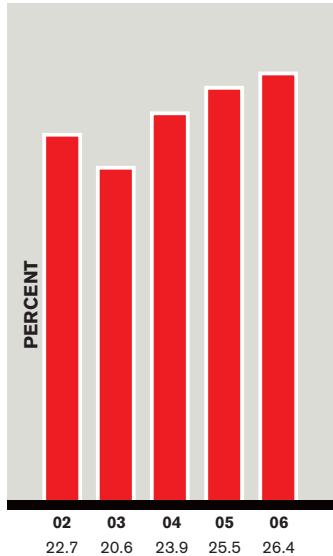


Cash Flow

Long-term Financial Goal

Maintaining return on invested capital greater than 20%

Return on Invested Capital



Maintaining a pretax return on invested capital* of greater than 20 percent is one of Grainger's long-term financial goals. It demonstrates the company's commitment to grow the areas of the business earning more than the cost of capital and to improve performance in areas earning less.

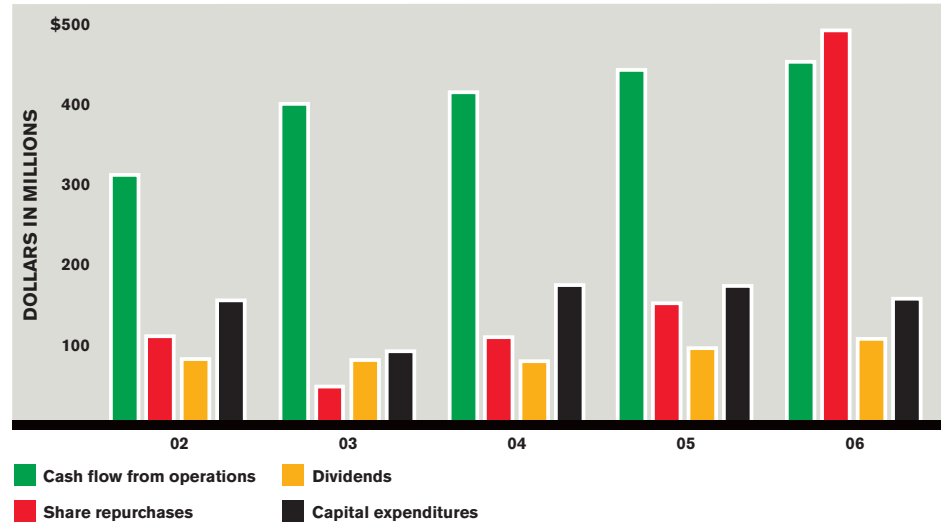
*The GAAP financial statements are the source for all amounts used in the Return on Invested Capital (ROIC) calculation. ROIC is calculated using annualized operating earnings based on year-to-date operating earnings divided by a 13-point average for net working assets. Net working assets are working assets minus working liabilities, defined as follows: working assets equal total assets less cash equivalents (nonoperating cash), deferred taxes, and investments in unconsolidated entities, plus the LIFO reserve. Working liabilities are the sum of trade payables, accrued compensation and benefits, accrued contributions to employees' profit sharing plans, and accrued expenses.

Throughout its 80-year history, Grainger has maintained a strong financial position characterized by impressive cash generation and limited debt. Grainger continued this consistent pattern in 2006, with \$437 million in cash flow from operations.

Grainger has a solid record of creating value by investing for growth and by returning capital to shareholders through share repurchases and dividends. In 2006, Grainger used its cash flow, plus a portion of its cash reserve, to invest \$137 million in key growth programs, pay \$98 million in dividends and fund \$473 million in share repurchases. Despite this aggressive outlay of capital, Grainger maintained its strong financial position and was able to hold debt as a percent of total capitalization to 0.4 percent.

Grainger maintains a debt ratio and liquidity position that allows it flexibility in managing the business, including adequate reserves to fund acquisitions, such as the six completed by Lab Safety Supply since 2001, and other projects and programs. In addition, Grainger has various sources of financing available including commercial paper sales and bank borrowings under lines of credit. At December 31, 2006, Grainger's long-term debt rating by Standard & Poor's was AA+, and its available line of credit totaled \$250 million.

Uses of Cash Flow from Operations



In 2007, Grainger expects to continue its tradition of robust cash generation and is forecasting operating cash flow to be in the range of \$450 million to \$500 million. Grainger is committed to maintaining its strong financial position while generating attractive returns for its shareholders. Going forward, the company expects to:

- Invest in programs that will profitably grow the business and create value for shareholders
- Make acquisitions that expand the company's served markets and complement existing businesses
- Continue to return capital to shareholders through share repurchases and dividends

Capital Expenditures

Grainger uses cash to fund initiatives that grow the business and improve efficiencies, resulting in greater profitability. Since 1999, Grainger has invested in its logistics network and information systems to improve productivity, customer service and product availability.

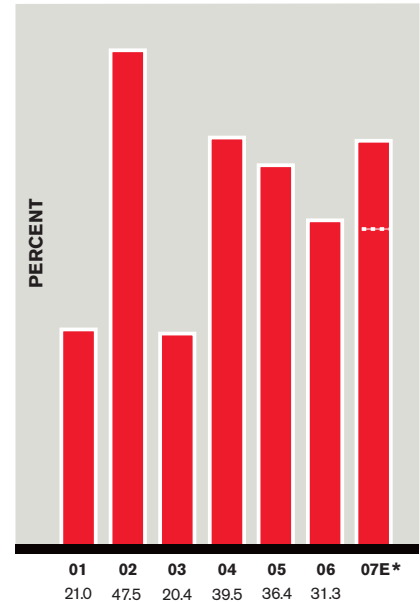
Capital spending in 2006 primarily supported the market expansion and product line expansion programs, Shanghai start-up costs and the SAP implementation. These programs accounted for \$75 million of the total capital expenditures of \$137 million.

In 2007, the company anticipates total capital expenditures in the range of \$150 million to \$175 million. Grainger evaluates proposed projects, other than the maintenance of its facilities, to ensure they meet or exceed the company's cost of capital. Some of the larger projects anticipated for 2007 include:

- Market expansion
- Information technology
- International
- Product line expansion

Capital Expenditures

As percent of cash flow from operations



* 2007 estimated range 30-39 percent

Capital Expenditures



Market Expansion
\$50 million to \$80 million

Grainger's multiyear strategy to improve its local presence in top metropolitan markets across the United States is expected to generate sales growth that is on average 5 percent higher than markets not involved in this initiative. Metropolitan areas targeted in 2007 include Dallas/Fort Worth, Detroit, New York, Phoenix and the Phase 6 markets of Boston, Chicago, Minneapolis, Pittsburgh and San Francisco.



Information Technology
\$10 million to \$15 million

IT-driven capabilities, such as the ability to handle orders for sourced products and parts and to identify and provide sales leads to the account managers, provide Grainger with a sustainable competitive advantage. In 2006, Grainger implemented one of the world's largest instances of SAP in its U.S. business, and the company expects to realize approximately \$50 million in benefits from this project. Grainger plans to extend SAP to other parts of the business over the next several years.



International
\$10 million to \$12 million

Grainger will continue to invest in expanding its markets that demonstrate high growth potential; in 2007, these will include China and Mexico.



Product Line Expansion
\$3 million to \$5 million

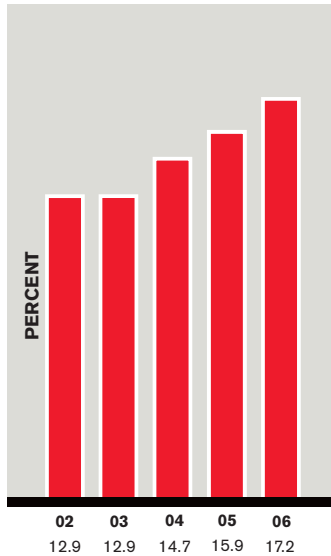
Grainger is in the midst of a multiyear expansion of its product line. To accommodate the greater breadth and depth of product offered to customers, the company expects to spend a nominal amount of capital on additional inventory storage and racking.

Cash Flow

Returning Capital to Shareholders

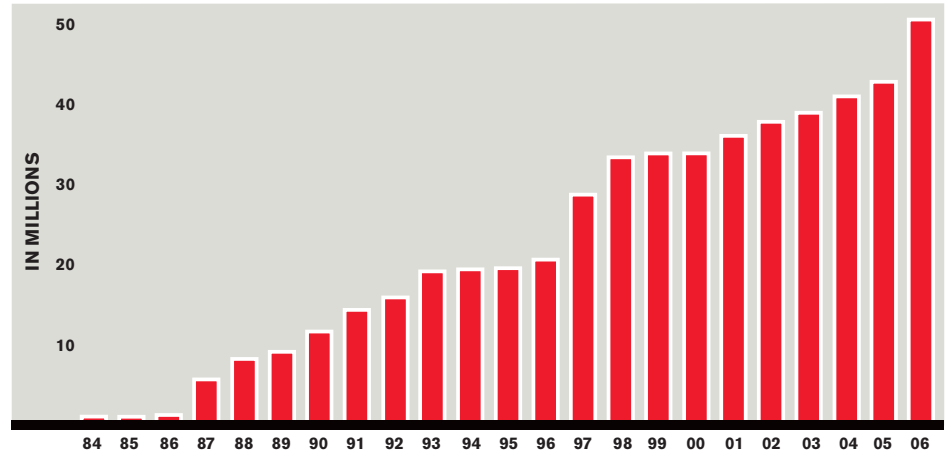
As a result of the company's strong cash flow, Grainger has consistently returned to shareholders a portion of the cash generated each year in the form of share repurchases and dividends.

Return on Equity



Shares Repurchased – Cumulative

Shares adjusted to account for stock splits

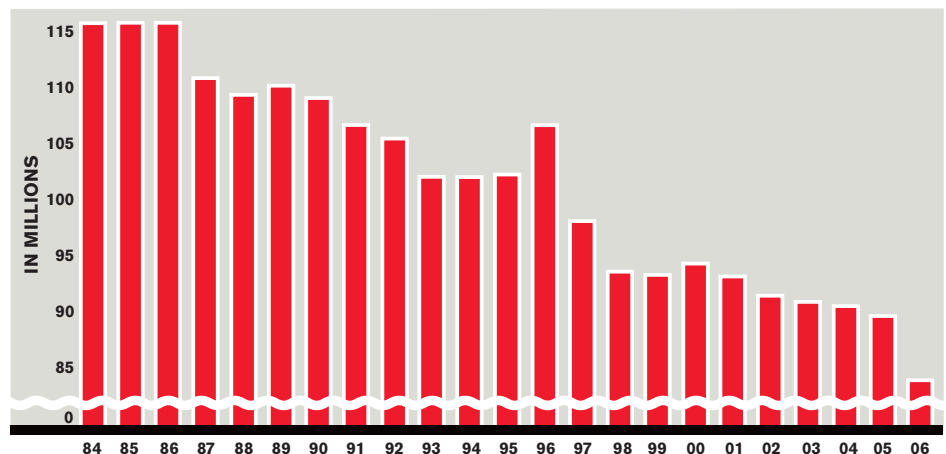


Share Repurchases

In 1984, Grainger launched a share repurchase program intended to return capital to shareholders and reduce the number of shares outstanding. Over the past 23 years, Grainger has allocated \$1.9 billion in capital to purchase more than 49 million shares. This program has enhanced shareholder value by reducing total shares outstanding by 27 percent.

Grainger allocated more capital to share repurchase in 2006 than in any year since the program's inception. In 2006, Grainger bought 7 million shares of stock at an average share price of \$69, ending the year with 84 million shares outstanding. In October 2006, the company's Board of Directors authorized the repurchase of an additional 10 million shares; as of December 31, 2006, approximately 7.7 million shares remained under the authorization. The company intends to allocate \$250 million to \$350 million in capital for share repurchases in 2007.

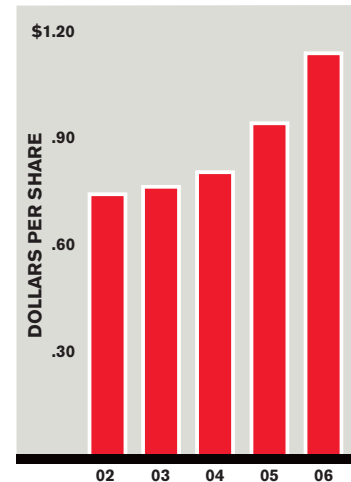
Shares Outstanding



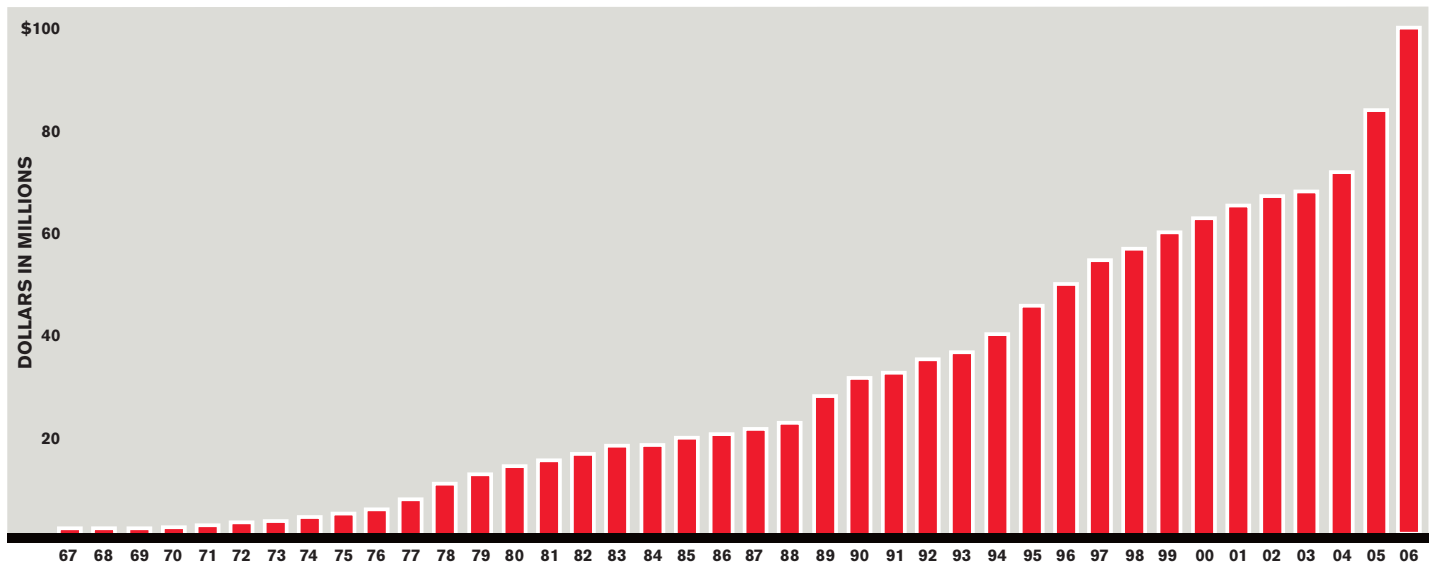
Dividends

In 2006, Grainger increased its quarterly dividend by 21 percent from 24 to 29 cents per share, and for the full year paid \$98 million in dividends to shareholders. Grainger has increased dividends for 35 consecutive years, putting the company among only 25 companies in the S&P 500 with such a record. For the past eleven years Grainger has been recognized as a Dividend Aristocrat by Standard & Poor's.

Dividends Paid



Cash Dividend History

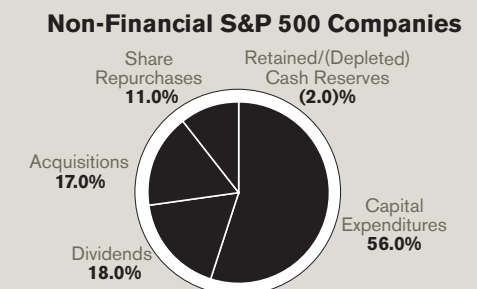
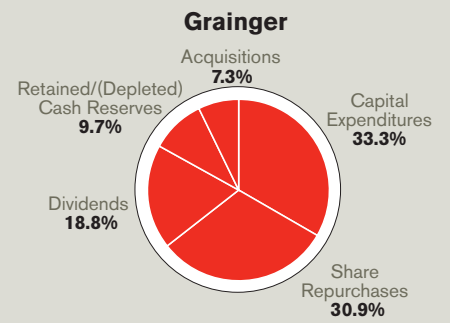


How Corporations Use Cash Flow – Grainger versus the S&P 500
(10-Year period of 1996–2005)

Use of Operating Cash	Grainger	Non-Financial S&P 500 Companies
Capital Expenditures	33.3%	56.0%
Dividends	18.8	18.0
Share Repurchases	30.9	11.0
Acquisitions	7.3	17.0
Retained/(Depleted) Cash Reserves	9.7	(2.0)
Total	100.0%	100.0%

Source: Thomson Financial and company information

Over the last 10 years, Grainger's capital expenditures were substantially less, on a percentage basis, than those of the non-financial members of the S&P 500. Grainger also has returned significantly more capital to shareholders through dividends and share repurchases than this comparator group.

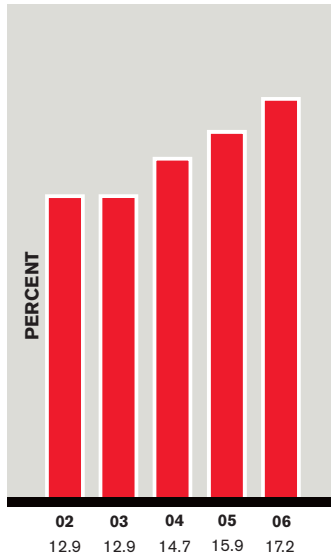


Cash Flow

Returning Capital to Shareholders

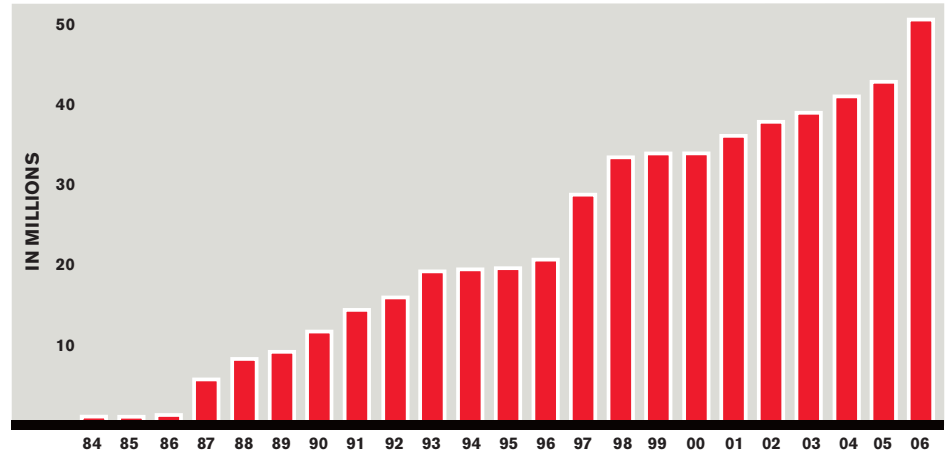
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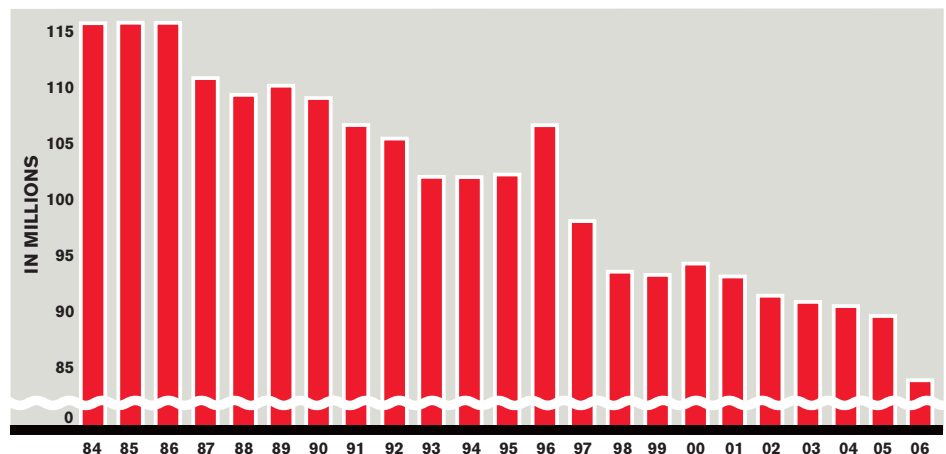


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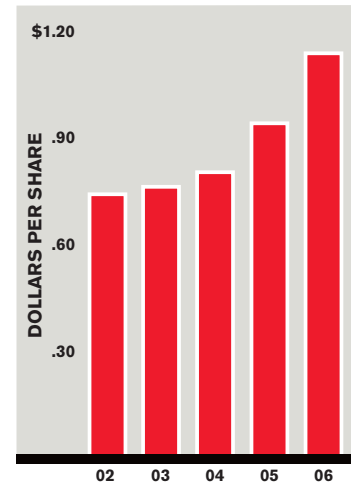
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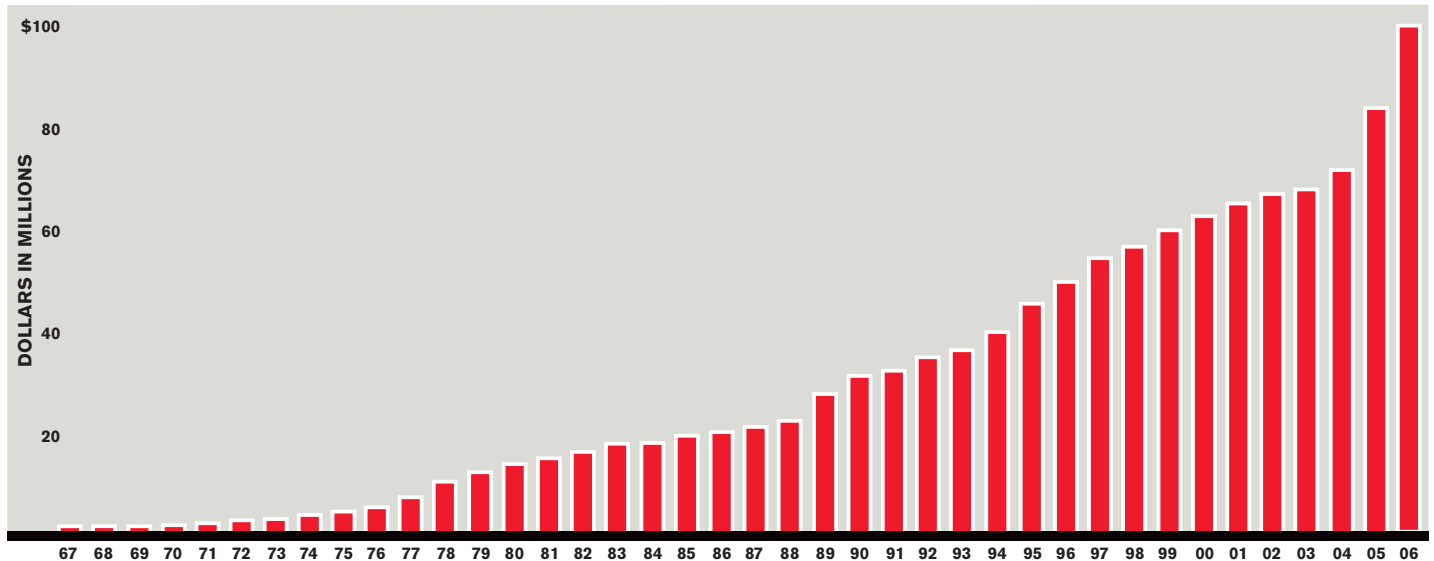
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