%	39.8%
ROIC* for Canada				-3.2%	-7.0%

*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 $173.6 million), deferred taxes, and investments in unconsolidated entities, plus the LIFO reserve (5-point average of $386.7 million). Working liabilities are the sum of trade payables, accrued compensation and benefits, accrued contributions to employees' profit sharing plans, and accrued expenses.

2017 and 2018 GAAP to Non-GAAP Reconciliations

	Three Months Ended December 31,			Twelve Months Ended December 31,		
	2018	2017	%	2018	2017	%
Diluted earnings per share reported	$ 3.68	$ 2.63	40%	$ 13.73	$ 10.02	37%
Restructuring (United States)	0.08	0.25		0.33	0.76	
Branch gains (United States)	(0.02)	(0.08)		(0.18)	(0.56)	
Other (gains)/charges (United States)	-	(0.03)		-	(0.08)	
Restructuring (Canada)	0.23	0.22		0.61	0.67	
Branch gains (Canada)	(0.01)	-		(0.01)	-	
Restructuring (Other businesses)	0.03	0.24		0.11	0.94	
Intangible charges (Other businesses)	-	-		2.43	-	
Restructuring (Unallocated expense)	0.05	0.18		(0.03)	0.18	
Total pretax adjustments	0.36	0.78		3.26	1.91	
Tax effect of impairment	-	-		(0.10)	-	
Tax effect (1)	(0.08)	(0.21)		(0.19)	(0.21)	
U.S. tax legislation (2)	-	(0.06)		-	(0.06)	
Discrete tax items	-	(0.20)		-	(0.20)	
Total, net of tax	0.28	0.31		2.97	1.44	
Diluted earnings per share adjusted	$ 3.96	$ 2.94	35%	$ 16.70	$ 11.46	46%

	Twelve Months Ended December 31, 2018
	Total Company
Tax rate reported	23.9%
Stock-based compensation	-1.3%
Restructuring, impairment and other charges, net	-0.9%
Tax rate adjusted	21.7%

	Three Months Ended December 31, 2018	
	U.S. Segment	Total Company
Net sales growth reported	6 %	5 %
Foreign exchange	—	1
Constant currency sales growth reported	6	6
Selling day adjustment (64 days v. 63 days)	(1)	(2)
Net sales growth on daily basis	5	4
December holiday timing	1	1
Net sales growth normalized for holiday timing	6 %	5 %

(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.

This slide presentation also includes certain non-GAAP forward-looking information (including, but not limited to, slides 18 and 19). 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.

IR Contacts

Irene Holman
Vice President, Investor Relations
Irene.Holman@grainger.com
847.535.0809

Monica Gupta
Director, Investor Relations
Monica.Gupta@grainger.com

Michael P. Ferreter
Senior Manager, Investor Relations
Michael.Ferreter@grainger.com
847.535.1439