

CASH FLOW

Long-term financial goals:

**Return on Invested Capital
Greater than 20%**

Five-year results:

Return on Invested Capital



A pretax ROIC greater than 20 percent is one of Grainger's long-term financial goals. The company plans to grow the areas of the business earning more than the cost of capital and improve the performance of those areas earning less than the cost of capital in order to maintain ROIC above 20 percent. Grainger's uses of cash are to reinvest in the business and to improve returns to shareholders in the form of dividends and share repurchases.

Grainger's financial strength, including its low debt and strong cash flow, leaves it well positioned to fund growth initiatives and improve operating effectiveness.

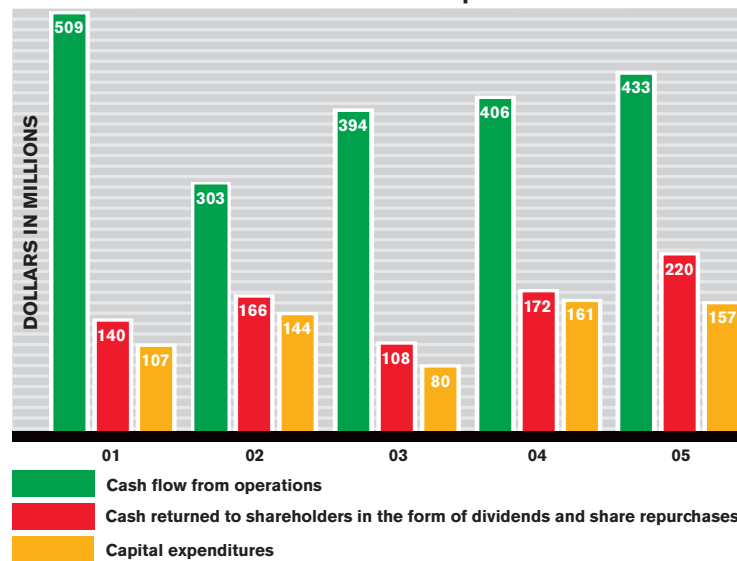
Grainger's primary source of cash generation comes from operating activities. In 2005, operating cash flow was \$433 million. Grainger used the cash to fund the Lab Safety Supply acquisition program, the market and product line expansions, and the SAP initiative as well as ongoing maintenance projects. Cash was also returned to shareholders through dividends and share repurchases.

In 2006, Grainger expects operating cash flow in the range of \$425 million to \$475 million.

Grainger maintains a debt ratio and liquidity position that provides flexibility in funding working capital needs and long-term cash requirements. Grainger has various sources of financing available, including commercial paper sales and bank borrowings under lines of credit. At December 31, 2005, Grainger's long-term debt rating by Standard & Poor's was AA+ and its available lines of credit totaled \$250 million.

Total debt as a percent of total capitalization was 0.4 percent for 2005.

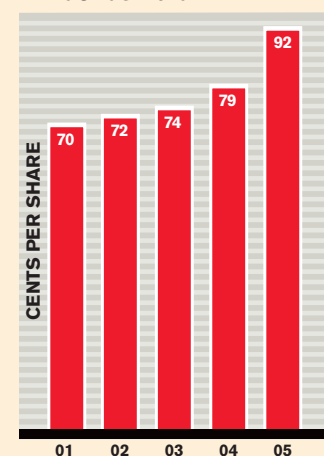
Sources and Uses of Cash Flow from Operations



Dividends

In 2005, Grainger increased its dividend by 20 percent, paying out \$83 million to shareholders in the form of dividends. Grainger has increased dividends for 34 consecutive years, putting the company among only 57 companies in the S&P 500 with such a record.

Dividends Paid



***Note on ROIC**

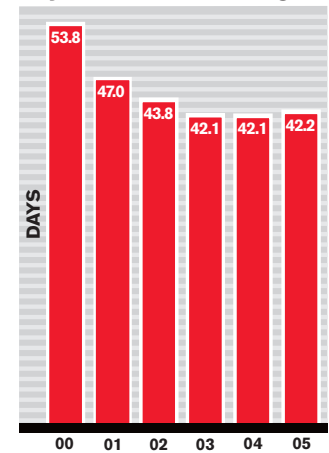
The GAAP financial statements are the source for all amounts used in the Return on Invested Capital (ROIC) calculation. ROIC is calculated using annualized operating earnings based on year-to-date operating earnings divided by a 13-point average for net working assets. Net working assets are working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

Cash processing

Using the latest financial processing systems, Grainger handles 5.8 million checks from its U.S. branch-based customers each year and makes deposits six days per week. This enables Grainger to quickly credit customer accounts, which helps facilitate future purchases. Performing this work in-house costs less than if the checks were processed through bank lock boxes. This, along with other processes, has allowed the company to reduce days sales outstanding (DSO) by more than 11 days since 2000.



Days Sales Outstanding

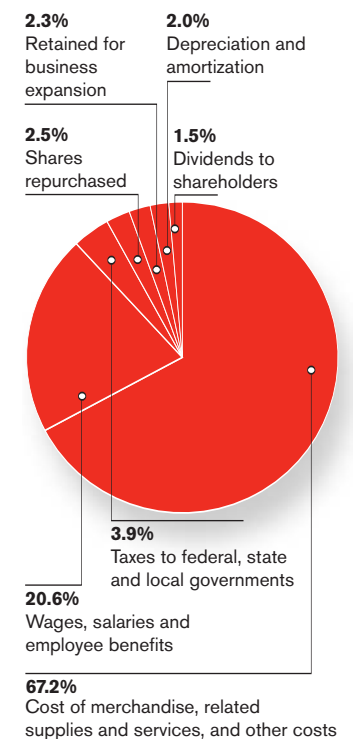


Grainger has continuously improved its cash processing techniques for more than 18 years. The cash processing system is integrated with accounts receivable, immediately updating customer accounts.

Distribution of sales dollars – Total company

(In thousands of dollars)	For the Years Ended December 31,					
	2005		2004		2003	
Cost of merchandise, related supplies and services, and other costs	\$3,716,642	67.2%	\$3,460,770	68.5%	\$3,276,707	70.2%
Wages, salaries and employee benefits	1,141,181	20.6	1,014,414	20.1	895,750	19.2
Taxes to federal, state and local governments	213,707	3.9	189,422	3.8	177,333	3.8
Depreciation and amortization	108,782	2.0	98,256	1.9	90,253	1.9
Dividends to shareholders	82,663	1.5	71,243	1.4	67,281	1.5
Shares repurchased	137,473	2.5	100,872	2.0	41,204	0.9
Retained for business expansion	126,188	2.3	114,808	4.3	118,486	2.5
Net sales	\$5,526,636	100.0%	\$5,049,785	100.0%	\$4,667,014	100.0%

2005



Share repurchases

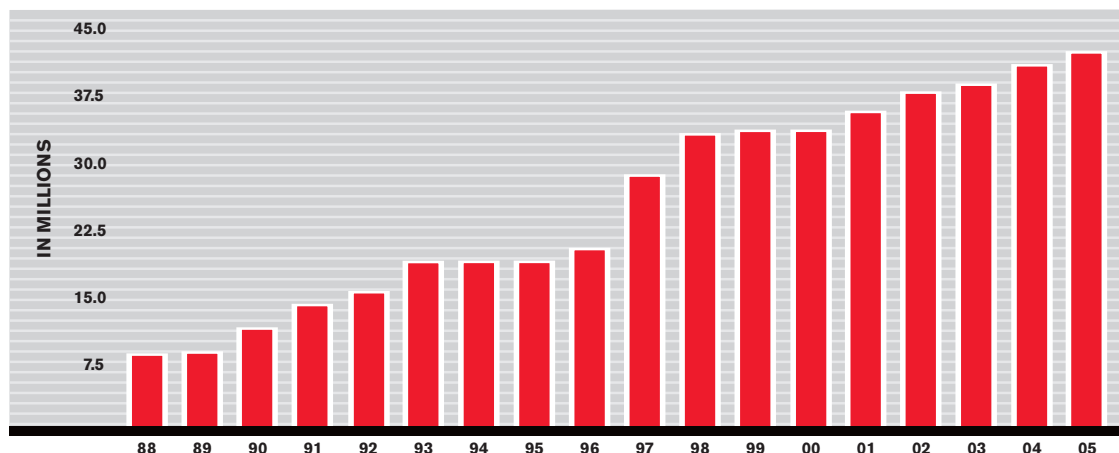
One of Grainger's key uses of cash is repurchasing shares in order to reduce the number of shares of stock outstanding, thereby enhancing shareholder value.

Through an aggressive share repurchase program, Grainger has reduced its shares of stock outstanding by more than 17 percent since 1988. In 2005, Grainger repurchased approximately 2.4 million shares at a cost of \$137 million. Approximately 4.7 million shares remained under the current authorization as of year-end 2005.

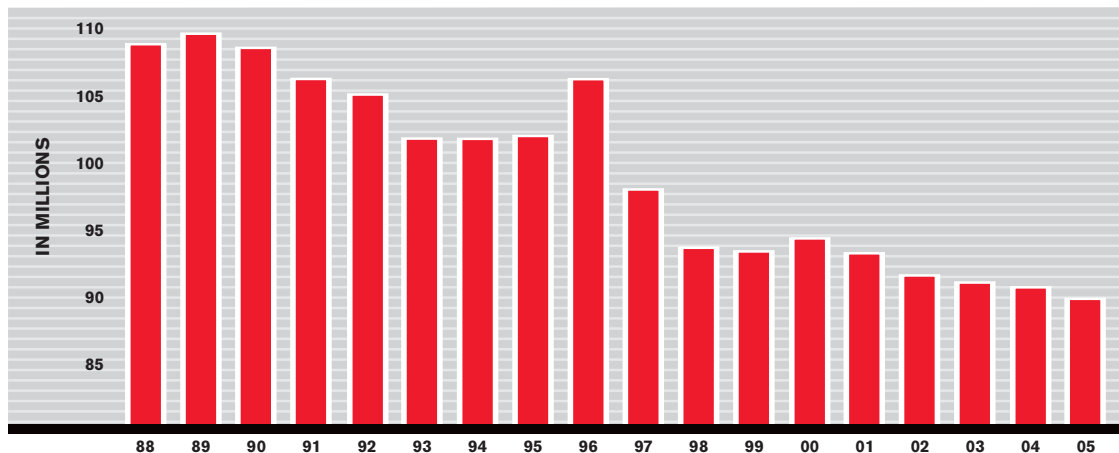
In 2006, Grainger expects to spend in the range of \$150 million to \$200 million on share repurchases.

Since 1988, Grainger has invested more than \$1.3 billion to repurchase shares of stock, reducing the number of shares outstanding by more than 17 percent.

Shares Repurchased – Cumulative



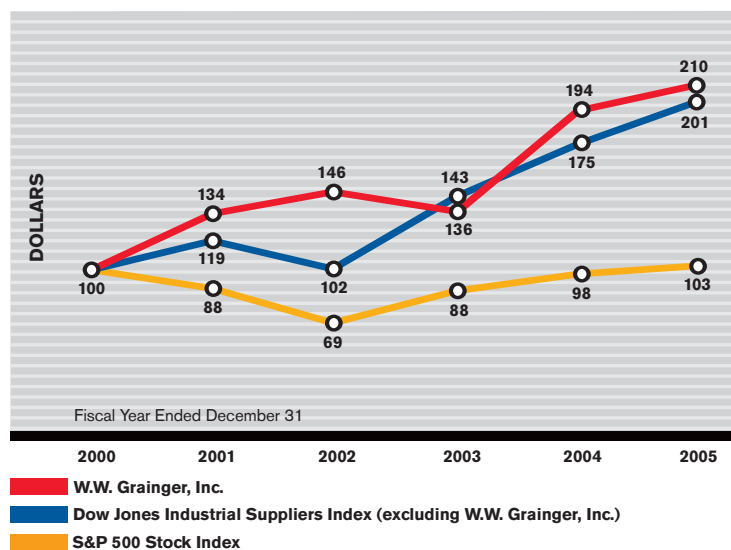
Shares Outstanding



Stock performance

This stock price performance graph compares the cumulative total return on an investment in Grainger common stock with the cumulative total return of an investment in each of the S&P 500 Stock Index and a peer group index made up of all the companies, other than Grainger, which constitute the Dow Jones Industrial Suppliers Index. It covers the period commencing December 31, 2000, and ending December 31, 2005. The graph assumes that the value for the investment in Grainger common stock and in each index was \$100 on December 31, 2000, and that all dividends were reinvested.

Stock Price Performance



Capital expenditures

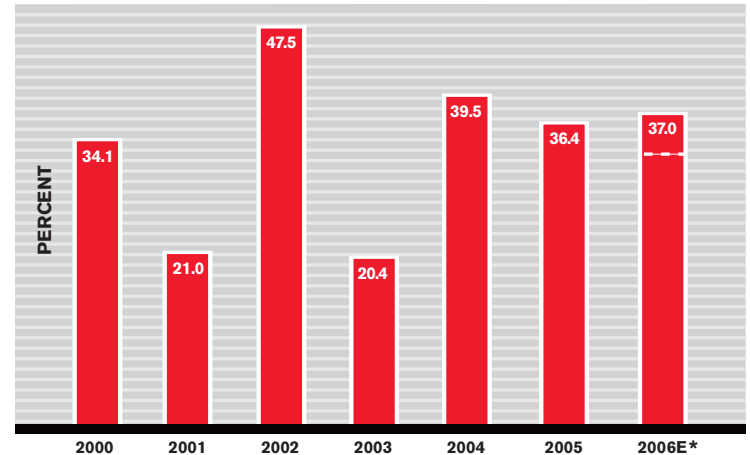
Grainger uses cash to fund initiatives that grow the business and improve efficiencies, resulting in greater profitability. In recent years, Grainger has invested in its logistics network and information systems to improve productivity and its branch network to realign its locations to new and changing markets.

Capital spending in 2005 primarily supported two key initiatives – market expansion and the implementation of SAP. Together, these two programs accounted for \$88 million of the total capital expenditures of \$157 million in 2005.

In 2006, total capital expenditures in the range of \$140 million to \$175 million are anticipated to fund market expansion, SAP, international expansion into areas such as China and the expansion of the company's product line.

Grainger evaluates projects, other than maintenance of its facilities, to ensure they meet or exceed its cost of capital. Some of the larger projects are listed below. The company also started a program for finding ways to reduce costs and improve productivity. These small projects are expected to help the company reduce its operating expenses over the coming years.

Capital Expenditures
as percent of cash flow from operations



*2006 estimated range 33 – 37 percent

Total capital expenditures – 2006

\$140 million – \$175 million



Market expansion

\$50 million – \$60 million

Grainger expects to invest \$50 million to \$60 million in 2006 to improve its local presence in top metropolitan markets across the United States. Sales growth in these markets is expected to be 5 to 10 percent greater than sales growth in markets not involved in the initiative.



SAP

\$15 million – \$20 million

Grainger has implemented SAP, an Enterprise Resource Planning (ERP) system in the U.S. business. Grainger expects to see \$50 million to \$60 million in benefits from this project by 2007. The company is extending SAP to other parts of the business in 2006 and 2007.



International

\$20 million – \$22 million

In 2006, Grainger will invest in expanding its presence in Mexico, refining its systems and processes in Canada and building its operations in China.



Product line expansion

\$5 million – \$10 million

With the release of Catalog 397, Grainger is launching the biggest product expansion in its history, adding more than 39,000 new products. The program is expected to contribute 1 percentage point to the planned sales growth for 2006.