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December 31, 2005, 2004 and 2003

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheet of W.W. Grainger, Inc. and Subsidiaries as of December 31, 2005, and the related consolidated statements of earnings, comprehensive earnings, shareholders' equity, and cash flows for the year ended December 31, 2005. 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. The financial statements of W.W. Grainger, Inc. for the year ended December 31, 2004 and 2003, were audited by other auditors whose report dated February 11, 2005, expressed an unqualified opinion on those statements.

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 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2005 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, 2005, and the consolidated results of its operations and its cash flows for the year ended December 31, 2005, 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), the effectiveness of W.W. Grainger, Inc.'s internal control over financial reporting as of December 31, 2005, 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 21, 2006, expressed an unqualified opinion thereon.

Ernst & Young LLP

Chicago, Illinois
February 21, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that W.W. Grainger, Inc. maintained effective internal control over financial reporting as of December 31, 2005, 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. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of 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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, 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, management's assessment that W.W. Grainger, Inc. maintained effective internal control over financial reporting as of December 31, 2005 is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, W.W. Grainger, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005 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, 2005, and the related consolidated statements of earnings, comprehensive earnings, shareholders' equity, and cash flows for the year ended December 31, 2005 of W.W. Grainger, Inc. and our report dated February 21, 2006, expressed an unqualified opinion thereon.

Ernst & Young LLP

Chicago, Illinois
February 21, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of W.W. Grainger, Inc., and Subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of earnings, comprehensive earnings, shareholders' equity, and cash flows for the two years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements.

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 financial position of W.W. Grainger, Inc., and Subsidiaries as of December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of W.W. Grainger, Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 11, 2005 (not presented herein) expressed an unqualified opinion on the effectiveness of W.W. Grainger, Inc., and Subsidiaries' internal control over financial reporting.

GRANT THORNTON LLP

Chicago, Illinois
February 11, 2005

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,		
	2005	2004	2003
Net sales	\$5,526,636	\$5,049,785	\$4,667,014
Cost of merchandise sold	3,365,095	3,143,133	2,975,513
Gross profit	2,161,541	1,906,652	1,691,501
Warehousing, marketing and administrative expenses	1,642,552	1,465,624	1,303,197
Restructuring charge	—	(226)	(564)
Total operating expenses	<u>1,642,552</u>	<u>1,465,398</u>	<u>1,302,633</u>
Operating earnings	518,989	441,254	388,868
Other income and (expense):			
Interest income	12,882	6,376	3,347
Interest expense	(1,863)	(4,388)	(6,015)
Equity in income (loss) of unconsolidated entities – net.....	2,809	996	(2,288)
Write-off of investments in unconsolidated entities	—	—	(1,921)
Gain on sale of unconsolidated entity	—	750	—
Unclassified – net	(143)	151	(901)
Total other income and (expense)	<u>13,685</u>	<u>3,885</u>	<u>(7,778)</u>
Earnings before income taxes	532,674	445,139	381,090
Income taxes	<u>186,350</u>	<u>158,216</u>	<u>154,119</u>
Net earnings	<u>\$ 346,324</u>	<u>\$ 286,923</u>	<u>\$ 226,971</u>
Earnings per share:			
Basic	<u>\$ 3.87</u>	<u>\$ 3.18</u>	<u>\$ 2.50</u>
Diluted.....	<u>\$ 3.78</u>	<u>\$ 3.13</u>	<u>\$ 2.46</u>
Weighted average number of shares outstanding:			
Basic	<u>89,568,746</u>	<u>90,206,773</u>	<u>90,731,013</u>
Diluted.....	<u>91,588,295</u>	<u>91,673,375</u>	<u>92,394,085</u>

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

W.W. Grainger, Inc. and Subsidiaries**CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS**

(In thousands of dollars)

	For the Years Ended December 31,		
	2005	2004	2003
Net earnings	\$346,324	\$286,923	\$226,971
Other comprehensive earnings (losses):			
Foreign currency translation adjustments, net of tax (expense) benefit of \$(1,642), \$(8,734) and \$9,527, respectively	9,383	15,458	37,600
Unrealized holding loss on deferred compensation plan, net of tax benefit of \$226 for 2005	(353)	—	—
Gains (losses) on investment securities:			
Unrealized holding gains, net of tax (expense) of \$(312) for 2003	—	—	488
Reclassifications for net losses included in earnings, net of tax (benefit) of \$(158) for 2003	—	—	248
	<u>9,030</u>	<u>15,458</u>	<u>38,336</u>
Comprehensive earnings.....	<u>\$355,354</u>	<u>\$302,381</u>	<u>\$265,307</u>

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

W.W. Grainger, Inc. and Subsidiaries**CONSOLIDATED BALANCE SHEETS**

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

ASSETS	As of December 31,		
	2005	2004	2003
CURRENT ASSETS			
Cash and cash equivalents	\$ 544,894	\$ 429,246	\$ 402,824
Accounts receivable (less allowances for doubtful accounts of \$18,401, \$23,375 and \$24,736, respectively)	518,625	480,893	431,896
Inventories	791,212	700,559	661,247
Prepaid expenses and other assets	54,334	47,086	37,947
Deferred income taxes	88,803	96,929	99,499
Total current assets	1,997,868	1,754,713	1,633,413
PROPERTY, BUILDINGS AND EQUIPMENT			
Land	162,123	154,673	153,357
Buildings, structures and improvements	841,031	804,317	785,890
Furniture, fixtures, machinery and equipment	716,497	679,141	605,903
	1,719,651	1,638,131	1,545,150
Less accumulated depreciation and amortization	949,026	876,558	813,158
Property, buildings and equipment – net	770,625	761,573	731,992
DEFERRED INCOME TAXES	4,373	18,871	20,296
INVESTMENTS IN UNCONSOLIDATED ENTITIES	25,155	26,126	22,822
GOODWILL	182,726	165,011	156,269
OTHER ASSETS AND INTANGIBLES – NET	127,174	83,279	59,886
TOTAL ASSETS	<u>\$3,107,921</u>	<u>\$2,809,573</u>	<u>\$2,624,678</u>

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS – CONTINUED

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

LIABILITIES AND SHAREHOLDERS' EQUITY	As of December 31,		
	2005	2004	2003
CURRENT LIABILITIES			
Current maturities of long-term debt.....	\$ 4,590	\$ 9,485	\$ 144,135
Trade accounts payable	319,254	289,388	257,806
Accrued compensation and benefits	164,574	138,143	121,550
Accrued contributions to employees' profit sharing plans	106,825	89,878	58,100
Accrued expenses.....	107,167	100,287	81,359
Income taxes	24,554	35,253	43,690
Total current liabilities	726,964	662,434	706,640
LONG-TERM DEBT (less current maturities)	4,895	—	4,895
DEFERRED INCOME TAXES.....	7,019	4,482	—
ACCRUED EMPLOYMENT-RELATED BENEFITS COSTS	80,067	74,687	68,008
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; issued, 109,667,938, 109,672,938 and 109,377,216 shares, respectively	54,834	54,836	54,689
Additional contributed capital.....	451,578	432,171	394,409
Retained earnings	2,722,103	2,458,442	2,242,762
Unearned restricted stock compensation	(17,280)	(14,463)	(11,471)
Accumulated other comprehensive earnings.....	27,082	18,052	2,594
Treasury stock, at cost – 19,952,297, 19,075,511 and 18,356,227 shares, respectively	(949,341)	(881,068)	(837,848)
Total shareholders' equity	2,288,976	2,067,970	1,845,135
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$3,107,921	\$2,809,573	\$2,624,678

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

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of dollars)

	For the Years Ended December 31,		
	2005	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net earnings	\$ 346,324	\$ 286,923	\$ 226,971
Provision for losses on accounts receivable	1,326	5,159	9,263
Deferred income taxes	23,663	(4,450)	5,382
Depreciation and amortization:			
Property, buildings and equipment	98,087	85,566	74,583
Capitalized software and other intangibles	10,695	12,690	15,670
Tax benefit of stock incentive plans	11,962	12,068	2,091
Gains on sales of investment securities	—	(50)	(1,208)
Net gains on sales of property, buildings and equipment	(7,337)	(1,725)	(1,607)
(Income) losses and write-off of unconsolidated entities ...	(2,809)	(996)	4,209
Change in operating assets and liabilities – net of business acquisitions and joint venture contributions:			
(Increase) decrease in accounts receivable	(36,378)	(49,935)	(7,194)
(Increase) decrease in inventories	(84,031)	(30,728)	83,530
(Increase) decrease in prepaid expenses	(6,251)	(9,087)	(7)
Increase (decrease) in trade accounts payable	27,121	29,302	(37,420)
Increase (decrease) in other current liabilities	47,690	66,305	9,307
Increase (decrease) in current income taxes payable	(10,632)	(4,268)	3,333
Increase (decrease) in accrued employment-related benefits costs	5,380	6,679	4,217
Other – net	7,733	3,034	2,988
Net cash provided by operating activities	432,543	406,487	394,108
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to property, buildings and equipment	(112,297)	(128,276)	(74,064)
Proceeds from sales of property, buildings and equipment – net	15,037	17,616	12,144
Additions to capitalized software	(44,950)	(32,482)	(6,422)
Proceeds from sales of investment securities	—	50	6,115
Net cash paid for business acquisitions	(24,817)	—	(36,713)
Loan repayment from (investments in and loans to) unconsolidated entities	4,088	—	(8,241)
Other – net	(46)	700	1,900
Net cash used in investing activities	(162,985)	(142,392)	(105,281)

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS – CONTINUED

(In thousands of dollars)

	For the Years Ended December 31,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net decrease in short-term debt	\$ —	\$ —	\$ (2,967)
Long-term debt payments	—	(140,800)	(1,915)
Long-term debt issuance	—	—	318
Stock options exercised	65,997	72,275	15,171
Purchase of treasury stock – net	(137,473)	(100,872)	(41,204)
Cash dividends paid.....	<u>(82,663)</u>	<u>(71,243)</u>	<u>(67,281)</u>
 Net cash used in financing activities.....	 (154,139)	 (240,640)	 (97,878)
 Exchange rate effect on cash and cash equivalents	 <u>229</u>	 <u>2,967</u>	 <u>3,347</u>
 NET INCREASE IN CASH AND CASH EQUIVALENTS.....	 115,648	 26,422	 194,296
 Cash and cash equivalents at beginning of year	 <u>429,246</u>	 <u>402,824</u>	 <u>208,528</u>
 Cash and cash equivalents at end of year	 <u>\$ 544,894</u>	 <u>\$ 429,246</u>	 <u>\$ 402,824</u>
 Supplemental cash flow information:			
Cash payments for interest (net of amounts capitalized)	\$ 1,791	\$ 3,408	\$ 6,082
Cash payments for income taxes	162,030	154,589	144,025
 Noncash investing activities:			
Fair value of noncash assets acquired in business acquisition.....	\$ 26,811	\$ —	\$ 37,381
Liabilities assumed in business acquisition.....	(1,994)	—	(668)
Increase in fair value of investment securities, net of tax	—	—	736

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

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

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

	Common Stock	Additional Contributed Capital	Retained Earnings	Unearned Restricted Stock Compensation	Accumulated Other Comprehensive Earnings (Losses)	Treasury Stock
Balance at January 1, 2003	\$54,509	\$379,942	\$2,083,072	\$(17,144)	\$(35,742)	\$(796,939)
Exercise of stock options	205	14,726	—	—	—	250
Tax benefits on stock options exercised	—	1,855	—	—	—	—
Issuance of other stock-based compensation awards	(5)	(448)	—	(1,083)	—	—
Tax benefits on other vested stock-based compensation awards ...	—	236	—	—	—	—
Remeasurement of other stock-based compensation awards ...	—	129	—	—	—	—
Cancellation of other stock-based compensation awards ...	(20)	(1,986)	—	2,005	—	—
Amortization of unearned compensation on other stock-based compensation awards	—	—	—	4,751	—	—
Purchase of 918,300 shares of treasury stock; 6,160 shares issued ...	—	(45)	—	—	—	(41,159)
Other comprehensive earnings	—	—	—	—	38,336	—
Net earnings	—	—	226,971	—	—	—
Cash dividends paid (\$0.735 per share)	—	—	(67,281)	—	—	—
Balance at December 31, 2003	\$54,689	\$394,409	\$2,242,762	\$(11,471)	\$ 2,594	\$(837,848)
Exercise of stock options	253	11,910	—	—	—	60,112
Tax benefits on stock options exercised	—	10,138	—	—	—	—
Issuance of other stock-based compensation awards	5	12,647	—	(12,652)	—	—
Tax benefits on other vested stock-based compensation awards ...	—	1,930	—	—	—	—
Conversion of restricted stock to restricted stock units	(108)	108	—	—	—	—
Remeasurement of stock options and other stock-based compensation awards	—	2,620	—	(809)	—	—
Cancellation of other stock-based compensation awards	(3)	(1,479)	—	1,482	—	—
Amortization of unearned compensation on other stock-based compensation awards	—	—	—	8,987	—	—
Settlement of other stock-based compensation awards	—	(161)	—	—	—	(2,411)
Purchase of 2,001,000 shares of treasury stock; 5,510 shares issued ...	—	49	—	—	—	(100,921)
Other comprehensive earnings	—	—	—	—	15,458	—
Net earnings	—	—	286,923	—	—	—
Cash dividends paid (\$0.785 per share)	—	—	(71,243)	—	—	—
Balance at December 31, 2004	\$54,836	\$432,171	\$2,458,442	\$(14,463)	\$ 18,052	\$(881,068)

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY – CONTINUED

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

	Common Stock	Additional Contributed Capital	Retained Earnings	Unearned Restricted Stock Compensation	Accumulated Other Comprehensive Earnings (Losses)	Treasury Stock
Balance at December 31, 2004	\$54,836	\$432,171	\$2,458,442	\$(14,463)	\$18,052	\$(881,068)
Exercise of stock options	—	(3,882)	—	—	—	69,879
Tax benefits on stock options exercised	—	11,546	—	—	—	—
Issuance of other stock-based compensation awards	—	12,932	—	(12,932)	—	—
Tax benefits on other vested stock-based compensation awards ...	—	416	—	—	—	—
Remeasurement of stock options and other stock-based compensation awards	—	303	—	(208)	—	—
Cancellation of other stock-based compensation awards	(2)	(1,401)	—	1,403	—	—
Amortization of unearned compensation on other stock-based compensation awards	—	—	—	8,920	—	—
Vesting of restricted stock	—	—	—	—	—	(994)
Settlement of other stock-based compensation awards	—	(507)	—	—	—	315
Purchase of 2,372,300 shares of treasury stock	—	—	—	—	—	(137,473)
Other comprehensive earnings	—	—	—	—	9,030	—
Net earnings	—	—	346,324	—	—	—
Cash dividends paid (\$0.920 per share)	—	—	(82,663)	—	—	—
Balance at December 31, 2005	<u>\$54,834</u>	<u>\$451,578</u>	<u>\$2,722,103</u>	<u>\$(17,280)</u>	<u>\$27,082</u>	<u>\$(949,341)</u>

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