NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005, 2004 and 2003

NOTE 1 – BACKGROUND AND BASIS OF PRESENTATION

INDUSTRY INFORMATION

W.W. Grainger, Inc. is the leading broad-line supplier of facilities maintenance and other related products in North America. In this report, the words "Company" or "Grainger" mean W.W. Grainger, Inc. and its subsidiaries.

MANAGEMENT ESTIMATES

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and revenues and expenses. Actual results could differ from those estimates.

RECLASSIFICATIONS

Certain amounts in the 2004 and 2003 financial statements, as previously reported, have been reclassified to conform to the 2005 presentation.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions are eliminated from the consolidated financial statements.

FOREIGN CURRENCY TRANSLATION

The financial statements of the Company's foreign subsidiaries are measured using the local currency as the functional currency. Net exchange gains or losses resulting from the translation of financial statements of foreign operations and related long-term debt are recorded as a separate component of shareholders' equity. See Note 2 to the Consolidated Financial Statements.

INVESTMENTS IN UNCONSOLIDATED ENTITIES

For investments in which the Company owns or controls from 20% to 50% of the voting shares, the equity method of accounting is used. The Company also accounts for investments below 20% using the equity method when significant influence can be exercised over the operating and financial policies of the investee company. See Note 7 to the Consolidated Financial Statements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REVENUE RECOGNITION

Revenues recognized include product sales, billings for freight and handling charges and fees earned for services provided. The Company recognizes product sales and billings for freight and handling charges primarily on the date products are shipped to, or picked up by, the customer. The Company's standard shipping terms are FOB shipping point. On occasion, the Company will negotiate FOB destination terms. These sales are recognized upon delivery to the customer. Fee revenues, which account for less than 1% of total revenues, are recognized after services are completed.

VENDOR CONSIDERATION

The Company accounts for vendor consideration in accordance with Emerging Issues Task Force (EITF) "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor" (Issue 02-16). The Company provides numerous advertising programs to promote its vendors' products, including catalogs and other printed media, Internet and other marketing programs. Most of these programs relate to multiple vendors, which makes supporting the specific, identifiable and incremental criteria difficult, and would require numerous assumptions and judgments. Based on the inexact nature of trying to track reimbursements to the exact advertising expenditure for each vendor, the Company treats most vendor advertising allowances as a reduction of cost of merchandise sold rather than a reduction of operating (advertising) expenses. Rebates earned from vendors that are based on purchases are capitalized into inventory as part of product purchase price. These rebates are credited to cost of merchandise sold based on sales. Vendor rebates that are earned based on product sales are credited directly to cost of merchandise sold.

COST OF MERCHANDISE SOLD

Cost of merchandise sold includes product and product-related costs, vendor consideration, freight-out costs and handling costs. The Company defines handling costs as those costs incurred to fulfill a shipped sales order.

WAREHOUSING, MARKETING AND ADMINISTRATIVE EXPENSES

Included in this category are purchasing, branch operations, information services, and marketing and selling expenses, as well as other types of general and administrative costs.

STOCK INCENTIVE PLANS

The Company maintains various stock incentive plans. See Note 14 to the Consolidated Financial Statements. The Company accounts for these plans under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. The Company recognizes compensation cost for restricted shares and restricted stock units granted to employees. No compensation cost is recognized for stock option grants. All options granted under the Company's plans have an exercise price equal to the closing market price of the underlying common stock on the last trading day preceding the date of grant. The following table illustrates the effect on net earnings and earnings per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," to stock-based compensation.

The following table also provides the amount of stock-based compensation cost included in net earnings as reported:

	For the Years Ended December 31,		
	2005	2004	2003
	(In thousands of dollars, except for per share amounts)		
Net earnings, as reported	$346,324	$286,923	$226,971
Deduct:			
Total stock-based employee compensation expense determined under the fair value based method for all awards, net of tax	(16,733)	(20,940)	(17,740)
Add:			
Stock-based employee compensation expense, net of tax, included in net earnings, as reported	6,644	7,256	3,479
Net earnings, pro forma	$336,235	$273,239	$212,710
Earnings per share:			
Basic – as reported	$ 3.87	$ 3.18	$ 2.50
Basic – pro forma	$ 3.75	$ 3.03	$ 2.34
Diluted – as reported	$ 3.78	$ 3.13	$ 2.46
Diluted – pro forma	$ 3.65	$ 2.97	$ 2.31

ADVERTISING

Advertising costs are expensed in the year the related advertisement is first presented. Advertising expense was $102.3 million, $98.2 million and $94.9 million for 2005, 2004 and 2003, respectively. The majority of vendor provided allowances are classified as an offset to cost of merchandise sold. Any reimbursements from vendors that are classified as an offset against operating (advertising) costs are recorded when the related advertising is expensed. For additional information see subsection VENDOR CONSIDERATION.

For interim reporting purposes, advertising expense is amortized equally over each period, based on estimated expenses for the full year. Advertising costs for media that have not been distributed by year-end are capitalized as Prepaid expenses. Amounts included in Prepaid expenses at December 31, 2005, 2004 and 2003 were $20.8 million, $18.2 million and $12.9 million, respectively.

SOFTWARE COSTS

The Company does not sell, lease or market software.

INCOME TAXES

The Company accounts for income taxes in accordance with SFAS No. 109, “Accounting for Income Taxes.” Income taxes are recognized during the year in which transactions enter into the determination of financial statement income, with deferred taxes being provided for temporary differences between financial and tax reporting.

OTHER COMPREHENSIVE EARNINGS (LOSSES)

The Company’s Other comprehensive earnings (losses) include foreign currency translation. Through the third quarter of 2004, the foreign currency translation adjustments were partially offset by the after-tax effects of a designated hedge. Also, included in Other comprehensive earnings (losses) are unrealized (losses) on a deferred compensation plan.

The following table sets forth the components of Accumulated other comprehensive earnings (losses), net of related income tax effects:

	As of December 31,		
	2005	2004	2003
	(In thousands of dollars)		
Foreign currency translation adjustments	$27,435	$18,052	$ 2,594
Unrealized (losses) on deferred compensation plan	(353)	—	—
Total accumulated other comprehensive earnings (losses)	$27,082	$18,052	$ 2,594

CASH FLOWS

The Company considers investments in highly liquid debt instruments, purchased with an original maturity of ninety days or less, to be cash equivalents. For cash equivalents, the carrying amount approximates fair value due to the short maturity of these instruments.

CONCENTRATION OF CREDIT RISK

The Company places temporary cash investments with institutions of high credit quality and, by policy, limits the amount of credit exposure to any one institution.

The Company has a broad customer base representing many diverse industries doing business in all regions of the United States as well as other areas of North America. Consequently, no significant concentration of credit risk is considered to exist.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Company establishes reserves for customer accounts that are potentially uncollectible. The method used to estimate the allowances is based on several factors including the age of the receivables and the historical ratio of actual write-offs to the age of the receivables. These analyses also take into consideration economic conditions that may have an impact on a specific industry, group of customers or a specific customer. Write-offs could be materially different than the reserves provided if economic conditions change or actual results deviate from historical trends.

INVENTORIES

Inventories are valued at the lower of cost or market. Cost is determined primarily by the last-in, first-out (LIFO) method, which accounts for approximately 77% of total inventory. For the remaining inventory, cost is determined by the first-in, first-out (FIFO) method.

PROPERTY, BUILDINGS AND EQUIPMENT

Property, buildings and equipment are valued at cost. For financial statement purposes, depreciation and amortization are provided in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives, principally on the declining-balance and sum-of-the-years-digits methods. The principal estimated useful lives for determining depreciation are as follows:

Buildings, structures and improvements	10 to 45 years
Furniture, fixtures, machinery and equipment	3 to 10 years

Improvements to leased property are amortized over the initial terms of the respective leases or the estimated service lives of the improvements, whichever is shorter.

The Company capitalized interest costs of $0.3 million, $0.2 million and $0.2 million in 2005, 2004 and 2003, respectively.

LONG-LIVED ASSETS

The carrying value of long-lived assets is evaluated whenever events or changes in circumstances indicate that the carrying value of the asset may be impaired. An impairment loss is recognized when estimated undiscounted future cash flows resulting from use of the asset, including disposition, is less than the carrying value of the asset. Impairment is measured as the amount by which the carrying amount exceeds the fair value.

GOODWILL AND OTHER INTANGIBLES

The Company follows SFAS No. 142, "Goodwill and Other Intangible Assets" in accounting for goodwill and other intangibles. Under SFAS No. 142, goodwill is recognized as the excess cost of an acquired entity over the net amount assigned to assets acquired and liabilities assumed. Goodwill is not amortized, but rather tested for impairment on an annual basis and more often if circumstances require. Impairment losses are recognized whenever the implied fair value of goodwill is less than its carrying value.

The Company recognizes an acquired intangible apart from goodwill whenever the intangible arises from contractual or other legal rights, or whenever it can be separated or divided from the acquired entity and sold, transferred, licensed, rented or exchanged, either individually or in combination with a related contract, asset or liability. Such intangibles are amortized over their estimated useful lives unless the estimated useful life is determined to be indefinite. Amortizable intangible assets are being amortized over useful lives of three to 17 years. Impairment losses are recognized if the carrying amount of an intangible, subject to amortization, is not recoverable from expected future cash flows and its carrying amount exceeds its fair value.

The Company also maintains intangible assets with indefinite lives, which are not amortized. These intangibles are tested for impairment on an annual basis and more often if circumstances require, similar to the treatment for goodwill. Impairment losses are recognized whenever the implied fair value of these assets is less than their carrying value.

INSURANCE RESERVES

The Company purchases insurance for catastrophic exposures and those risks required to be insured by law. It also retains a significant portion of the risk of losses related to workers' compensation, general liability and property. Reserves for these potential losses are based on an external analysis of the Company's historical claims results and other actuarial assumptions.

WARRANTY RESERVES

The Company generally warrants the products it sells against defects for one year. For a significant portion of warranty claims, the manufacturer of the product is responsible for the expenses. For warranty expenses not covered by the manufacturer, the Company provides a reserve for future costs based primarily on historical experience. The reserve activity was as follows:

	As of December 31,		
	2005	2004	2003
	(In thousands of dollars)		
Beginning balance	$ 3,428	$ 2,863	$ 3,000
Returns	(9,179)	(9,908)	(8,143)
Provisions	9,514	10,473	8,006
Ending balance	$ 3,763	$ 3,428	$ 2,863

NEW ACCOUNTING STANDARDS

In March 2005, the FASB issued Financial Interpretation No. 47 (FIN 47), "Accounting for Conditional Asset Retirement Obligations." FIN 47 is an interpretation of certain terms and concepts in SFAS No. 143, "Accounting for Asset Retirement Obligations." FIN 47 clarifies that conditional obligations meet the definition of an asset retirement obligation as used in SFAS No. 143, and therefore should be recognized if the fair value of the contractual obligation is reasonably estimable. Clarification of when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation is also contained in FIN 47, as well as identification of certain required disclosures about unrecognized asset retirement obligations. The provisions of FIN 47 are effective no later than the end of fiscal years ending after December 15, 2005 (as of year-end December 31, 2005 for the Company). Retrospective application for interim financial information is permitted but not required. The adoption of FIN 47 had no material effect on results of operations or financial position for the year ended December 31, 2005.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R). This statement requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements. Compensation cost is to be measured based on the estimated fair value of the equity-based compensation awards issued as of the grant date. The related compensation expense will be based on the estimated number of awards expected to vest and will be recognized over the requisite service period (often the vesting period) for each grant. The statement requires the use of assumptions and judgments about future events and some of the inputs to the valuation models will require considerable judgment by management. SFAS No. 123R replaces FASB Statement No. 123 (SFAS No. 123), "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees."

In March 2005, the SEC released Staff Accounting Bulletin No. 107, "Share-Based Payment" (SAB 107), which provides interpretive guidance related to the interaction between SFAS No. 123R and certain SEC rules and regulations, as well as provides the SEC staff's views regarding the valuation of share-based payment arrangements for public companies. SAB 107 does not change the accounting required by SFAS No. 123R.

On April 14, 2005, the SEC approved a new rule that delayed the effective date of SFAS No. 123R. The SEC's new rule did not change the accounting required by SFAS No. 123R; it changed only the dates for compliance with the standard. Under the rule approved by the SEC, the provisions of SFAS No. 123R are now required to be applied by public companies as of the first annual reporting period that begins after June 15, 2005 (as of January 1, 2006 for the Company). The Company has applied APB Opinion No. 25 to equity-based compensation awards until the effective date of SFAS No. 123R. At the effective date of SFAS No. 123R, the Company will use the modified prospective application transition method without restatement of prior periods. This will result in the Company recognizing compensation cost based on the requirements of SFAS No. 123R for all equity-based compensation awards issued after January 1, 2006. For all equity-based compensation awards that are unvested as of January 1, 2006, compensation cost will be recognized for the unamortized portion of compensation cost not previously included in the SFAS No. 123 pro forma footnote disclosure. The Company has evaluated the impact of adoption of SFAS No. 123R on its results of operations and financial position and projects that adoption will have an estimated $0.15 per diluted share effect for 2006.

On June 1, 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections," a replacement of APB Opinion No. 20 and SFAS No. 3. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. SFAS No. 154's retrospective application requirement replaces APB No. 20's requirement to recognize most voluntary changes in accounting principle by including the cumulative effect of changing to the new accounting principle in net income of the period of the change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 (as of January 1, 2006, for the Company). Earlier application is permitted for accounting changes and correction of errors made in fiscal years beginning after June 1, 2005. The Company does not expect adoption of SFAS No. 154 to have a material effect on its results of operations or financial position.

NOTE 3 – BUSINESS ACQUISITIONS

On January 14, 2005, Lab Safety Supply, Inc. (Lab Safety), a wholly owned subsidiary of the Company, acquired substantially all of the assets and assumed certain liabilities of AW Direct, Inc. AW Direct, Inc., a targeted direct marketer of products to the service vehicle accessories market, had sales of more than $28 million in 2004. The results of the AW Direct business are included in the Company's consolidated results for the period subsequent to January 14, 2005.

The aggregate purchase price was $24.8 million in cash and approximately $2.0 million in assumed liabilities. Goodwill recognized in this transaction amounted to $14.0 million and is expected to be fully deductible for tax purposes. Due to the immaterial nature of this transaction, disclosures of amounts assigned to the acquired assets and assumed liabilities and pro forma results of operations are not considered necessary.

On April 14, 2003, Lab Safety acquired substantially all of the assets and assumed certain liabilities of Gempler's, a direct marketing division of Gempler's Inc., located in Wisconsin. The results of Gempler's operations have been included in the Company's consolidated financial statements since that date. Gempler's serves the agricultural, horticultural, grounds maintenance and contractor markets. The aggregate purchase price was $36.7 million in cash and $0.7 million in assumed liabilities. Goodwill recognized in this transaction was $22.8 million. Due to the immaterial nature of this transaction, disclosures of amounts assigned to the acquired assets and liabilities and pro forma results of operations were not considered necessary.

NOTE 4 – RESTRUCTURING CHARGE

A reserve was originally established in 2001 to provide $39.1 million (after-tax $23.2 million) for the shutdown of the Material Logic business. Activity in 2003 and 2004 represented the final wind-down of this business.

The following tables show the activity from January 1, 2003 to December 31, 2004 related to the Material Logic restructuring reserve (in thousands of dollars):

	Jan. 1, 2003	Deductions	Adjustments	Dec. 31, 2003
Restructuring reserve (Operating expenses):				
Workforce reductions	$ 1,644	$(1,100)	$(122)	$ 422
Other shutdown costs	850	(202)	(442)	206
	$ 2,494	$(1,302)	$(564)	$ 628

	Dec. 31, 2003	Deductions	Adjustments	Dec. 31, 2004
Restructuring reserve (Operating expenses):				
Workforce reductions	$ 422	$ (325)	$ (97)	$ —
Other shutdown costs	206	(77)	(129)	—
	$ 628	$ (402)	$(226)	$ —

Deductions in 2003 and 2004 reflect cash payments of $1.3 million and $0.4 million, respectively. The amounts in the adjustments column are reductions to reflect the Company's revised estimate of costs by expense category.

NOTE 5 – ALLOWANCE FOR DOUBTFUL ACCOUNTS

The following table shows the activity in the allowance for doubtful accounts:

	For the Years Ended December 31,		
	2005	2004	2003
	(In thousands of dollars)		
Balance at beginning of period	$ 23,375	$ 24,736	$ 26,868
Provision for uncollectible accounts	1,326	5,159	9,263
Write-off of uncollectible accounts, less recoveries	(6,380)	(6,662)	(11,713)
Foreign currency exchange impact	80	142	318
Balance at end of period	$ 18,401	$ 23,375	$ 24,736

NOTE 6 – INVENTORIES

Inventories primarily consist of merchandise purchased for resale.

Inventories would have been $246.3 million, $238.4 million and $234.4 million higher than reported at December 31, 2005, 2004 and 2003, respectively, if the FIFO method of inventory accounting had been used for all Company inventories. Net earnings would have increased by $4.9 million, $2.4 million and $4.3 million for the years ended December 31, 2005, 2004 and 2003, respectively, using the FIFO method of accounting. Inventory values using the FIFO method of accounting approximate replacement cost.

NOTE 7 – INVESTMENTS IN UNCONSOLIDATED ENTITIES

The Company has a 50% ownership interest in USI-AGI Prairies Inc., a joint venture formed between Acklands and Uni-Select Inc. (Uni-Select), a Canadian company. The joint venture is managed by Uni-Select. Under the terms of a shareholder agreement, Uni-Select has a call option under which it can acquire, for a price based on a formula, all of Acklands' ownership interest in USI-AGI Prairies, Inc. The carrying value of Ackland's investment in this joint venture includes U.S. $5.1 million of allocated goodwill. In 2003, Acklands made a loan denominated in Canadian dollars to USI-AGI Prairies Inc., of U.S. $3.7 million bearing interest at market rates. The loan was paid in full in the second quarter of 2005. The gains or losses due to exchange rate fluctuations are recognized in the foreign currency translation adjustment as a component of Accumulated other comprehensive earnings (losses). The Company accounts for the joint venture using the equity method of accounting.

The Company also has held investments in three Asian joint ventures. In the fourth quarter of 2003, the Company wrote off its investment in two of these Asian joint ventures due to the uncertainty regarding their future profitability and their ability to secure sufficient capital funding. In the first quarter of 2004, the Company sold its 11% interest in one of these investments for a gain of $0.8 million. At December 31, 2005, the ownership percentages of the two remaining investments were 39% and 49%. The Company accounts for these joint ventures using the equity method of accounting.

The table below summarizes the activity of these investments:

	Investment Cost	Loan	Cumulative After-Tax Equity Income (Losses)	Divestiture/ Write-off	Foreign Currency Translation Adjustment	Total
	(In thousands of dollars)					
Balance at January 1, 2003	$ 55,289	$ —	$ (21,085)	$ (17,621)	$ (595)	$ 15,988
USI-AGI Prairies Inc.	—	3,706	1,442	—	2,802	7,950
Other equity investments	4,535	—	(3,730)	(1,921)	—	(1,116)
Balance at December 31, 2003	59,824	3,706	(23,373)	(19,542)	2,207	22,822
USI-AGI Prairies Inc.	—	—	2,103	—	1,784	3,887
Other equity investment	—	—	(1,107)	—	524	(583)
Balance at December 31, 2004	59,824	3,706	(22,377)	(19,542)	4,515	26,126
USI-AGI Prairies Inc.	—	(3,706)	2,337	—	255	(1,114)
Other equity investment	—	—	472	—	(329)	143
Balance at December 31, 2005	$ 59,824	$ —	$ (19,568)	$ (19,542)	$ 4,441	$ 25,155

NOTE 8 – INVESTMENTS

The Company completed the sale of certain investments in nonpublicly traded equity securities in 2004 and its marketable securities in 2003. Gains on sales of investments of $50,000 and $1.2 million in 2004 and 2003, respectively, were calculated using the specific identification method and were reported in Unclassified – net. The proceeds from these sales were $50,000 and $6.1 million in 2004 and 2003, respectively.

NOTE 9 – CAPITALIZED SOFTWARE

Amortization of capitalized software is on a straight-line basis over three and five years. Amortization begins when the software is available for its intended use. Amortization expense was $7.6 million, $10.7 million and $14.0 million for the years ended December 31, 2005, 2004 and 2003, respectively. The Company reviews the amounts capitalized for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. In 2004 and 2003, the Company determined certain capitalized amounts were no longer recoverable and wrote down their carrying value by $1.0 million in each year.

NOTE 10 – SHORT-TERM DEBT

The Company has had no short-term borrowings since 2003. For 2003, the maximum borrowing at any month-end was approximately $3.0 million, with the average amount outstanding during the year approximately $1.4 million. The weighted average interest rate during the year was 2.6%.

The Company and its subsidiaries had committed lines of credit totalling $250.0 million at December 31, 2005 and 2004, and $265.4 million at December 31, 2003. There were no borrowings under the committed lines of credit. The committed lines of credit at December 31, 2003 included $15.4 million denominated in Canadian dollars.

The Company also had $8.6 million, $8.3 million and $7.7 million of uncommitted lines of credit denominated in Canadian dollars at December 31, 2005, 2004 and 2003, respectively.

The Company had $15.8 million, $16.0 million and $15.0 million of letters of credit at December 31, 2005, 2004 and 2003, respectively, primarily related to the Company's casualty insurance program. The Company also had $1.4 million, $0.9 million and $2.5 million at December 31, 2005, 2004 and 2003, respectively, in letters of credit to facilitate the purchase of product from foreign sources.

NOTE 11 – EMPLOYEE BENEFITS

Retirement Plans

A majority of the Company's employees are covered by a noncontributory profit sharing plan. This plan provides for annual employer contributions generally based upon a formula related primarily to earnings before federal income taxes, limited to 25% of the total compensation paid to all eligible employees. The Company also sponsors additional defined contribution plans, which cover most of the other employees. Provisions under all plans were $92.8 million, $74.2 million and $45.9 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Postretirement Benefits

The Company has a postretirement healthcare benefits plan that provides coverage for a majority of its retired employees and their dependents should they elect to maintain such coverage. Covered employees become eligible for participation when they qualify for retirement while working for the Company. Participation in the plan is voluntary and requires participants to make contributions toward the cost of the plan, as determined by the Company.

The Company's accumulated postretirement benefit obligation (APBO) and net periodic benefit costs include the effect of the federal subsidy provided by the "Medicare Prescription Drug, Improvement and Modernization Act of 2003" (the Medicare Act). The Medicare Act provides a federal subsidy to retiree healthcare benefit plan sponsors that provide a prescription drug benefit that is at least actuarially equivalent to that provided by Medicare, with subsidy payments beginning January 1, 2006. The Company first reflected the effect of the subsidy in 2004, in which the APBO was reduced by $20.8 million and net periodic benefit costs were reduced by $3.8 million. The 2005 APBO and net periodic benefit costs have decreased by approximately $30.6 million and $4.4 million, respectively, due to the effect of the Medicare Act.

The net periodic benefits costs charged to operating expenses, which were valued with a measurement date of January 1 for each year, including the effect of the Medicare Act in 2005 and 2004, consisted of the following components:

	For the Years Ended December 31,		
	2005	2004	2003
	(In thousands of dollars)		
Service cost	$ 7,577	$ 6,380	$ 6,462
Interest cost	6,287	5,292	5,662
Expected return on assets	(2,502)	(2,064)	(1,081)
Amortization of transition asset	(143)	(143)	(143)
Amortization of unrecognized losses	1,923	1,371	2,002
Amortization of prior service cost	(858)	(858)	(641)
Net periodic benefits costs	$ 12,284	$ 9,978	$ 12,261

The Company has elected to amortize the amount of net unrecognized losses over a period equal to the average remaining service period for active plan participants expected to retire and receive benefits, or approximately 17.3 years for 2005.

Reconciliations of the beginning and ending balances of the APBO, which is calculated using a December 31 measurement date, the fair value of assets and the funded status of the benefit obligation follow:

	2005	2004	2003
	(In thousands of dollars)		
Benefit obligation at the beginning of the year	$103,381	$107,710	$ 90,141
Service cost	7,577	6,380	6,462
Interest cost	6,287	5,292	5,662
Plan participant contributions	1,527	1,364	1,070
Amendments	—	(2,843)	(6,903)
Actuarial (gains) losses	12,843	(11,194)	14,172
Benefits paid	(4,017)	(3,328)	(2,894)
Benefit obligation at the end of the year	127,598	103,381	107,710
Fair value of plan assets at the beginning of the year	41,706	34,405	20,013
Actual returns on plan assets	1,515	3,026	5,235
Employer contributions	5,772	6,239	10,981
Plan participant contributions	1,527	1,364	1,070
Benefits paid	(4,017)	(3,328)	(2,894)
Fair value of plan assets at the end of the year	46,503	41,706	34,405
Funded status	(81,095)	(61,675)	(73,305)
Unrecognized transition asset	(1,285)	(1,428)	(1,571)
Unrecognized net actuarial losses	38,065	26,157	39,685
Unrecognized prior service cost	(8,014)	(8,872)	(6,887)
Accrued postretirement benefits cost	$ (52,329)	$ (45,818)	$ (42,078)

The benefit obligation was determined by applying the terms of the plan and actuarial models required by SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." These models include various actuarial assumptions, including discount rates, assumed rates of return on plan assets and healthcare cost trend rates. The actuarial assumptions also anticipate future cost-sharing changes to retiree contributions that will maintain the current cost-sharing ratio between the Company and the retirees. The Company evaluates its actuarial assumptions on an annual basis and considers changes in these long-term factors based upon market conditions, historical experience and the requirements of SFAS No. 106.

The plan amendment effective January 1, 2004 changed the retiree co-payments, coinsurance amounts and out-of-pocket maximums for participants. The plan amendment effective January 1, 2003 changed the prescription drug benefits.

The following assumptions were used to determine benefit obligations at December 31:

	2005	2004	2003
Discount rate	5.5%	5.75%	6.0%
Expected long-term rate of return on plan assets, net of tax at 40%	6.0%	6.0%	6.0%
Initial healthcare cost trend rate	10.0%	10.0%	10.5%
Ultimate healthcare cost trend rate	5.0%	5.0%	5.0%
Year ultimate healthcare cost trend rate reached	2016	2016	2016

The following assumptions were used to determine net periodic benefit cost for years ended December 31:

	2005	2004	2003
Discount rate	5.75%	6.0%	6.5%
Expected long-term rate of return on plan assets, net of tax at 40%	6.0%	6.0%	5.4%
Initial healthcare cost trend rate	10.0%	10.0%	10.5%
Ultimate healthcare cost trend rate	5.0%	5.0%	5.0%
Year ultimate healthcare cost trend rate reached	2016	2016	2016

The discount rate assumptions reflect the rates available on high-quality fixed income debt instruments on December 31 of each year. These rates have been selected due to their similarity to the projected cash flows of the postretirement healthcare benefit plan.

The Company reviews external data and its own historical trends for healthcare costs to determine the healthcare cost trend rates. Assumed healthcare cost trend rates have a significant effect on the amounts reported for the healthcare plans. A one-percentage-point change in assumed healthcare cost trend rates would have the following effects on December 31, 2005 results:

	1-Percentage-Point	
	Increase	(Decrease)
	(In thousands of dollars)	
Effect on total of service and interest cost	$ 3,285	$ (2,530)
Effect on accumulated postretirement benefit obligation	26,093	(20,932)

The Company has established a Group Benefit Trust to fund the plan and process benefit payments. The assets of the trust are invested entirely in funds designed to track the Standard & Poor's 500 Index (S&P 500). This investment strategy reflects the long-term nature of the plan obligation and seeks to take advantage of the superior earnings potential of equity securities. The Company uses the long-term historical return on the plan assets and the historical performance of the S&P 500 to develop its expected return on plan assets. The required use of an expected long-term rate of return on plan assets may result in recognizing income that is greater or less than the actual return on plan assets in any given year. Over time, however, the expected long-term returns are designed to approximate the actual long-term returns and, therefore, result in a pattern of income recognition that more closely matches the pattern of the services provided by the employees. The change in the expected long-term rate of return on plan assets did not have a material effect on the net periodic benefit cost for the year ended December 31, 2004.

The funding of the trust is an estimated amount which is intended to allow the maximum deductible contribution under the Internal Revenue Code of 1986 (IRC), as amended, and was $5.8 million, $6.2 million and $11.0 million, for the years ended December 31, 2005, 2004 and 2003, respectively. During those years, $2.7 million, $1.7 million and $2.0 million were used directly for benefit payments. There are no minimum funding requirements and the Company intends to follow its practice of funding the maximum deductible contribution under the IRC.

The Company forecasts the following benefit payments (which include a projection for expected future employee service), and subsidy receipts (in thousands of dollars):

	Estimated gross benefit payments	Estimated Medicare subsidy receipts
2006	$ 2,664	$ (279)
2007	3,099	(324)
2008	3,506	(388)
2009	4,033	(454)
2010	4,623	(533)
2011-2015	$35,646	$(4,174)

Executive Death Benefit Plan

The Executive Death Benefit Plan provides one of two potential benefits: supplemental income benefit (SIB) or an executive death benefit (EDB). The SIB provides income continuation at 50% of total compensation, payable for ten years to the beneficiary of a participant if that participant dies while employed by the Company. Alternatively, the EDB provides an after-tax lump sum payment of one times final total compensation to the beneficiary of a participant who dies after retirement. Plan participation is determined by a committee of management. There are no plan assets. Benefits are paid as they come due from the general assets of the Company.

The net periodic benefits costs charged to operating expenses, which were valued with a measurement date of January 1 for each year, consisted of the following components:

	For the Years Ended December 31,		
	2005	2004	2003
	(In thousands of dollars)		
Service cost	$ 277	$ 242	$ 211
Interest cost	791	869	861
Amortization of unrecognized losses	69	185	167
Net periodic benefits costs	$ 1,137	$ 1,296	$ 1,239

Reconciliations of the beginning and ending balances of the projected benefit obligation, which is calculated using a December 31 measurement date, the fair value of assets and the status of the benefit obligation follow:

	2005	2004	2003
	(In thousands of dollars)		
Benefit obligation at the beginning of the year	$ 13,921	$ 14,660	$ 13,406
Service cost	277	242	211
Interest cost	791	869	861
Actuarial losses (gains)	562	(1,126)	299
Benefits paid	(329)	(724)	(117)
Benefit obligation at the end of the year	15,222	13,921	14,660
Fair value of plan assets at the beginning of the year	—	—	—
Employer contributions	329	724	117
Benefits paid	(329)	(724)	(117)
Fair value of plan assets at the end of the year	—	—	—
Benefit obligation	(15,222)	(13,921)	(14,660)
Unrecognized net actuarial losses	1,485	992	2,304
Accrued postretirement benefits cost	$ (13,737)	$ (12,929)	$ (12,356)

The benefit obligation was determined by applying the terms of the plan and actuarial models required by SFAS No. 87, "Employers' Accounting for Pensions." These models include various actuarial assumptions, including discount rates, mortality and salary progression. The Company evaluates its actuarial assumptions on an annual basis and considers changes in these long-term factors based upon market conditions, historical experience and the requirements of SFAS No. 87.

The following assumptions were used to determine benefit obligations at December 31:

	2005	2004	2003
Discount rate used to determine benefit obligation	5.50%	5.75%	6.00%
Discount rate used to determine net periodic benefit cost	5.75%	6.00%	6.50%
Compensation increase used to determine obligation and cost	4.00%	4.00%	4.00%

The discount rate assumptions reflect the rates available on high-quality fixed income debt instruments on December 31 of each year. These rates have been selected due to their similarity to the projected cash flows of the executive death benefit plan.

Projected future benefit payments (in thousands of dollars):

	Benefit Payments
2006	$ 395
2007	466
2008	557
2009	609
2010	664
2011-2015	$4,300

Deferred Compensation Plans

The Executive Deferred Compensation Plans are money purchase defined benefit plans. These benefits are reduced for early retirement. Plan participation was limited to Company executives during the years 1984 to 1986; no new executives have been added since that time. Participants were allowed to defer a portion of their compensation for the years 1984 through 1990. In return, under the plan, each participant receives an individually specified benefit at age 65. There are no plan assets. Benefits are paid as they come due from the general assets of the Company.

The net periodic benefits costs charged to operating expenses, which were valued with a measurement date of January 1 for each year, consisted of the following components:

	For the Years Ended December 31,		
	2005	2004	2003
	(In thousands of dollars)		
Interest cost	$ 610	$ 659	$ 695
Amortization of unrecognized losses (gains)	108	28	(60)
Net periodic benefits costs	$ 718	$ 687	$ 635

Reconciliations of the beginning and ending balances of the projected benefit obligation, which is calculated using a December 31 measurement date, the fair value of assets and the status of the benefit obligation follow:

	2005	2004	2003
	(In thousands of dollars)		
Benefit obligation at the beginning of the year	$ 11,550	$ 11,401	$ 11,048
Interest cost	610	659	695
Actuarial losses	179	394	387
Benefits paid	(920)	(904)	(729)
Benefit obligation at the end of the year	11,419	11,550	11,401
Fair value of plan assets at the beginning of the year	—	—	—
Employer contributions	920	904	729
Benefits paid	(920)	(904)	(729)
Fair value of plan assets at the end of the year	—	—	—
Benefit obligation	(11,419)	(11,550)	(11,401)
Unrecognized net actuarial losses	579	508	142
Accrued postretirement benefits cost	$ (10,840)	$ (11,042)	$ (11,259)

The benefit obligation was determined by applying the terms of the plan and actuarial models required by SFAS No. 87, "Employers' Accounting for Pensions." These models include various actuarial assumptions, including discount rates, mortality and retirement age. The Company evaluates its actuarial assumptions on an annual basis and considers changes in these long-term factors based upon market conditions, historical experience and the requirements of SFAS No. 87.

The following assumptions were used to determine benefit obligations at December 31:

	2005	2004	2003
Discount rate used to determine benefit obligation	5.25%	5.50%	6.00%
Discount rate used to determine net periodic benefit cost	5.50%	6.00%	6.50%

The discount rate assumptions reflect the rates available on high-quality fixed income debt instruments on December 31 of each year. These rates have been selected due to their similarity to the projected cash flows of the deferred compensation benefit plan.

Projected future benefit payments (in thousands of dollars):

	Benefit Payments
2006	$ 884
2007	1,181
2008	1,156
2009	1,158
2010	1,118
2011-2015	$ 5,559

Other Postretirement Benefits

Certain of the Company's non-U.S. subsidiaries provide limited non-pension benefits to retirees in addition to government-mandated programs. The cost of these programs is not significant to the Company. Most retirees outside the United States are covered by government-sponsored and administered programs.

NOTE 12 – LONG-TERM DEBT

Long-term debt consisted of the following:

	As of December 31,		
	2005	2004	2003
	(In thousands of dollars)		
Commercial paper	$ —	$ —	$114,127
Derivative instrument	—	—	25,418
Industrial development revenue and private activity bonds	9,485	9,485	9,485
	9,485	9,485	149,030
Less current maturities	4,590	9,485	144,135
	$ 4,895	$ —	$ 4,895

During 2002, the Company issued commercial paper in support of a cross-currency swap (derivative instrument). This derivative instrument was designated as a partial hedge of the net investment in the Company's Canadian subsidiary and was recognized on the balance sheet at its fair value.

On September 27, 2004, the two-year cross-currency swap and related commercial paper debt matured and were liquidated with payments totalling U.S.$140.8 million. While the cross-currency swap was outstanding, the Company formally assessed, on a quarterly basis, whether the cross-currency swap was effective at offsetting changes in the fair value of the underlying exposure. Because of the high degree of effectiveness between the hedging instrument and the underlying exposure being hedged, exchange rate changes in the value of the cross-currency swap were generally offset by changes in the value of the net investment. Under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," changes in the fair value of this instrument were recognized in foreign currency translation adjustments, a component of Accumulated other comprehensive earnings (losses), to offset the change in the value of the net investment of the Canadian investment being hedged. During 2004, the Company recognized a U.S.$0.6 million net of tax loss related to this hedge, which included the settlement of the cross-currency swap, in Accumulated other comprehensive earnings (losses). The impact to 2004 and 2003 earnings resulting from the ineffective portion of the hedge was immaterial.

The industrial development revenue and private activity bonds include various issues that bear interest at variable rates capped at 15%, and come due in various amounts from 2009 through 2021. At December 31, 2005, the weighted average interest rate was 2.79%. Interest rates on some of the issues are subject to change at certain dates in the future. The bondholders may require the Company to redeem certain bonds concurrent with a change in interest rates and certain other bonds annually. In addition, $4.6 million of these bonds had an unsecured liquidity facility available at December 31, 2005, for which the Company compensated a bank through a commitment fee of 0.07%. There were no borrowings related to this facility at December 31, 2005. The Company classified $4.6 million, $9.5 million and $4.6 million of bonds currently subject to redemption options in current maturities of long-term debt at December 31, 2005, 2004 and 2003, respectively. In 2006, $4.6 million of long-term debt options is subject to redemption and the balance of $4.9 million is subject to redemption options in 2010.

The Company's debt instruments include only standard affirmative and negative covenants that are normal in debt instruments of similar amounts and structure. The Company's debt instruments do not contain financial or performance covenants restrictive to the business of the Company, reflecting its strong financial position. The Company is in compliance with all debt covenants for the year ended December 31, 2005.

NOTE 13 – LEASES

The Company leases certain land, buildings, and equipment under noncancellable operating leases that expire at various dates through 2034. The Company capitalizes all significant leases that qualify for capitalization, of which there were none at December 31, 2005. Many of the building leases obligate the Company to pay real estate taxes, insurance and certain maintenance costs, and contain multiple renewal provisions, exercisable at the Company's option. Leases that contain predetermined fixed escalations of the minimum rentals are recognized in rental expense on a straight-line basis over the lease term. Cash or rent abatements received upon entering into certain operating leases are also recognized on a straight-line basis over the lease term.

At December 31, 2005, the approximate future minimum lease payments for all operating leases were as follows (in thousands of dollars):

	Future Minimum Lease Payments
2006	$ 25,620
2007	23,029
2008	17,726
2009	15,019
2010	9,742
Thereafter	29,043
Total minimum payments required	$120,179
Less amounts representing sublease income	(3,263)
	$116,916

Rent expense, including items under lease and items rented on a month-to-month basis, was $28.6 million, $22.3 million and $19.5 million for 2005, 2004 and 2003, respectively. These amounts are net of sublease income of $0.4 million, $0.5 million and $0.5 million for 2005, 2004 and 2003, respectively.

NOTE 14 – STOCK INCENTIVE PLANS

The Company maintains stock incentive plans under which the Company may grant a variety of incentive awards to employees and Directors. Shares of common stock were authorized for issuance under the plans in connection with awards of nonqualified stock options, stock appreciation rights, restricted stock, stock units and other stock-based awards.

The plans authorize the granting of options to purchase shares at a price of not less than 100% of the closing market price on the last trading day preceding the date of grant. All options expire no later than ten years after the date of grant.

Shares relating to terminated, surrendered or canceled options and stock appreciation rights or to forfeited restricted stock or other awards are again available for awards under the plans.

Options

In 2005, 2004, and 2003, the Company provided broad-based stock option grants covering 231,500, 181,200 and 161,300 shares, respectively, to those employees who reached major service milestones and were not participants in other stock option programs.

In 2005, 2004 and 2003 the Company issued stock option grants to employees as part of their incentive compensation. Stock option grants were 1,183,650, 1,034,850 and 1,679,450 for the years 2005, 2004, and 2003, respectively.

In 2004 and 2003, nonemployee directors received an annual grant denominated in dollars but settled with options to purchase shares of common stock. The number of options issued was equal to the dollar amount of the grant divided by the fair market value of a share of common stock at the time of the award, rounded to the next ten-share increment. The number of options were 13,360 and 15,840 for 2004 and 2003, respectively. The options were fully exercisable upon award and have a ten-year term.

Transactions involving stock options are summarized as follows:

	Shares Subject to Option	Weighted Average Price Per Share	Options Exercisable
Outstanding at January 1, 2003	9,464,838	$44.44	3,320,888
Granted	1,856,590	$45.69	
Exercised	(427,857)	$36.72	
Canceled or expired	(479,639)	$45.90	
Outstanding at December 31, 2003	10,413,932	$44.91	4,148,846
Granted	1,229,410	$53.25	
Exercised	(1,885,415)	$40.08	
Canceled or expired	(552,133)	$47.54	
Outstanding at December 31, 2004	9,205,794	$46.86	4,415,343
Granted	1,415,150	$54.20	
Exercised	(1,550,316)	$44.51	
Canceled or expired	(378,788)	$48.98	
Outstanding at December 31, 2005	8,691,840	$48.37	4,572,250

All options were issued at the closing market price on the last trading day preceding the date of grant. Options were issued in 2005, 2004 and 2003 with initial vesting periods ranging from immediate to three years.

Information about stock options outstanding and exercisable as of December 31, 2005, is as follows:

Options Outstanding			
		Weighted Average	
Range of Exercise Prices	Number Outstanding	Remaining Contractual Life	Exercise Price
$30.87 – $43.50	2,045,304	4.6 years	$39.70
$43.51 – $48.59	1,992,905	7.1 years	$45.62
$48.60 – $54.06	2,191,931	6.3 years	$51.25
$54.07 – $70.95	2,461,700	7.4 years	$55.25
	8,691,840	6.4 years	$48.37

Options Exercisable		
Range of Exercise Prices	Number Exercisable	Weighted Average Exercise Price
$30.87 – $43.50	1,770,674	$40.03
$43.51 – $48.59	405,355	$44.50
$48.60 – $54.06	1,092,921	$50.21
$54.07 – $70.95	1,303,300	$54.61
	4,572,250	$47.75

The weighted average fair value of the stock options granted during 2005, 2004 and 2003 was $13.36, $13.08 and $10.43, respectively. The fair value of each option grant was estimated using the Black-Scholes option-pricing model based on the date of grant and the following weighted average assumptions:

	2005	2004	2003
Risk-free interest rate	4.1%	4.1%	3.4%
Expected life	7 years	7 years	7 years
Expected volatility	20.1%	20.1%	20.1%
Expected dividend yield	1.8%	1.8%	1.8%

See Note 2 to the Consolidated Financial Statements for the pro forma net earnings and earnings per share, as calculated under SFAS No. 123.

Restricted Stock

The plans authorize the granting of restricted stock, which is held by the Company pursuant to the terms and conditions related to the applicable grants. Except for the right of disposal, holders of restricted stock have full shareholders' rights during the period of restriction, including voting rights and the right to receive dividends.

Compensation expense related to restricted stock awards is based upon the closing market price on the last trading day preceding the date of grant and is charged to earnings on a straight-line basis over the vesting period. The following table summarizes the transactions involving restricted stock granted to employees:

	2005	2004	2003
Beginning shares outstanding	322,000	682,000	798,040
Issuances	—	10,000	20,000
Shares Converted to Restricted Stock Units	—	(215,000)	—
Cancellations	(5,000)	(5,000)	(39,250)
Vesting	(47,000)	(150,000)	(96,790)
Ending shares outstanding	270,000	322,000	682,000
Weighted average per share value of issuances	NA	$50.66	$47.72
Restricted stock compensation expense	$1.0 million	$4.3 million	$4.8 million

Restricted Stock Units (RSUs)

Awards of RSUs are provided for under the stock compensation plans. RSUs granted to management vest over periods from three to seven years from issuance, although accelerated vesting is provided in certain instances. Holders of RSUs are entitled to receive cash payments equivalent to cash dividends and other distributions paid with respect to common stock. At various times after vesting, RSUs will be settled by the issuance of stock certificates evidencing the conversion of the RSUs into shares of the Company common stock on a one-for-one basis. Compensation expense related to RSUs is based upon the closing market prices on the last trading day preceding the date of award and is charged to earnings on a straight-line basis over the vesting period.

The following table summarizes RSU activity granted to employees:

	2005	2004	2003
Beginning units outstanding	510,915	95,720	95,720
Issuances	239,675	227,300	—
Restricted Stock converted to RSUs	—	215,000	—
Cancellations	(22,375)	(23,600)	—
Settlements	(10,765)	(3,505)	—
Ending units outstanding	717,450	510,915	95,720
Units Vested	85,600	48,900	95,720
Weighted average per share value of issuances	$53.69	$53.43	NA
RSU compensation expense	$7.9 million	$4.7 million	NA

Director Stock Awards

In 2005, the Company provided the Directors with deferred stock unit grants. The number of shares covered by each grant is equal to $60,000 divided by the fair market value of a share of common stock at the time of the grant, rounded up to the next ten-share increment. The Company also awards stock units in connection with deferrals of director fees and dividend equivalents on existing stock units. A stock unit is the economic equivalent of a share of common stock. Deferred fees and dividend equivalents on existing stock units are converted into stock units on the basis of the market value of the stock at the relevant times. Payment of the value of stock units is scheduled to be made after termination of service as a director. As of December 31, 2005, 2004 and 2003, there were ten, ten and nine current and former nonemployee directors, respectively, that held stock units. The Company recognizes income (expense) for the change in value of equivalent stock units.

The following table summarizes the activity for stock units related to deferred director fees (dollars in thousands):

	2005		2004		2003	
	Units	Dollars	Units	Dollars	Units	Dollars
Beginning Balance	39,398	$ 2,625	39,506	$ 1,872	45,556	$ 3,297
Dividends	722	45	555	30	619	29
Deferred Fees	15,039	856	1,532	86	1,359	63
Retirement Distributions	(3,182)	(198)	(2,195)	(104)	(8,028)	(378)
Unit Appreciation / (Depreciation)	—	368	—	741	—	(1,139)
Ending Balance	51,977	$ 3,696	39,398	$ 2,625	39,506	$ 1,872

In 2004 and 2003, a retainer fee for board service was paid to nonemployee directors in the form of an annual award of unrestricted shares of common stock. The number of shares awarded was equal to the retainer fee divided by the fair market value of a share of common stock at the time of the award, rounded up to the next ten-share increment. Total shares granted were 5,510 and 6,160 in 2004 and 2003, respectively. The weighted average fair market value of these grants was $54.54 and $45.50 for 2004 and 2003, respectively. In 2005, the Directors' retainer reverted to a cash basis.

Other

Shares available for issuance in connection with awards of stock options, stock appreciation rights, stock units, shares of common stock, restricted shares of common stock and other stock-based awards to employees and directors were 8,159,695, 1,201,876 and 2,016,160 at December 31, 2005, 2004 and 2003, respectively.

NOTE 15 – CAPITAL STOCK

The Company had no shares of preferred stock outstanding as of December 31, 2005, 2004 and 2003. The activity of outstanding common stock and common stock held in treasury was as follows:

	2005		2004		2003	
	Outstanding Common Stock	Treasury Stock	Outstanding Common Stock	Treasury Stock	Outstanding Common Stock	Treasury Stock
Balance at beginning of period	90,597,427	19,075,511	91,020,989	18,356,227	91,568,055	17,449,587
Exercise of stock options	1,503,259	(1,503,259)	1,825,085	(1,319,363)	415,244	(5,500)
Issuance and vesting of restricted stock, net of 15,493, 45,647 and 30,920 shares retained, respectively	(15,493)	15,493	(35,647)	45,647	(10,920)	—
Settlement of restricted stock units, net of 3,017 and 1,015 shares retained, respectively	7,748	(7,748)	2,490	(2,490)	—	—
Cancellation of restricted shares	(5,000)	—	(5,000)	—	(39,250)	—
Conversion of restricted stock to restricted stock units	—	—	(215,000)	—	—	—
Purchase of treasury shares, net of 0, 5,510 and 6,160 shares issued, respectively	(2,372,300)	2,372,300	(1,995,490)	1,995,490	(912,140)	912,140
Balance at end of period	89,715,641	19,952,297	90,597,427	19,075,511	91,020,989	18,356,227

NOTE 16 – INCOME TAXES

The Company accounts for income taxes under the provisions of SFAS No. 109, "Accounting for Income Taxes." SFAS No. 109 requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse.

Income tax expense consisted of:

	For the Years Ended December 31,		
	2005	2004	2003
	(In thousands of dollars)		
Current provision:			
Federal	$134,194	$135,391	$121,671
State	27,517	24,815	22,307
Foreign	976	2,460	4,759
Total current	162,687	162,666	148,737
Deferred tax provision (benefit):			
Federal	17,575	(5,986)	3,454
State	3,298	(684)	395
Foreign	2,790	2,220	1,533
Total deferred	23,663	(4,450)	5,382
Total provision	$186,350	$158,216	$154,119

The income tax effects of temporary differences that gave rise to the net deferred tax asset were:

	As of December 31,		
	2005	2004	2003
	(In thousands of dollars)		
Deferred tax assets:			
Inventory	$ 28,817	$ 37,927	$ 42,365
Accrued expenses	30,463	31,219	28,841
Accrued employment-related benefits	71,446	65,760	56,449
Intangibles	—	663	4,896
Foreign operating loss carryforwards	9,272	9,616	10,248
Unrealized capital losses	649	649	4,671
Tax benefit related to designated hedge	—	—	9,914
Other	4,765	4,129	1,401
Deferred tax assets	145,412	149,963	158,785
Less valuation allowance	(10,872)	(10,265)	(14,919)
Deferred tax assets, net of valuation allowance	$134,540	$139,698	$143,866
Deferred tax liabilities:			
Purchased tax benefits	$ (8,965)	$ (10,090)	$ (11,008)
Property, buildings and equipment	(17,423)	(9,594)	(9,154)
Intangibles	(10,219)	—	—
Other	(11,776)	(8,696)	(3,909)
Deferred tax liabilities	(48,383)	(28,380)	(24,071)
Net deferred tax asset	$ 86,157	$111,318	$119,795
The net deferred tax asset is classified as follows:			
Current assets	$ 88,803	$ 96,929	$ 99,499
Noncurrent assets	4,373	18,871	20,296
Noncurrent liabilities (foreign)	(7,019)	(4,482)	—
Net deferred tax asset	$ 86,157	$111,318	$119,795

At December 31, 2005, the Company had $27.3 million of foreign operating loss carryforwards related to foreign operations, which begin to expire in 2008. The valuation allowance represents a provision for uncertainty as to the realization of the tax benefits of these carryforwards.

In addition, the Company recorded a valuation allowance to reflect the estimated amount of deferred tax assets that may not be realized due to capital loss limitations.

The purchased tax benefits represent lease agreements acquired in prior years under the provisions of the Economic Recovery Act of 1981.

The changes in the valuation allowance were as follows:

	For the Years Ended December 31,		
	2005	2004	2003
	(In thousands of dollars)		
Beginning balance	$ 10,265	$ 14,919	$ 11,982
Increase (decrease) related to foreign net operating loss carryforwards	607	(632)	216
(Realized) unrealized capital losses	—	(4,022)	2,721
Ending balance	$ 10,872	$ 10,265	$ 14,919

A reconciliation of income tax expense with federal income taxes at the statutory rate follows:

	For the Years Ended December 31,		
	2005	2004	2003
	(In thousands of dollars)		
Federal income tax at the statutory rate	$186,436	$155,799	$133,382
State income taxes, net of federal income tax benefit	20,030	16,130	14,500
Foreign operations tax effects	(123)	(661)	1,025
Resolution of prior year tax contingencies	(9,700)	(3,356)	—
Other – net	(10,293)	(9,696)	5,212
Income tax expense	$186,350	$158,216	$154,119
Effective tax rate	35.0%	35.5%	40.4%

Undistributed earnings of such foreign subsidiaries at December 31, 2005, amounted to $2.2 million. No provision for deferred U.S. income taxes has been made for these subsidiaries because the Company intends to permanently reinvest such earnings in those foreign operations. Additionally, if such earnings were repatriated, U.S. taxes payable would be substantially eliminated by available tax credits arising from taxes paid outside of the United States.

The Company regularly undergoes examination of its federal income tax returns by the Internal Revenue Service (the IRS). The Company and the IRS have settled tax years through 2003. Additionally, the Company is routinely involved in state and local income tax audits, and on occasion, foreign jurisdiction tax audits. The Company expects to resolve these audits within the amounts paid and/or reserved for these liabilities.

NOTE 17 – EARNINGS PER SHARE

Basic earnings per share is based on the weighted average number of shares outstanding during the year. Diluted earnings per share is based on the combination of weighted average number of shares outstanding and dilutive potential shares. The Company had additional outstanding stock options of 0.04 million, 2.68 million and 3.48 million for the years ended December 31, 2005, 2004 and 2003, respectively, that were excluded from the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common stock.

The following table sets forth the computation of basic and diluted earnings per share:

	For the Years Ended December 31,		
	2005	2004	2003
	(In thousands, except for per share amounts)		
Net earnings	$346,324	$286,923	$226,971
Denominator for basic earnings per share – weighted average shares	89,569	90,207	90,731
Effect of dilutive securities – stock-based compensation	2,019	1,466	1,663
Denominator for diluted earnings per share – weighted average shares adjusted for dilutive securities	91,588	91,673	92,394
Basic earnings per common share	$ 3.87	$ 3.18	$ 2.50
Diluted earnings per common share	$ 3.78	$ 3.13	$ 2.46

NOTE 18 – PREFERRED SHARE PURCHASE RIGHTS

The Company has a shareholder rights plan, under which there is outstanding one preferred share purchase right (Right) for each outstanding share of the Company's common stock. Each Right, under certain circumstances, may be exercised to purchase one one-hundredth of a share of Series A-1999 Junior Participating Preferred Stock (intended to be the economic equivalent of one share of the Company's common stock) at a price of $250.00, subject to adjustment. The Rights become exercisable only after a person or a group, other than a person or group exempt under the plan, acquires or announces a tender offer for 15% or more of the Company's common stock. If a person or group, other than a person or group exempt under the plan, acquires 15% or more of the Company's common stock or if the Company is acquired in a merger or other business combination transaction, each Right generally entitles the holder, other than such person or group, to purchase, at the then-current exercise price, stock and/or other securities or assets of the Company or the acquiring company having a market value of twice the exercise price.

The Rights expire on May 15, 2009, unless earlier redeemed. They generally are redeemable at $.001 per Right until thirty days following announcement that a person or group, other than a person or group exempt under the plan, has acquired 15% or more of the Company's common stock. The Rights do not have voting or dividend rights and, until they become exercisable, have no dilutive effect on the earnings of the Company.

NOTE 19 – SEGMENT INFORMATION

The Company has two reportable segments: Branch-based Distribution and Lab Safety. Branch-based Distribution is an aggregation of the following business units: Industrial Supply, Acklands – Grainger Inc. (Canada), Grainger, S.A. de C.V. (Mexico), Grainger Caribe Inc. (Puerto Rico) and China Distribution. Lab Safety is a direct marketer of safety and other industrial products.

The Company's segments offer differing ranges of services and products and require different resources and marketing strategies. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Intersegment transfer prices are established at external selling prices, less costs not incurred due to a related party sale.

	2005		
	Branch-based Distribution	Lab Safety	Total
	(In thousands of dollars)		
Total net sales	$5,150,213	$380,091	$5,530,304
Intersegment net sales	(1,117)	(2,551)	(3,668)
Net sales to external customers	5,149,096	377,540	5,526,636
Segment operating earnings	536,641	52,712	589,353
Segment assets	2,211,739	175,201	2,386,940
Depreciation and amortization	88,632	7,756	96,388
Additions to long-lived assets	$ 146,731	$ 27,107	$ 173,838

	2004		
	Branch-based Distribution	Lab Safety	Total
	(In thousands of dollars)		
Total net sales	$4,716,207	$336,720	$5,052,927
Intersegment net sales	(1,064)	(2,078)	(3,142)
Net sales to external customers	4,715,143	334,642	5,049,785
Segment operating earnings	465,545	45,467	511,012
Segment assets	2,034,624	144,471	2,179,095
Depreciation and amortization	75,608	7,870	83,478
Additions to long-lived assets	$ 155,166	$ 2,910	$ 158,076

	2003		
	Branch-based Distribution	Lab Safety	Total
	(In thousands of dollars)		
Total net sales	$4,365,506	$305,480	$4,670,986
Intersegment net sales	(2,158)	(1,814)	(3,972)
Net sales to external customers	4,363,348	303,666	4,667,014
Segment operating earnings	395,784	41,881	437,665
Segment assets	1,891,734	142,466	2,034,200
Depreciation and amortization	67,030	7,239	74,269
Additions to long-lived assets	$ 75,126	$ 33,123	$ 108,249

Following are reconciliations of the segment information with the consolidated totals per the financial statements:

	2005	2004	2003
	(In thousands of dollars)		
Operating earnings:			
Total operating earnings for reportable segments	$ 589,353	$ 511,012	$ 437,665
Unallocated expenses	(70,364)	(69,758)	(48,797)
Total consolidated operating earnings	$ 518,989	$ 441,254	$ 388,868
Assets:			
Total assets for reportable segments	$2,386,940	$2,179,095	$2,034,200
Unallocated assets	720,981	630,478	590,478
Total consolidated assets	$3,107,921	$2,809,573	$2,624,678

	2005		
	Segment Totals	Unallocated	Consolidated Total
	(In thousands of dollars)		
Other significant items:			
Depreciation and amortization	$ 96,388	$ 12,394	$ 108,782
Additions to long-lived assets	$ 173,838	$ 5,528	$ 179,366

	Revenues	Long-Lived Assets
Geographic Information:		
United States	$4,897,309	$ 864,154
Canada	504,373	178,609
Other foreign countries	124,954	4,610
	$5,526,636	$1,047,373

	2004		
	Segment Totals	Unallocated	Consolidated Total
	(In thousands of dollars)		
Other significant items:			
Depreciation and amortization	$ 83,478	$ 14,778	$ 98,256
Additions to long-lived assets	$ 158,076	$ 2,682	$ 160,758

	Revenues	Long-Lived Assets
Geographic Information:		
United States	$4,507,030	$ 808,564
Canada	436,877	165,240
Other foreign countries	105,878	4,236
	$5,049,785	$ 978,040

	2003		
	Segment Totals	Unallocated	Consolidated Total
	(In thousands of dollars)		
Other significant items:			
Depreciation and amortization	$ 74,269	$ 15,984	$ 90,253
Additions to long-lived assets	$ 108,249	$ 3,680	$ 111,929

	Revenues	Long-Lived Assets
Geographic Information:		
United States	$4,183,321	$ 773,411
Canada	393,938	143,007
Other foreign countries	89,755	4,052
	$4,667,014	$ 920,470

Long-lived assets consist of property, buildings, equipment, capitalized software, goodwill and other intangibles.

Revenues are attributed to countries based on the ship-to location of the customer.

Unallocated expenses and unallocated assets primarily relate to the Company headquarters' support services, which are not part of any business segment. Unallocated expenses include payroll and benefits, depreciation and other costs associated with headquarters-related support services. Unallocated assets include nonoperating cash and cash equivalents, certain prepaid expenses and property, buildings and equipment – net. Unallocated expenses increased $21.8 million in the year ended December 31, 2004 when compared with the prior year. The year-over-year variance included increases in payroll and benefits at headquarters driven by stock-based compensation, and bonus and profit sharing accruals, as well as higher severance and benefits related to organizational changes made during 2004.

The change in the carrying amount of goodwill by segment from January 1, 2003 to December 31, 2005 is as follows:

Goodwill, net by Segment	Branch-based Distribution	Lab Safety	Total
	(In thousands of dollars)		
Balance at January 1, 2003	$ 89,323	$ 25,105	$114,428
Acquisition	—	22,823	22,823
Translation	19,018	—	19,018
Balance at December 31, 2003	108,341	47,928	156,269
Translation	8,742	—	8,742
Balance at December 31, 2004	117,083	47,928	165,011
Acquisition	—	14,019	14,019
Translation	3,696	—	3,696
Balance at December 31, 2005	$120,779	$ 61,947	$182,726

NOTE 20 – SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

A summary of selected quarterly information for 2005 and 2004 is as follows:

	2005 Quarter Ended (In thousands of dollars, except for per share amounts)				
	March 31	June 30	September 30	December 31	Total
Net sales	$1,334,880	$1,372,808	$1,428,342	$1,390,606	$5,526,636
Cost of merchandise sold	836,004	845,679	880,180	803,232	3,365,095
Gross profit	498,876	527,129	548,162	587,374	2,161,541
Warehousing, marketing and administrative expenses	385,919	400,936	412,280	443,417	1,642,552
Operating earnings	112,957	126,193	135,882	143,957	518,989
Net earnings	72,792	81,589	88,109	103,834	346,324
Earnings per share – basic	0.81	0.91	0.98	1.17	3.87
Earnings per share – diluted	$ 0.79	$ 0.89	$ 0.97	$ 1.13	$ 3.78

	2004 Quarter Ended (In thousands of dollars, except for per share amounts)				
	March 31	June 30	September 30	December 31	Total
Net sales	$1,227,799	$1,255,974	$1,301,057	$1,264,955	$5,049,785
Cost of merchandise sold	780,334	796,147	821,774	744,878	3,143,133
Gross profit	447,465	459,827	479,283	520,077	1,906,652
Warehousing, marketing and administrative expenses	346,764	352,686	371,558	394,616	1,465,624
Restructuring charge	—	(226)	—	—	(226)
Operating earnings	100,701	107,367	107,725	125,461	441,254
Net earnings	62,559	66,619	67,689	90,056	286,923
Earnings per share – basic	0.69	0.74	0.75	1.00	3.18
Earnings per share – diluted	$ 0.69	$ 0.72	$ 0.74	$ 0.98	$ 3.13

In the fourth quarter of 2005, the gross profit margins were higher than the first three quarters. This primarily related to favorable inventory adjustments from fourth quarter physicals ($18.6 million) and favorable adjustments related to the year-end LIFO calculations ($9.5 million).

In the fourth quarter of 2005, the Company reduced its income tax rate for the year to 35.0% from its previous projection of 37.0%. This reduction was primarily due to the recognition of tax benefits related to a favorable revision to the estimate of income taxes for various state and local taxing jurisdictions and the resolution of federal and state tax contingencies. The reduction was not determinable until the fourth quarter when these items were finalized and their effect on the rate quantified.

In the fourth quarter of 2004, the gross profit margins were higher than the first three quarters. This primarily related to favorable inventory adjustments from fourth quarter physicals ($15.5 million) and favorable adjustments related to the year-end LIFO calculations ($7.4 million).

In the fourth quarter of 2004, the Company reduced its income tax rate for the year to 35.5% from its previous projection of 38.0%. This reduction was primarily due to the recognition of tax benefits from the Medicare Act, capital loss carrybacks created by the sale of investment securities and the resolution of certain federal and state tax contingencies. The reduction in rate was not determinable until the fourth quarter when these items were finalized and their effect on the rate quantified.

NOTE 21 – UNCLASSIFIED – NET

The components of Unclassified – net were as follows:

	For the Years Ended December 31,		
	2005	2004	2003
	(In thousands of dollars)		
Gains on sales of investment securities	$ —	$ 50	$ 1,208
Other income items	25	334	198
Total income	25	384	1,406
Write-down of investments	—	—	(1,614)
Other expense items	(168)	(233)	(693)
Total expense	(168)	(233)	(2,307)
Unclassified – net	$ (143)	$ 151	$ (901)

NOTE 22 – CONTINGENCIES AND LEGAL MATTERS

The Company has an outstanding guarantee relating to an industrial revenue bond assumed by the buyer of one of the Company's formerly owned facilities. The maximum exposure under this guarantee is $8.5 million and it expires on December 15, 2008. The Company has not recorded any liability relating to this guarantee and believes it is unlikely that material payments will be required.

The Company has been named, along with numerous other nonaffiliated companies, as a defendant in litigation in various states involving asbestos and/or silica. These lawsuits typically assert claims of personal injury arising from alleged exposure to asbestos and/or silica as a consequence of products purportedly distributed by the Company. As of January 23, 2006, the Company is named in cases filed on behalf of approximately 3,400 plaintiffs in which there is an allegation of exposure to asbestos and/or silica. In addition, five cases alleging exposure to cotton dust were amended during 2004 to add allegations relating to asbestos; as of January 23, 2006, approximately 1,300 plaintiffs in these cases are alleging asbestos exposure.

The Company has denied, or intends to deny, the allegations in all of the above-described lawsuits. In 2005, lawsuits relating to asbestos and/or silica and involving approximately 700 plaintiffs were dismissed with respect to the Company, typically based on the lack of product identification. If a specific product distributed by the Company is identified in any of these lawsuits, the Company would attempt to exercise indemnification remedies against the product manufacturer. In addition, the Company believes that a substantial number of these claims are covered by insurance. The Company is engaged in active discussions with its insurance carriers regarding the scope and amount of coverage. While the Company is unable to predict the outcome of these lawsuits, it believes that the ultimate resolution will not have, either individually or in the aggregate, a material adverse effect on its consolidated financial position or results of operations.

In its Form 10-Q for the quarter ended September 30, 2005, Grainger reported a proceeding against Grainger's Canadian subsidiary, Acklands – Grainger Inc. (Acklands), for alleged violations of the Canadian Environmental Protection Act, 1999. In November 2005, Acklands resolved this matter by entering into an environmental protection alternative measures (EPAM) agreement. The agreement requires Acklands to, among other things, pay C$150,000 to the Environment Damages Fund administered by Environment Canada.

In addition to the foregoing, from time to time the Company is involved in various other legal and administrative proceedings that are incidental to its business. These include claims relating to product liability, general negligence, environmental issues, employment, intellectual property and other matters. As a government contractor, from time to time the Company is also subject to governmental or regulatory inquiries or audits. It is not expected that the ultimate resolution of any of these matters will have, either individually or in the aggregate, a material adverse effect on its consolidated financial position or results of operations.

NOTE 23 – SUBSEQUENT EVENTS

On January 31, 2006, Lab Safety, through a wholly owned subsidiary, acquired substantially all of the assets of Rand Materials Handling Equipment Co. (Rand). Rand is a national catalog distributor of warehouse, storage and packaging supplies, part of the $80 billion material handling market. The purchase price is expected to be approximately $14 million in cash and approximately $2 million in assumed liabilities. Any goodwill recognized in this transaction will be deductible for tax purposes. Rand had more than $16 million in sales in 2005.

On February 23, 2006 Acklands received a Notice of Purchase advising Acklands that Uni-Select Inc. was exercising its contractual option to purchase all of Acklands' shares in the USI-AGI Prairies Inc. joint venture. The sale price will be determined by a formula included in the joint venture agreement and is projected to be approximately Canadian $29 million (U.S. $25.5 million). The transaction is expected to close on May 31, 2006 and to result in a small gain for the Company. The joint venture investment is reported in "Investments in Unconsolidated Entities" on the Company's balance sheet, and the Company recognized U.S. $2.3 million in equity income from the joint venture in 2005.

W.W. Grainger, Inc. and Subsidiaries

COMPUTATIONS OF EARNINGS PER SHARE

	2005	2004	2003
BASIC:			
Weighted average number of shares outstanding during the year	89,568,746	90,206,773	90,731,013
Net earnings	$346,324,000	$286,923,000	$226,971,000
Earnings per share	$ 3.87	$ 3.18	$ 2.50
DILUTED:			
Weighted average number of shares outstanding during the year	89,568,746	90,206,773	90,731,013
Potential shares:			
Shares issuable under common stock equivalents	10,087,382	8,445,302	7,571,428
Shares which could have been purchased using the proceeds from the common stock equivalents exercised, based on the average market value for the year	(8,106,909)	(7,015,367)	(5,920,171)
	1,980,473	1,429,935	1,651,257
Dilutive effect of exercised options prior to being exercised	39,076	36,667	11,815
	2,019,549	1,466,602	1,663,072
Adjusted weighted average number of shares outstanding during the year	91,588,295	91,673,375	92,394,085
Net earnings	$346,324,000	$286,923,000	$226,971,000
Earnings per share	$ 3.78	$ 3.13	$ 2.46

CONSENTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements on (Form S-8 No.'s. 33-43902, 333-24215, 333-61980, 333-105185, 333-124356 and Form S-4 No. 33-32091) of W.W. Grainger, Inc. and in the related prospectuses of our report dated February 21, 2006, with respect to the consolidated financial statements of W.W. Grainger, Inc., W.W. Grainger, Inc. management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of W.W. Grainger, Inc., included in this Annual Report (Form 10-K) for the year ended December 31, 2005.

ERNST & YOUNG LLP

Chicago, Illinois
February 24, 2006

We hereby consent to the incorporation of our report dated February 11, 2005 accompanying the consolidated financial statements and management's assessment of the effectiveness of internal control over financial reporting on page 27 of the Annual Report for the year ended December 31, 2004 by reference in the prospectuses constituting part of the Registration Statements on Form S-8 (Nos. 33-43902, 333-24215, 333-61980, 333-105185 and 333-124356) and on Form S-4 (No. 33-32091) of W.W. Grainger, Inc.

GRANT THORNTON LLP

Chicago, Illinois
February 24, 2006

CERTIFICATION

I, R. L. Keyser, certify that:

1. I have reviewed this Annual Report on Form 10-K of W.W. Grainger, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2006

By: R. L. Keyser

Name: R. L. Keyser

Title: Chairman and Chief Executive Officer

CERTIFICATION

I, P. O. Loux, certify that:

1. I have reviewed this Annual Report on Form 10-K of W.W. Grainger, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2006

By: P. O. Loux

Name: P. O. Loux

Title: Senior Vice President, Finance
and Chief Financial Officer

EXHIBIT 32(a)

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, R. L. Keyser, Chairman and Chief Executive Officer of W.W. Grainger, Inc. ("Grainger"), certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Annual Report on Form 10-K of Grainger for the annual period ended December 31, 2005, (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Grainger.

R. L. Keyser

R. L. Keyser
Chairman and Chief Executive Officer

February 24, 2006

EXHIBIT 32(b)

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, P. O. Loux, Senior Vice President, Finance and Chief Financial Officer of W.W. Grainger, Inc. ("Grainger"), certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Annual Report on Form 10-K of Grainger for the annual period ended December 31, 2005, (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Grainger.

P. O. Loux

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

February 24, 2006