## INDEX TO FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

December 31, 2010, 2009 and 2008

# MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of W.W. Grainger, Inc. (Grainger) is responsible for establishing and maintaining adequate internal control over financial reporting. Grainger's internal control system was designed to provide reasonable assurance to Grainger's management and Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements under all potential conditions. Therefore, effective internal control over financial reporting provides only reasonable, and not absolute, assurance with respect to the preparation and presentation of financial statements.

Grainger's management assessed the effectiveness of Grainger's internal control over financial reporting as of December 31, 2010, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework. Based on its assessment under that framework and the criteria established therein, Grainger's management concluded that Grainger's internal control over financial reporting was effective as of December 31, 2010.

Ernst & Young LLP, an independent registered public accounting firm, has audited Grainger's internal control over financial reporting as of December 31, 2010, as stated in their report which is included herein.

# REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
W.W. Grainger, Inc.

We have audited W.W. Grainger, Inc. and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2010 based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). W.W. Grainger, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, W.W. Grainger, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of W.W. Grainger, Inc. and subsidiaries as of December 31, 2010, 2009 and 2008 and the related consolidated statements of earnings, comprehensive earnings, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2010 of W.W. Grainger, Inc. and subsidiaries and our report dated February 25, 2011 expressed an unqualified opinion thereon.

Ernst & Young LLP

Chicago, Illinois
February 25, 2011

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
W.W. Grainger, Inc.

We have audited the accompanying consolidated balance sheets of W.W. Grainger, Inc. and subsidiaries as of December 31, 2010, 2009 and 2008, and the related consolidated statements of earnings, comprehensive earnings, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of W.W. Grainger, Inc. and subsidiaries at December 31, 2010, 2009, and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), W.W. Grainger, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 25, 2011, expressed an unqualified opinion thereon.

Ernst & Young LLP

Chicago, Illinois
February 25, 2011

## W.W. Grainger, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands of dollars, except for per share amounts)

| | For the Years Ended December 31, | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| Net sales | $7,182,158 | $6,221,991 | $6,850,032 |
| Cost of merchandise sold | 4,176,474 | 3,623,465 | 4,041,810 |
| Gross profit | 3,005,684 | 2,598,526 | 2,808,222 |
| Warehousing, marketing and administrative expenses | 2,145,209 | 1,933,302 | 2,025,550 |
| Operating earnings | 860,475 | 665,224 | 782,672 |
| Other income and (expense): | | | |
| Interest income | 1,215 | 1,358 | 5,069 |
| Interest expense | (8,187) | (8,766) | (14,485) |
| Equity in net (loss) income of unconsolidated entities | (182) | 1,497 | 3,642 |
| Gain (write-off) of investment in unconsolidated entities – net | — | 47,343 | (6,031) |
| Other non-operating income | 1,608 | 964 | 2,668 |
| Other non-operating expense | (1,151) | (283) | (317) |
| Total other income and (expense) | (6,697) | 42,113 | (9,454) |
| Earnings before income taxes | 853,778 | 707,337 | 773,218 |
| Income taxes | 340,196 | 276,565 | 297,863 |
| Net earnings | 513,582 | 430,772 | 475,355 |
| Less: Net earnings attributable to noncontrolling interest | 2,717 | 306 | — |
| Net earnings attributable to W.W. Grainger, Inc. | $ 510,865 | $ 430,466 | $ 475,355 |
| Earnings per share: | | | |
| Basic | $ 7.05 | $ 5.70 | $ 6.07 |
| Diluted | $ 6.93 | $ 5.62 | $ 5.97 |
| Weighted average number of shares outstanding: | | | |
| Basic | 70,836,945 | 73,786,346 | 76,579,856 |
| Diluted | 72,138,858 | 74,891,852 | 77,887,620 |

The accompanying notes are an integral part of these consolidated financial statements.

## W.W. Grainger, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands of dollars)

| | For the Years Ended December 31, | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| Net earnings | $513,582 | $430,772 | $475,355 |
| Other comprehensive earnings (losses): | | | |
| Foreign currency translation adjustments, net of tax (expense) benefit of $(3,397), $(7,813) and $11,454, respectively | 46,450 | 54,693 | (79,287) |
| Derivative instruments, net of tax benefit of $2,257 | (3,559) | — | — |
| Reclassification of cumulative currency translation gain | — | (3,145) | — |
| Defined postretirement benefit plan, net of tax benefit of $1,821, $984 and $19,368, respectively | (2,874) | (1,552) | (30,550) |
| Other employment-related benefit plans, net of tax benefit of $64, $205 and $544, respectively | (728) | (554) | (859) |
| Total other comprehensive earnings (losses) | 39,289 | 49,442 | (110,696) |
| Comprehensive earnings, net of tax | 552,871 | 480,214 | 364,659 |
| Less: Comprehensive earnings attributable to noncontrolling interest: | | | |
| Net earnings | 2,717 | 306 | — |
| Foreign currency translation adjustments | 8,712 | (1,457) | — |
| Comprehensive earnings attributable to W.W. Grainger, Inc. | $541,442 | $481,365 | $364,659 |

The accompanying notes are an integral part of these consolidated financial statements.

## W.W. Grainger, Inc. and Subsidiaries

## CONSOLIDATED BALANCE SHEETS

(In thousands of dollars, except for per share amounts)

| | As of December 31, | | |
|---|---|---|---|
| ASSETS | 2010 | 2009 | 2008 |
| CURRENT ASSETS | | | |
| Cash and cash equivalents | $ 313,454 | $ 459,871 | $ 396,290 |
| Accounts receivable (less allowances for doubtful accounts of $24,552, $25,850 and $26,481, respectively) | 762,895 | 624,910 | 589,416 |
| Inventories – net | 991,577 | 889,679 | 1,009,932 |
| Prepaid expenses and other assets | 87,125 | 88,364 | 73,359 |
| Deferred income taxes | 44,627 | 42,023 | 52,556 |
| Prepaid income taxes | 38,393 | 26,668 | 22,556 |
| Total current assets | 2,238,071 | 2,131,515 | 2,144,109 |
| PROPERTY, BUILDINGS AND EQUIPMENT | | | |
| Land | 249,119 | 237,867 | 192,916 |
| Buildings, structures and improvements | 1,133,392 | 1,078,439 | 1,048,440 |
| Furniture, fixtures, machinery and equipment | 995,249 | 950,187 | 890,507 |
| | 2,377,760 | 2,266,493 | 2,131,863 |
| Less accumulated depreciation and amortization | 1,414,088 | 1,313,222 | 1,201,552 |
| Property, buildings and equipment – net | 963,672 | 953,271 | 930,311 |
| DEFERRED INCOME TAXES | 87,244 | 79,472 | 97,442 |
| INVESTMENTS IN UNCONSOLIDATED ENTITIES | 3,461 | 3,508 | 20,830 |
| GOODWILL | 387,232 | 351,182 | 213,159 |
| OTHER ASSETS AND INTANGIBLES – NET | 224,697 | 207,384 | 109,566 |
| TOTAL ASSETS | $3,904,377 | $3,726,332 | $3,515,417 |

## W.W. Grainger, Inc. and Subsidiaries

## CONSOLIDATED BALANCE SHEETS – CONTINUED

(In thousands of dollars, except for per share amounts)

| | As of December 31, | | |
|---|---|---|---|
| LIABILITIES AND SHAREHOLDERS' EQUITY | 2010 | 2009 | 2008 |
| CURRENT LIABILITIES | | | |
| Short-term debt | $ 42,769 | $ 34,780 | $ 19,960 |
| Current maturities of long-term debt | 31,059 | 53,128 | 21,257 |
| Trade accounts payable | 344,295 | 300,791 | 290,802 |
| Accrued compensation and benefits | 169,343 | 135,323 | 162,380 |
| Accrued contributions to employees' profit sharing plans | 145,119 | 121,895 | 146,922 |
| Accrued expenses | 130,836 | 124,150 | 118,633 |
| Income taxes payable | 5,882 | 6,732 | 1,780 |
| Total current liabilities | 869,303 | 776,799 | 761,734 |
| LONG-TERM DEBT (less current maturities) | 420,446 | 437,500 | 488,228 |
| DEFERRED INCOME TAXES, TAX UNCERTAINTIES AND DERIVATIVE INSTRUMENTS | 82,502 | 62,215 | 33,219 |
| ACCRUED EMPLOYMENT-RELATED BENEFITS COSTS | 244,456 | 222,619 | 198,431 |
| SHAREHOLDERS' EQUITY | | | |
| Cumulative preferred stock – $5 par value – 12,000,000 shares authorized; none issued nor outstanding | — | — | — |
| Common Stock – $0.50 par value – 300,000,000 shares authorized; 109,659,219 shares issued | 54,830 | 54,830 | 54,830 |
| Additional contributed capital | 637,686 | 596,358 | 564,728 |
| Retained earnings | 4,326,761 | 3,966,508 | 3,670,726 |
| Accumulated other comprehensive earnings (losses) | 42,951 | 12,374 | (38,525) |
| Treasury stock, at cost – 40,281,417, 37,382,703 and 34,878,190 shares, respectively | (2,857,012) | (2,466,350) | (2,217,954) |
| Total W.W. Grainger, Inc. shareholders' equity | 2,205,216 | 2,163,720 | 2,033,805 |
| Noncontrolling interest | 82,454 | 63,479 | — |
| Total shareholders' equity | 2,287,670 | 2,227,199 | 2,033,805 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $3,904,377 | $3,726,332 | $3,515,417 |

The accompanying notes are an integral part of these consolidated financial statements.

## W.W. Grainger, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of dollars)

| | For the Years Ended December 31, | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net earnings | $ 513,582 | $ 430,772 | $ 475,355 |
| Provision for losses on accounts receivable | 6,718 | 10,748 | 12,924 |
| Deferred income taxes and tax uncertainties | (5,553) | 21,683 | 5,182 |
| Depreciation and amortization | 149,678 | 147,531 | 139,570 |
| Stock-based compensation | 49,796 | 43,301 | 47,870 |
| (Gain) write-off of unconsolidated entities | — | (47,343) | 6,031 |
| Change in operating assets and liabilities – net of business acquisitions: | | | |
| Accounts receivable | (127,790) | 2,794 | (5,592) |
| Inventories | (80,545) | 175,286 | (92,518) |
| Prepaid expenses | (8,806) | (11,180) | (33,629) |
| Trade accounts payable | 36,219 | (16,736) | (6,960) |
| Other current liabilities | 49,576 | (52,944) | 199 |
| Current income taxes payable | (1,503) | 2,472 | (7,784) |
| Accrued employment-related benefits costs | 18,128 | 22,080 | 3,216 |
| Other – net | (3,055) | 3,932 | (13,798) |
| Net cash provided by operating activities | 596,445 | 732,396 | 530,066 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Additions to property, buildings and equipment – net of dispositions | (120,616) | (140,730) | (181,355) |
| Cash paid for business acquisitions, net of cash acquired | (62,072) | (123,093) | (34,290) |
| Other – net | 13,529 | 1,260 | 13,010 |
| Net cash used in investing activities | $(169,159) | $(262,563) | $(202,635) |

## W.W. Grainger, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF CASH FLOWS – CONTINUED

(In thousands of dollars)

| | For the Years Ended December 31, | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Net increase (decrease) in commercial paper | $ 200,000 | $ — | $ (95,947) |
| Borrowings under lines of credit | 35,297 | 46,125 | 29,959 |
| Payments against lines of credit | (29,799) | (43,583) | (15,437) |
| Proceeds from issuance of long-term debt | — | — | 500,000 |
| Payments of long-term debt | (239,122) | (18,856) | — |
| Proceeds from stock options exercised | 86,528 | 91,165 | 46,833 |
| Excess tax benefits from stock-based compensation | 25,650 | 19,030 | 13,533 |
| Purchase of treasury stock | (504,803) | (372,727) | (394,247) |
| Cash dividends paid | (152,338) | (134,684) | (121,504) |
| Net cash used in financing activities | (578,587) | (413,530) | (36,810) |
| Exchange rate effect on cash and cash equivalents | 4,884 | 7,278 | (7,768) |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (146,417) | 63,581 | 282,853 |
| Cash and cash equivalents at beginning of year | 459,871 | 396,290 | 113,437 |
| Cash and cash equivalents at end of year | $ 313,454 | $ 459,871 | $ 396,290 |
| Supplemental cash flow information: | | | |
| Cash payments for interest (net of amounts capitalized) | $ 8,188 | $ 8,766 | $ 14,508 |
| Cash payments for income taxes | 319,754 | 235,043 | 306,960 |

The accompanying notes are an integral part of these consolidated financial statements.

## W.W. Grainger, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In thousands of dollars, except for per share amounts)

| | W.W. Grainger, Inc. Shareholders' Equity | | | | | |
|---|---|---|---|---|---|---|
| | Common Stock | Additional Contributed Capital | Retained Earnings | Accumulated Other Comprehensive Earnings (Losses) | Treasury Stock | Noncontrolling Interest |
| Balance at January 1, 2008 | $54,830 | $475,350 | $3,316,875 | $ 72,171 | $(1,821,118) | $ — |
| Exercise of stock options | — | (12,663) | — | — | 59,460 | — |
| Tax benefits on stock-based compensation awards | — | 15,458 | — | — | — | — |
| Stock option expense | — | 19,868 | — | — | — | — |
| Amortization of other stock-based compensation awards | — | 26,077 | — | — | — | — |
| Settlement and vesting of other stock-based compensation awards | — | (9,362) | — | — | 4,792 | — |
| Purchase of treasury stock | — | 50,000 | — | — | (461,088) | — |
| Net earnings | — | — | 475,355 | — | — | — |
| Other comprehensive earnings | — | — | — | (110,696) | — | — |
| Cash dividends paid ($1.55 per share) | — | — | (121,504) | — | — | — |
| Balance at December 31, 2008 | $54,830 | $564,728 | $3,670,726 | $ (38,525) | $(2,217,954) | $ — |
| Exercise of stock options | — | (15,614) | — | — | 106,255 | 96 |
| Tax benefits on stock-based compensation awards | — | 21,924 | — | — | — | — |
| Stock option expense | — | 16,100 | — | — | — | 98 |
| Amortization of other stock-based compensation awards | — | 24,307 | — | — | — | — |
| Settlement and vesting of other stock-based compensation awards | — | (15,087) | — | — | 7,599 | — |
| Purchase of treasury stock | — | — | — | — | (362,250) | — |
| Net earnings | — | — | 430,466 | — | — | 306 |
| Other comprehensive earnings | — | — | — | 50,899 | — | (1,457) |
| Cash dividends paid ($1.78 per share) | — | — | (134,684) | — | — | — |
| Fair value at acquisition | — | — | — | — | — | 64,436 |
| Balance at December 31, 2009 | $54,830 | $596,358 | $3,966,508 | $ 12,374 | $(2,466,350) | $ 63,479 |
| Exercise of stock options | — | (11,211) | — | — | 98,052 | 171 |
| Tax benefits on stock-based compensation awards | — | 28,225 | — | — | — | — |
| Stock option expense | — | 17,163 | — | — | — | 333 |
| Amortization of other stock-based compensation awards | — | 29,725 | — | — | — | — |
| Settlement and vesting of other stock-based compensation awards | — | (22,090) | — | — | 9,297 | — |
| Purchase of treasury stock | — | (484) | — | — | (498,011) | (428) |
| Net earnings | — | — | 510,865 | — | — | 2,717 |
| Other comprehensive earnings | — | — | — | 30,577 | — | 8,712 |
| Cash dividends paid ($2.08 per share) | — | — | (150,612) | — | — | (1,726) |
| Fair value at acquisition | — | — | — | — | — | 9,196 |
| Balance at December 31, 2010 | $54,830 | $637,686 | $4,326,761 | $ 42,951 | $(2,857,012) | $ 82,454 |

The accompanying notes are an integral part of these consolidated financial statements.