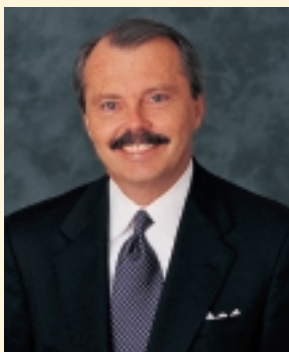




**At Grainger,** we have just one goal: to make it easy for customers to keep their facilities up and running. To make that happen, we concentrate on the fundamentals: offering the proximity, product breadth, and quick and reliable service customers expect. Adhering to this philosophy for 75 years has earned Grainger the respect of the industry and a reputation for excellence.

# Strong fundamentals enable growth

The fundamental management principles upon which this company was founded still govern Grainger today. Conservative financial practices, open and honest communication and an easily understood operating model remain the hallmarks of how Grainger does business.



**Wesley M. Clark**  
President and  
Chief Operating Officer



**P. Ogden Loux**  
Senior Vice President, Finance,  
and Chief Financial Officer

One of the elements enabling Grainger to grow has been our strong financial position. Even in lean years, Grainger's low debt and strong cash flow have provided us with the flexibility we've needed to invest in building the business.

Grainger has taken a number of steps to ensure that the financial framework of the company remains secure. Since 1941, we have helped our employees prepare for retirement through an employee profit sharing plan that is directly related to company profitability rather than through a defined benefit pension plan. In total, over the past 62 years, Grainger has contributed more than \$745 million to our employees' Profit Sharing Trust.

In addition, Grainger has long had in place many of the measures proposed over the past year to increase investor confidence in corporate governance and reporting.

Nine of the 12 members of Grainger's Board of Directors are independent of management. Only independent members sit on our Compensation, Audit, and Board Affairs and Nominating Committees. We have made it a practice to submit our equity incentive plans to shareholders for approval. We also require employees to certify their adherence to Grainger's Business Conduct Guidelines on an annual basis. More recently, Grainger has complied with the mandate that chief executive officers and chief financial officers of public companies certify under oath that their companies' securities filings are accurate and complete, and that the certifications have been reviewed with the companies' audit committees.

By adhering to the highest level of financial reporting, we are helping investors and other stakeholders remain informed of Grainger's overall financial condition.

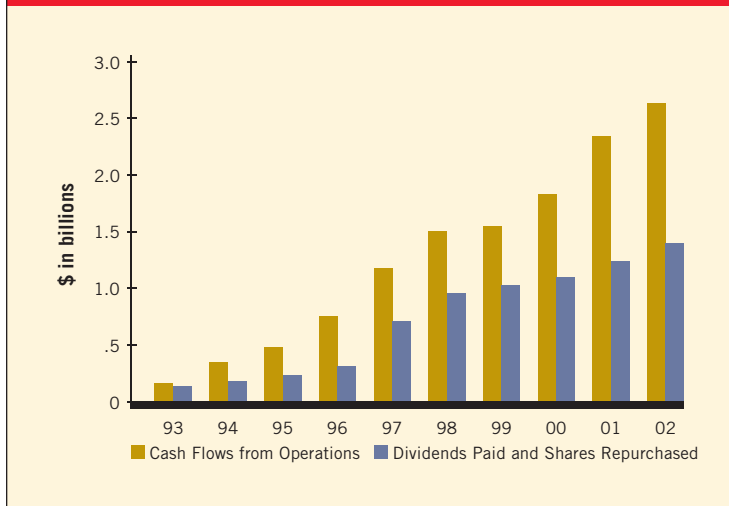


Strong cash flows enable Grainger to fund initiatives that strengthen its operations, such as a redesigned logistics network. With increased automation and more than

one million square feet of additional capacity, the new distribution centers will help Grainger serve customers much more efficiently. The network will be completed in 2004.



**Cumulative Cash Flows from Operations and Returns to Shareholders**



Grainger's strong cash flows have made it possible for the company to raise dividends for 31 consecutive years and buy back more than 37 million shares. In 2002 alone, Grainger returned more than \$160 million to shareholders in dividends and share repurchases.

# Inventory drives our business

Facilities maintenance needs are usually urgent and often unpredictable. Lead times can be as short as ten minutes. Given these factors, it's essential that we have the right products available and that we're able to get them to customers when and where they are needed.

**C**ustomers turn to Grainger because of the breadth and quality of the products we provide. By calling or visiting one of our 395 branches in the United States and Puerto Rico, customers can select brand-name products from 1,200 suppliers spanning 11 key product categories in our 4,000-page catalog or access more than 200,000 solutions online via [grainger.com](http://grainger.com).

Lab Safety Supply, Inc., our direct marketing business, offers 100,000 products through catalog and online sales, and our operations in Canada and Mexico extend our coverage throughout North America. For those customers needing on-site materials management services, Grainger's Integrated Supply division can help. And if customers have trouble locating the parts they need, Grainger's Parts division is ready to assist. For needs beyond that, Grainger has a successful sourcing division, FindMRO, to quickly locate a solution from a database of more than five million items.

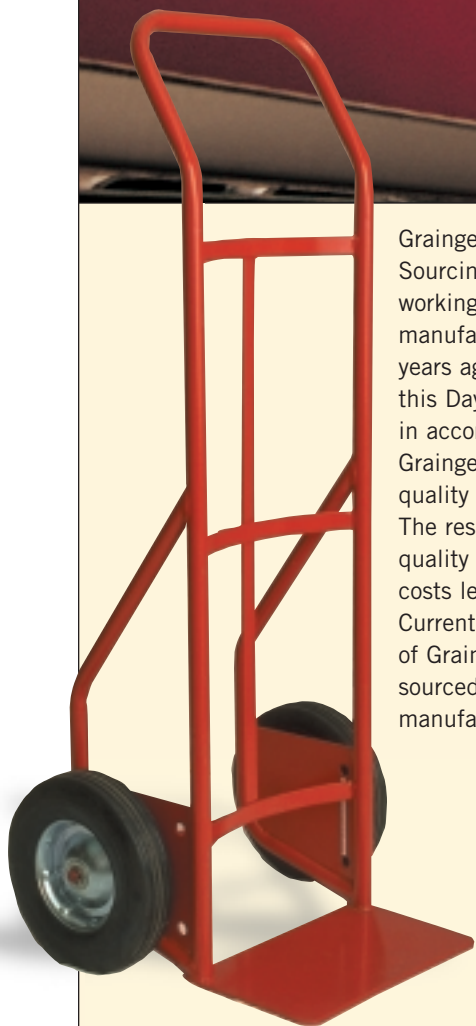


Boldly colored signage that matches the product categories in the Grainger catalog helps customers at the new 62,000-sq.-ft. branch in Atlanta, Ga., find what they need quickly from among the more than 35,000 products in stock.

## Improving our distribution capabilities

Grainger's U.S. logistics network forms the backbone of our multichannel service structure, ensuring that whenever customers place an order through our branches, service centers or online, the products they need are available. Since 2000, Grainger has invested \$150 million to improve the productivity of our logistics network through the construction and renovation of nine new distribution

centers, adding automation and extra capacity. In 2004, we will have completed the network for a total capital expenditure of almost \$210 million. These facilities will be responsible for shipping the majority of orders, with most customers receiving their orders the next day. The distribution centers will also replenish inventory in the branches so customers can get the products they need immediately.



Grainger's Global Sourcing division began working with Asian manufacturers several years ago to produce this Dayton® hand truck in accordance with Grainger's stringent quality standards. The resulting industrial-quality product now costs less to procure. Currently, 94 percent of Grainger's globally sourced products are manufactured in Asia.

Patrick Clark (*above*), an Associate at the Dallas Distribution Center, uses a radio frequency device to pick the products needed to fill customer orders. Advanced technology guides

each order along a 1.5-mile long conveyor that snakes through the facility. The system stops orders at the appropriate picking locations, then sorts them for shipment to customers.

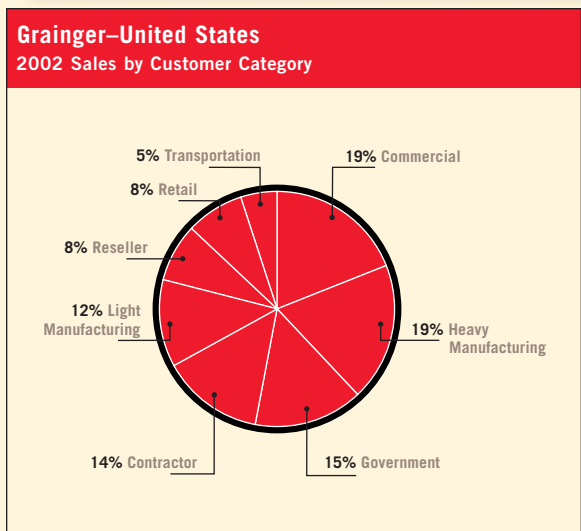
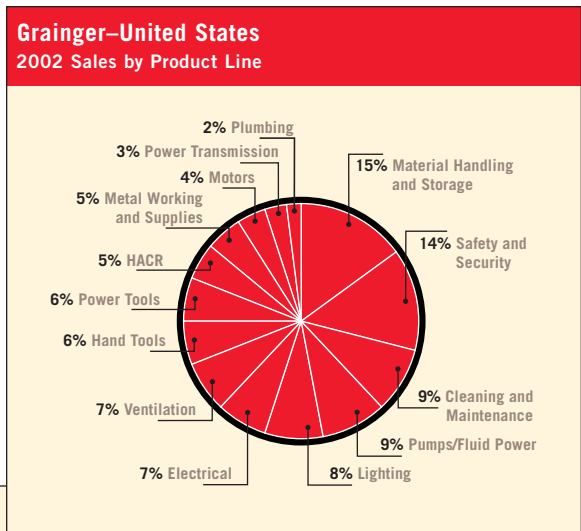


By producing and mailing catalogs targeted to specific customer needs, Lab Safety, Grainger's direct marketing subsidiary, can prospect for customers cost effectively while showcasing the depth of its product line. In 2002, Lab Safety produced 10 unique catalogs and offered some 100,000 different products.

Our Los Angeles and Dallas distribution centers have now been in operation for more than a year, and through their experiences we are learning how to efficiently bring the remaining facilities on line. To meet our productivity goals, we are emphasizing tighter supplier performance along with improved processes across our network.

We're also analyzing the product mix at each facility so that we're able to ship more complete orders to customers. And we're phasing in the branch replenishment function at the new distribution centers to help smooth the start-up process.

We opened our third new distribution center in Chicago in 2002 and stocked it with virtually all of the products offered in our catalog. This allows us to be prepared for a customer emergency without allocating valuable shelf space at each facility to products that sell less frequently. In the first quarter of 2003, we plan to open our fourth distribution center in Jacksonville, Fla. The Jacksonville facility enables us to ship next-day to south Florida.



As the leading broad-line industrial distributor in North America, Grainger carefully selects its product mix to offer customers a wide range of choices across the major subcategories of the

facilities maintenance market. Grainger's customer base is diverse as well. This leaves the company less exposed than most of its competitors during a manufacturing downturn.

The recently expanded showroom at Grainger's Morton Grove, Ill., branch (right) provides customers easy access to a wide range of brand-name products. In 2002 Grainger operated 395 branches in the United States and Puerto Rico, as well as 176 branches in Canada and five in Mexico.

The remaining distribution centers are located in Kansas City, Mo.; Greenville County, S.C.; Southaven, Miss. (near Memphis, Tenn.); Cleveland, Ohio; and Washington Township, N.J. (outside New York City).

### **Increasing product selection at our branches**

We're also working to continually improve customers' experiences in our branches. In 2002, we added more than \$90 million of the fastest-moving inventory to our U.S. branches and distribution centers. The inventory infusion was designed to broaden our product offering at the branch level to further improve service. Based on our experience, it also should help stimulate greater sales growth as the economy recovers.

### **Raising visibility throughout our network**

Having added additional inventory, the next step is to ensure that our employees have access to all the information they need to complete the customer's order. To help supply that information, we are continuing the rollout of our enterprise resource planning system to our central systems. Once completed, it will help us manage our day-to-day sales, distribution and materials management operations, driving improvements in productivity, service and growth. Systems integration is a critical element in effectively managing and growing our business.



FUNDAMENTALS

DISTRIBUTION

SERVICE

CORPORATE RESPONSIBILITY

# Service keeps customers coming back

What is exceptional service? For Grainger customers, it's having information at their fingertips and finding the products that solve their problems. It's placing the order, receiving the products and understanding the invoice without having to make a follow-up call. It's establishing a relationship that saves customers time and money again and again.

**F**or 75 years, we have understood our customers' needs and served them well. We're ensuring that exceptional service is something customers experience every time they do business with Grainger.

One of the primary ways that customers benefit from a relationship with Grainger is the overall value that we provide. Our broad inventory, multiple channels, North American presence, and time-saving tools and information are helping many customers better manage their procurement processes.

## Lowering the cost of procurement

We see a great opportunity to gain share through market consolidation as customers seek ways to lower the cost of indirect material purchases. For instance, in 2002,



Laura Hornsby, Account Manager, helps Raul Hernandez, Service Technician at Osprey Lake Apartments in Gurnee, Ill., locate the products that meet his needs. Grainger's 1,200 U.S. sales representatives work with customers face-to-face to better understand their needs and help guide them toward cost-saving solutions in the Grainger catalog, online or by accessing Grainger's repair parts or sourcing services.

the U.S. Postal Service scaled down its supplier base for janitorial products from 1,000 suppliers to just two. The Postal Service selected Grainger as a key supplier because of our ability to provide a broad range of products, documented cost savings, dedicated account representatives and supplier support. It also values the training we provide for improving customer service. As a result, the Postal Service has said it expects to realize significant savings in 2003.

## Identifying new opportunities for service improvements

Implementing service initiatives across all our sales channels gives

customers more ways to solve their problems through Grainger. For instance, we developed new, proprietary click-and-find technology to help our branch service





James Dewberry, *(above, left)* Customer Sales Associate at the on-site branch at Langley Air Force Base in Hampton Roads, Va., completes an order for the base's Operations Superintendent *(right)* while Grainger Branch Manager Mark Caffee *(center)* helps answer questions.

The Hampton Roads area is also home to the Norfolk Naval Station, where Grainger provides supplies that help maintain both the fleet and the buildings on the base. Overall, sales to federal, state and local government customers grew by 13 percent in 2002.

representatives more quickly navigate to in-stock product solutions that meet customer needs. This technology was used in more than 40 percent of our branch transactions in 2002.

In another example, we infused additional inventory into our four branches in Phoenix, Ariz. Customers found more of what they needed, and they kept coming back. As a result of this success, we're expanding inventory into several other major markets in 2003. In Atlanta, Ga., we found that customers valued the convenience of new checkout stations and customer cards that assist with account identification. Both of these successes can be duplicated elsewhere across the network. Finally, we added a new, on-site branch at



Debbie Weaver, Integrated Supply On-site Manager, works with Goodrich Tooling Manager Harold Dornon to oversee the indirect materials management process at Goodrich's landing gear plant in Tullahoma, Tenn. Grainger's Integrated Supply division implemented

automated point-of-use dispensing systems at the plant to help control inventory, manage information, and reduce costs. Since Integrated Supply began collaborating with the Tullahoma facility in late 2001, Goodrich has realized savings in excess of \$600,000 at the plant.



Langley Air Force Base in Hampton Roads, Va., making it easier for Air Force personnel to get the products they need quickly. As a result, sales to the base have increased dramatically. We plan to add several more on-site branches in 2003.

We're also continuing to leverage the Internet as a means of growth. Historically, customers who have begun to buy from Grainger online have shown subsequent incremental sales growth of more than 10 percent across all channels. In 2002, we implemented new

features such as online order management, which enables customers to monitor and place limits on the amount their employees can spend without further approval. As a result, customers can now more efficiently manage their procurement processes. Initial data shows that the average amount spent per order by customers using this system is almost 70 percent greater than the order size of customers not using online order management. We also continually work with larger customers that use fully integrated e-procurement systems. In 2002, we developed location-specific lists of pre-approved products so that customers can reduce their procurement costs by streamlining their supplier base. Currently, Grainger has connected to the e-procurement systems of more than 150 customers across some 11,000 locations.



Grainger sold more than 40 million General Electric light bulbs in 2002, making the company the leading commercial and industrial distributor of lighting products in North America for the sixth straight year.

Sales to the Henry Ford Health System in Michigan grew by almost 60 percent in 2002 because of Grainger's relationship with Premier, a leading healthcare alliance collectively

owned by more than 200 independent, not-for-profit hospitals and healthcare systems. By taking advantage of this national account agreement with Grainger, Premier's 1,500 member

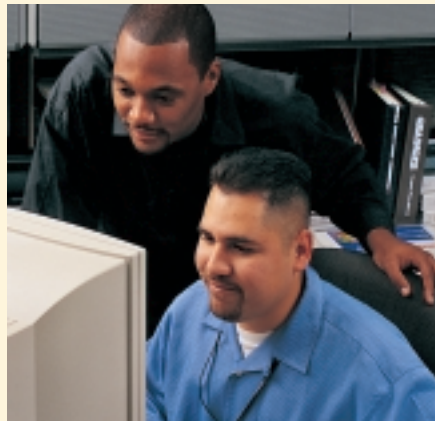
facilities can achieve significant cost savings. Overall, sales to Premier grew by more than 10 percent in 2002.

# Leadership means building for the future

Customers want to buy from companies they can count on. Employees want to work for companies that are involved in their communities. Shareholders want to invest in companies that are financially sound. At Grainger we've built that trust by upholding the highest ethical standards and forging strong relationships with those we serve.

**T**hroughout our 75-year history, Grainger has contributed to the communities in which we do business and helped them build for the future. In 2002, we contributed more than \$10 million in cash and product, including \$2.4 million through our Matching Charitable Gifts Program. Each calendar year, Grainger provides a three-for-one match for each employee's contributions of up to \$2,500 to educational, cultural and community health and human service organizations, for a total contribution of up to \$10,000. We are one of the few companies that match at this significant level.

In order to make the best use of any overstocked inventory, we often donate these products to not-for-profit



Christopher Lewis, Junior Network Engineer (*left*), and Juan Ruiz, Web Application Developer, consult on the design and functionality of a new Web application. They are the first employees to participate in Grainger's G-Star program, a rotational program initiated in 2002 as part of Grainger's vocational support and education efforts.

organizations. One recipient, the National Association for the Exchange of Industrial Resources, distributes our products to schools and other organizations. Another, Educational Assistance, Ltd., offers the inventory to colleges and universities in exchange for scholarships for thousands of needy students nationwide. In total, Grainger donated almost \$7 million in product in 2002.

Grainger also supports programs in the following key areas:

## Disaster Relief

When disaster strikes, Grainger is there with the supplies, people, and expertise that communities need to rebuild America. In 2002, Grainger donated cash and product to Red Cross chapters across the country, helping communities recover from fires, tornadoes, ice storms



and hurricanes. We are also a partner of the American Red Cross of Greater Chicago's "Ready When the Time Comes" Program, which trains employees as volunteers to support local disaster relief efforts. In 2002, Grainger sponsored a CD-ROM and Web site designed to help other Red Cross chapters nationwide launch similar programs in their communities.

**Minority Supplier Development**

In 2002 we continued our support of the National Minority Supplier Development Council's Advanced Management Education Program, contributing funds for a grant and a scholarship. The program helps minority business owners build their expertise so they can achieve and sustain accelerated growth.

**Vocational Support and Education**

Last year, we began a partnership with i.c.stars, a not-for-profit organization that prepares inner city young adults to attain technology positions in Chicago-area companies. In 2002, we established a rotational development program within our information services department, hiring two graduates of i.c.stars' intense technology education program as the first participants.

In each of the past two years, Grainger has provided more than a dozen internships and two scholarships to exceptional minority students through our affiliation with INROADS, a not-for-profit leadership training and career development organization.

To date, four INROADS interns have joined the Grainger team upon graduation.

