

GROWTH

PROFITABILITY

CASH FLOW

Drive Shareholder Value



Grainger plays a critical role in keeping the North American economy going. As the leading broad-line supplier of facilities maintenance products – motors, tools, lighting, fasteners, safety gear, material handling and other equipment – Grainger keeps businesses running. And customers can also save time and money maintaining their facilities because Grainger provides a wide range of products when and where they need them.

Grainger is positioned to deliver attractive growth and increase shareholder value, building on its reputation for integrity, unparalleled service, innovation, partnerships and technology.

GROWTH



\$5.5 billion in sales for 2005, up 9.4 percent (page 4)

Initiated six markets in market expansion program (page 6)

Launched largest product line expansion in 79-year history (page 7)

PROFITABILITY



21 percent increase in EPS in 2005 (page 1)

Operating margins grew to 9.4 percent (page 10)

Reduced product cycle time from supplier to available for sale by 5 percent (page 12)

CASH FLOW



Increased dividends by 20 percent (page 14)

2.4 million shares repurchased in 2005 (page 16)

Invested \$157 million in property, plant and equipment, and capitalized software (page 17)

CONTENTS

1	Grainger's Strategy
2	Grainger at a Glance
4	GROWTH
10	PROFITABILITY
14	CASH FLOW
18	Corporate Social Responsibility
22	Financial Information
28	Management
30	Board of Directors
32	Company Information

Grainger's Strategy

Customer service motivates us. It's what drives growth, profitability and cash flow, creating shareholder value.

Grainger is an essential partner to businesses across North America. As the leading broad-line supplier of facilities maintenance products, we ensure that our customers can get the products – motors, tools, safety gear, cleaning supplies – to get the job done.

The total North American market for the kinds of products we supply is more than \$140 billion. We have a few large competitors, but our primary competition comes from smaller, local or regional suppliers specializing in specific product lines. We deliver shareholder value by building on our reputation for integrity, unparalleled service, innovation, partnerships, and technology leadership. *Fortune* magazine ranks us among America's 100 most admired companies.

Proven performance

Our 2005 performance demonstrates our scale and service advantage: record sales of \$5.5 billion, up 9 percent; record earnings per share of \$3.78, up 21 percent. We posted these results while executing on key initiatives including our market and product line expansion programs and systems integration.

Our healthy balance sheet and strong cash flow enabled Grainger to return more than \$220 million to shareholders in the form of share repurchases and dividends in 2005. Grainger has 34 consecutive years of increasing dividends, one of only 57 companies in the S&P 500 with such a record.

Future outlook

Our long-term financial goals of average annual sales growth between 7 and 10 percent and pretax return on invested capital greater than 20 percent remain unchanged. Because our strategies have delivered improved performance, last year we raised our long-term operating margin range goal from 9 to 10 percent to 10 to 12 percent.

To achieve these goals, we must execute our strategic initiatives. We intend to continue to implement the market expansion program in the top U.S. metropolitan markets; roll out SAP to additional Grainger operations; expand our U.S. product line; find more bolt-on acquisitions for Lab Safety Supply to increase customer reach; continue to increase the overall profitability of the business, particularly Canada; and open a presence for Grainger distribution in China.

Every day our dedicated employees work hard to get the job done for our customers. We are confident that our sales growth, higher operating margins and investments in projects that return more than our cost of capital create tremendous value for our shareholders. The Grainger team has talent, heart and the passion to succeed. And we are nowhere near done.



Richard L. Keyser
Chairman and
Chief Executive Officer

R.L. Keyser

Long-term financial goals:

Sales Growth

7 to 10%

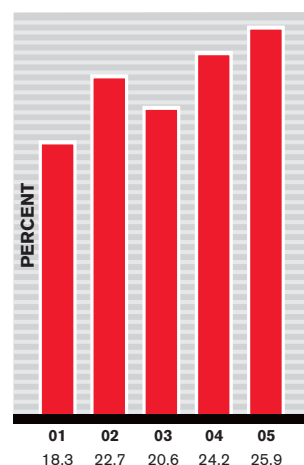
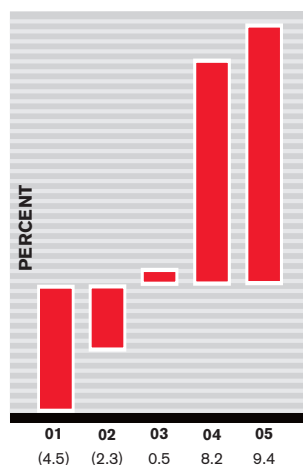
Operating Margins

10 to 12%

Return on Invested Capital

Greater than 20%

Five-year results:



Grainger at a Glance

BUSINESS MODEL

Branch-Based Business

Branch-Based Business

LOCATION

United States

Canada

MARKETS

Grainger operates in the United States through a network of 416 branches, 10 distribution centers and its Web site, grainger.com. Grainger offers a broad line of facilities maintenance products, repair parts, specialized product sourcing and inventory management. Grainger sells principally to industrial and commercial maintenance departments, contractors and government customers. Sales transactions during 2005 were made to approximately 1.3 million customers.

Acklands – Grainger Inc. is Canada's leading broad-line distributor of industrial, fleet and safety products. It serves 51,000 customers through 165 branches and five distribution centers across Canada. It also offers a bilingual Web site, acklandsgrainger.com, and catalogs.

VALUE PROPOSITION

Grainger provides the best combination of product selection, local availability, speed of delivery and simplicity of ordering at the lowest total cost of acquisition.

Acklands – Grainger provides customers with convenient access to a superior combination of product range, selection, fulfillment and before- and after-sales service.

2005 ACCOMPLISHMENTS

- Experienced growth in all customer end markets.
- Integrated major IT systems onto a single platform.
- Executed comprehensive expansion program in targeted metropolitan markets.

- Achieved record sales growth of 16 percent, 8 percent in Canadian currency.
- Opened six new branches, while closing seven smaller ones.

GROWTH OPPORTUNITIES

Grainger can save customers time and money by offering a comprehensive service package, and having the right products available locally to solve customer problems. Grainger operates in a highly fragmented, \$115 billion facilities maintenance market in the United States.

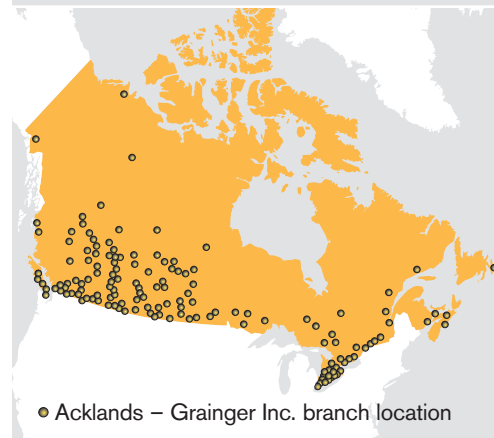
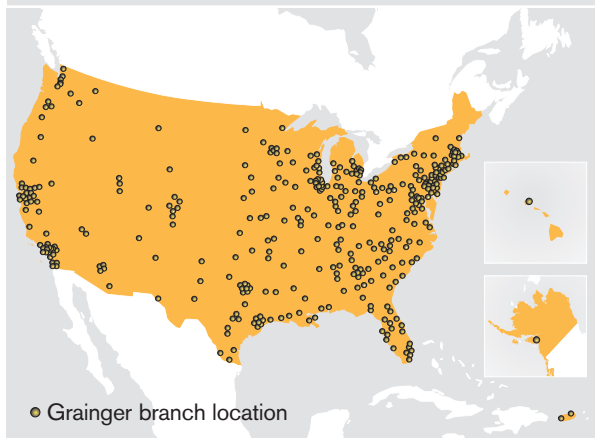
By providing a comprehensive offering, Acklands – Grainger plans to gain share in the Canadian facilities maintenance market, estimated at \$12 billion. In 2006, Acklands – Grainger plans to work on its systems infrastructure to improve service and reduce costs.

COMPETITORS

Fastenal
Home Depot Supply
McMaster-Carr
MSC Industrial Direct
Regional and local suppliers

Gregg Distributors
Hagemeyer
Home Depot Supply
Levitt Safety
Regional and local suppliers

SITES



Branch-Based Business	Branch-Based Business	Direct Marketing Business
Mexico	China	United States
Grainger, S.A. de C.V. , Mexico's leading facilities maintenance supplier, serves 25,000 local businesses through six branches, a distribution center, a catalog, and online at grainger.com.mx .	固安捷™ (Grainger) Grainger is developing a distribution presence in China.	Lab Safety Supply (LSS) reaches its North American customers through the distribution of multiple branded catalogs and other marketing materials and multiple Web sites for targeted markets. It supplies small and medium-sized companies in diverse industries, including manufacturing, government and agriculture.
Grainger, S.A. de C.V. quickly and easily provides local businesses with facilities maintenance and other products supplied from both Mexico and the United States.	Grainger's operations in China will provide the burgeoning market with facilities maintenance products through a catalog and branch presence in Shanghai.	LSS provides exceptional customer service and same-day shipping for a broad selection of safety and other products offered through direct mail catalogs and Web sites.
<ul style="list-style-type: none"> Achieved record sales growth of 19 percent. Expanded telesales and regional sales efforts. 	<ul style="list-style-type: none"> Established operations structure. 	<ul style="list-style-type: none"> Achieved record sales growth of 13 percent. Acquired the business of AW Direct, Inc. Expanded product line and targeted media. Issued 10 unique catalogs.
Grainger aims to gain share in the \$10 billion facilities maintenance market in Mexico. Through its expanded branch presence, Web site enhancements and improved telesales efforts, Grainger helps customers find and buy facilities maintenance products.	The facilities maintenance product market in China today is estimated at approximately \$30 billion, with half of that to industrial customers.	LSS continues to pursue strategic acquisitions to expand the number of markets it serves. Early in 2006, it acquired the business of Rand Material Handling Equipment.
Fastenal GE Supply Hagemeyer McMaster-Carr Regional and local suppliers	Regional and local suppliers	Airgas Safety Fisher Scientific Forestry Suppliers Global Industrial K+K America



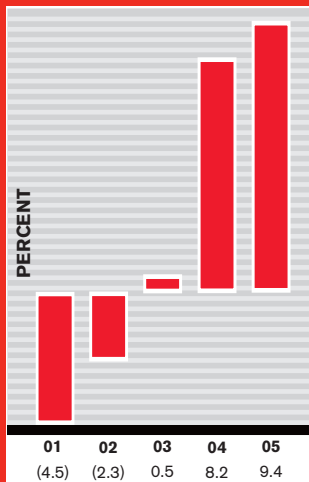
GROWTH

Long-term financial goals:

Average annual sales growth
7 to 10%

Five-year results:

Sales Growth



The company looks to grow sales by giving customers no reason to make unplanned purchases anywhere else. Grainger is targeting sales growth in the range of 8 to 11 percent for 2006.

Four strategic initiatives drive growth:

- Selling customers on Grainger's unique value proposition
- Enhancing Grainger's presence in local markets
- Increasing the number of products available
- Making acquisitions to complement Lab Safety Supply

Grainger makes it easy for customers to find, buy, receive and manage facilities maintenance products. That's what keeps customers coming back to Grainger and what spurred record sales of \$5.5 billion in 2005, up 9 percent.

Grainger continues to grow profitably by providing the industry's best:

- **Search and selection** – catalogs and Web sites with additional help from sales representatives, customer service associates, and technical support to find the products customers need
- **Products** – a broad array of more than 800,000 products available through catalogs, Web sites, and visual displays at branches, with special order sourcing for other needs
- **Ordering process** – phone, branch counter, Web site, fax, EDI, customer e-Procurement systems
- **Fulfillment** – North American branch network offering same-day fulfillment supported by 18 distribution centers providing shipping to customers

By giving customers no reason to purchase facilities maintenance products anywhere else, Grainger expects to take market share from competitors over the coming years.



The new branch in Mobile, Ala., played an essential role following Hurricane Katrina by providing emergency supplies to get businesses up and running.

Purchasing Pattern

Managing the unpredictable by relying on Grainger

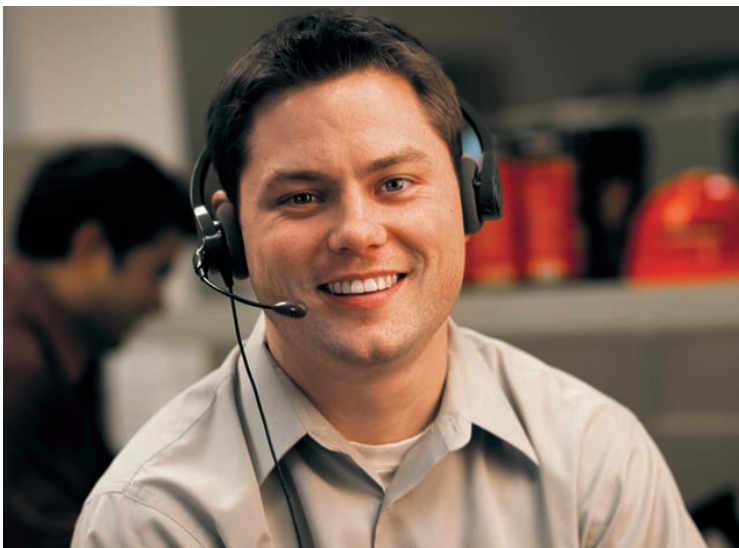


Growing with the Grainger Value Advantage

Grainger's customers are more than 1.7 million businesses and institutions worldwide. Grainger sells principally to industrial and commercial maintenance departments, contractors and government customers.

Customers are looking for ways to reduce the time and money it takes to purchase facilities maintenance products. Many are using the same techniques they use to reduce acquisition costs for raw materials and production consumables by consolidating suppliers and leveraging volume to negotiate a better price. It's an effective strategy when usage or demand is planned. Unplanned is the challenge.

This international package delivery company with more than 400,000 employees ordered 24,737 unique items from Grainger last year. The company purchased 19,726 items one to five times – 51 percent of them only once.



Grainger's stratified sales force provides targeted customer coverage. Large, complex customers receive frequent contact; small and mid-sized customers have dedicated sales people who reach them either in person or over the telephone. For 2006, Grainger plans to increase the number of sales representatives by more than 15 percent - with the majority of them targeting small to mid-sized customers.

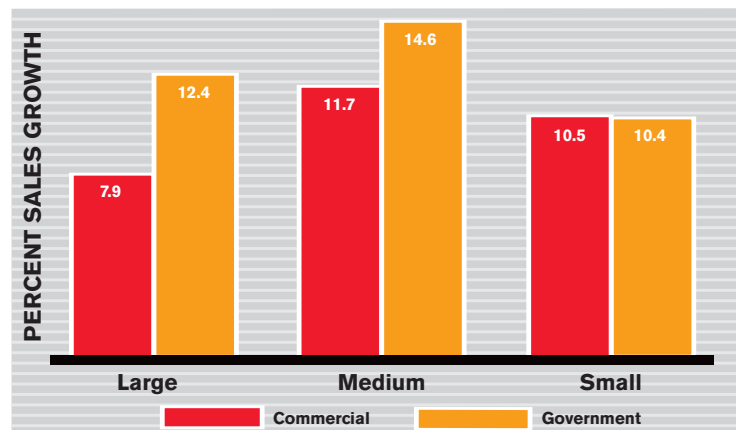
Customer coverage

Over the past four years, Grainger has expanded and stratified its sales force to provide the most comprehensive coverage in the industry. The U.S. sales force covers 15 percent of Grainger's accounts, but these accounts represent around 75 percent of the company's revenue.

Four years ago, Grainger had sales people calling on accounts of all types and sizes. Today, the sales force is specialized to provide targeted service to customers. Grainger expects to end 2006 with about 2,000 sales representatives in the United States. In 2005, Grainger added 33 telesales and sales representatives to extend customer coverage in Mexico.

These men and women will help customers understand how Grainger helps them save time and money.

U.S. Sales Growth – 2005 compared to 2004



Grainger's specialized sales force has driven growth among targeted customers in all segments.

While Grainger serves planned customer needs, its special value to customers is with unplanned product needs. Some 40 percent of customers' facilities maintenance product purchases are random and infrequent – those one-off buys that are needed immediately to keep a facility up and running. Over the period of a year, customers rarely purchase these same items twice. And product purchases seldom repeat from one year to the next. Sourcing these products is very costly, both in time and money. By consolidating with Grainger, customers are able to get great service at competitive prices from one convenient source.



Grainger branches are staffed by knowledgeable employees who quickly help customers get the right products and information to get the job done.

What distinguishes Grainger from its largest competitors is its branch network where customers can pick up a broad array of facilities maintenance products. Grainger estimates that two-thirds of U.S. businesses are within 20 minutes of a Grainger branch.

Market expansion

Grainger is in the process of a multiyear market expansion program to gain share by improving customer coverage and the overall positioning of its product and service offering. The program targets top metropolitan markets in the United States, which represent around 50 percent of the overall facilities maintenance products opportunity in the United States.

Grainger already has a national presence. The market expansion program improves this presence by examining branch size and location, inventory, sales coverage and marketing. The Grainger team uses a comprehensive process to determine which markets to tackle and where to place branches to capture the largest market share.

In 2005, Grainger added more than 345,000 additional square feet in branch showroom and warehouse capacity. For the program in 2005, Grainger opened nine full-size branches and five Grainger Express® locations, relocated eight branches, expanded 11 existing branches and closed four. It also increased sales coverage in the expansion markets by more than 25 percent. Last year, Grainger:

- completed three markets – Atlanta, Denver and Seattle
- implemented seven markets – Houston, St. Louis, Tampa and four markets in Southern California
- launched initiatives in six markets – Baltimore, Cincinnati, Kansas City, Philadelphia, South Florida (Miami/Ft. Lauderdale) and Washington, D.C.

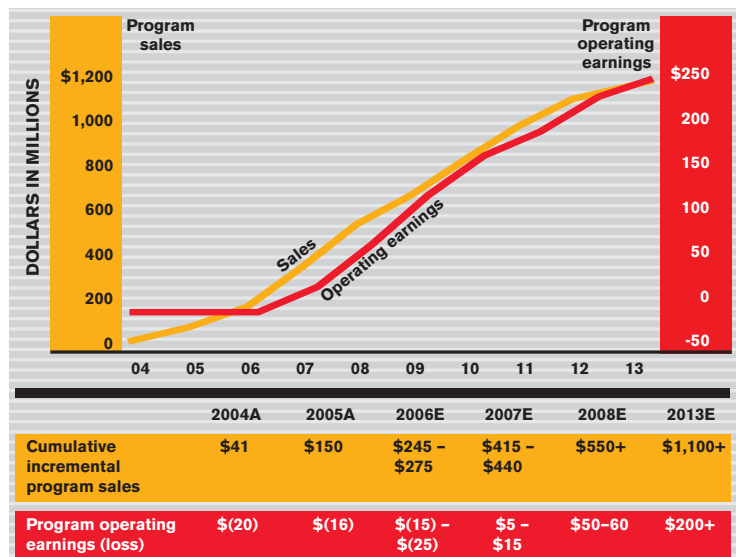
Sales growth in these markets is expected to be 5 to 10 percentage points greater than anticipated growth in markets in the rest of the country.



Market expansion financial projection

Grainger expects \$95 million to \$125 million in incremental sales from the market expansion program in 2006 over 2005. By 2013, Grainger anticipates total incremental revenue of more than \$1.1 billion, and a contribution of more than \$200 million in operating earnings. Over the past two years the company exceeded its earlier projections and revised its future outlook upward.

Mexico plans to examine its branch coverage over the next several years, adapting the market expansion program to its current presence in six markets. In 2006, it expects to open several new branches.



Product line expansion

Customers can reduce their supplier base by picking the supplier with the broadest product line that can handle planned and unplanned facilities maintenance product needs. To help fulfill more product needs, Grainger will expand its product line beginning in 2006.

The benefits of consolidating purchases for procurement professionals are easy to achieve in vertical product categories – lighting, electrical, safety, cleaning, pumps, motors, ventilation – but consolidating unplanned purchases across all categories requires a broad array of products.

Over the last few years, Grainger pruned its product line to reduce redundancy. Starting in 2006, Grainger is expanding the number and types of products in categories offered by its U.S. business.

Consider fasteners. Procurement professionals complained that they prepared for their unplanned fastener needs by storing large volumes of all different sizes and grades of fasteners in their facilities, taking up space and increasing carrying costs. By relying on Grainger for local availability, they can better manage such unplanned buying situations.

Grainger's 2006 catalog features more than 115,000 products as compared to some 82,400 products in its 2005 catalog. Grainger expects 2006 capital expenditures for the product line expansion to be \$5 million to \$10 million. Product line expansion – in safety, cleaning, security, motors, HVAC, lighting, electrical, pumps, plumbing, test equipment, material handling, tools and fasteners – should represent about 1 percentage point to the planned sales growth for 2006.



Fastener line expansion

With the publication of Catalog 397, Grainger launched the biggest product expansion in its 79-year history. The U.S. catalog will feature more than 39,000 new products. Over the next three to five years, the company intends to add more new products.

Grainger is taking an aggressive step into the \$8 billion facilities maintenance fastener market. The new 4,007-page catalog includes 31,000 fasteners over and above the 3,500 that Grainger already offered customers. The expanded line consists of 20 categories of fasteners – both national and private label brands – to address customers' unplanned needs. Fasteners have higher gross profit margins than the 39 percent total company average of Grainger's other products.

More than 4,000 fasteners will be readily available in local branches and Grainger will fill orders for the entire line from its distribution centers, shipping next day to the majority of its customers.

The decision to add these products came from extensive customer research. Grainger believes adding new products enhances its brand and reputation for having more of the hard-to-find, unplanned products.



Grainger has more than 4,000 fastener stock keeping units in each branch.



LSS offers extensive product depth, technical support and high service levels to customers representing diverse industries across North America. During 2005, LSS issued 10 unique catalogs covering safety supplies, material handling, lab supplies, security and other products targeted to specific customer groups.

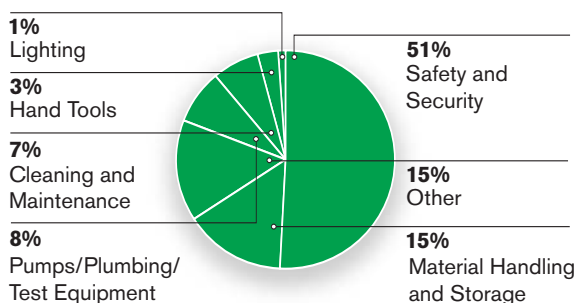
Lab Safety Supply

Lab Safety Supply, Inc. (LSS) helps save customers time and money in purchasing safety and other industrial products. With access to more than 130,000 products and superior customer service, LSS is a leading business-to-business direct marketer of safety and industrial supplies in North America. Approximately half of the products LSS sells are non-safety related, with only half safety focused.

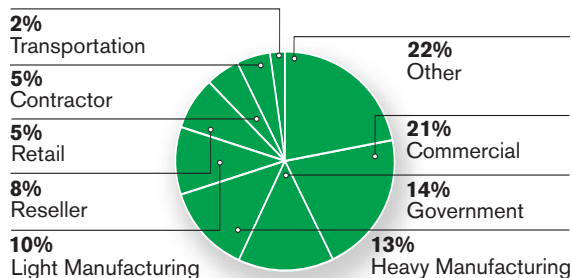
LSS serves customers who use a catalog or Web site and purchase online or over the phone. The competition for this business is largely a variety of small, specialized direct marketing competitors. LSS has the opportunity to expand its customer base and increase sales through strategic acquisitions.

What distinguishes LSS is its ability to acquire other direct marketing companies with limited customer overlap. It can then cross market a full array of products that are already part of LSS, enhancing its growth and making the acquisitions accretive in the first year.

Lab Safety Supply – 2005 Sales by Product Line



Lab Safety Supply – 2005 Sales by Customer Group



Acquisition Criteria

- Market leader
- High ROIC
- Growth potential
- Limited customer base overlap

FISCAL YEAR	ACQUISITION	OPPORTUNITY
February 2001	Ben Meadows	Direct marketer specializing in equipment for the natural resources and forestry management markets.
April 2003	Gempler's	Direct marketer serving the agricultural, horticultural, grounds maintenance and contractor markets.
January 2005	AW Direct	Direct marketer of products to the service vehicle accessories market, which includes the auto service, utilities, government and construction markets.
January 2006	Rand Materials Handling Equipment	Direct marketer of warehouse, storage and packaging supplies to the material handling market.

International growth

Grainger serves customers in more than 125 countries around the world. They value the broad product line and reliable delivery no matter where their facilities are located. Customers in emerging markets are a key growth opportunity for Grainger. In particular, Grainger has targeted Asia for potential growth opportunities.

Through export, Grainger ships products world-wide to customers who do not have a reliable local source of facilities maintenance products, especially items that are hard to find. Grainger helps customers through its network of U.S. and foreign-based territory managers. A centralized distribution platform provides order consolidation for customers.

The industrial distribution business is fundamentally a regional business. Already having a North American presence, the company sees opportunities in Asia.



In 2006, Grainger will launch its first catalog in China. The catalog will feature some 20,000 products sourced from manufacturers in China and other countries.

China

Grainger is developing a distribution presence in China. Much like the market in the United States, the market in China is highly fragmented and offers long-term growth potential. The facilities maintenance product market in China today is estimated at approximately \$30 billion, with half of that to industrial customers. In 2006, Grainger will formally open its operations in Shanghai, which accounts for about 6 percent of the total Chinese market for facilities maintenance products, and launch a catalog with some 20,000 products.

Mexico

Grainger, S.A. de C.V. – Grainger's business in Mexico – is the leading distributor of facilities maintenance products in Mexico. The country has a market opportunity estimated at \$10 billion.

Customers have access to more than 35,000 products through a Spanish-language general catalog, which is customized to the local marketplace; online at grainger.com.mx; or over the counter at one of six branches. In 2006, Grainger looks to add several new branches to better serve customers.

Canada

Grainger's business in Canada, Acklands – Grainger Inc., is the nation's leading broad-line distributor of industrial, fleet and safety products. The Canadian market opportunity is estimated at \$12 billion.

Acklands – Grainger offers more than 180,000 in-stock items to more than 51,000 customers. Customers have access to products online at acklandsgrainger.com and through a catalog, both in English and French. The company operates 165 branches and five distribution centers throughout the country. In 2006, the Canadian business plans to focus on preparing to implement SAP by examining its processes and improving the way it delivers service.



The branch in Queretaro, Mexico, is one of six in the country. Customers can also purchase products using a Spanish-language general catalog or through grainger.com.mx.

PROFITABILITY

Long-term financial goals:

**Operating Margins
10 to 12%**

Five-year results:

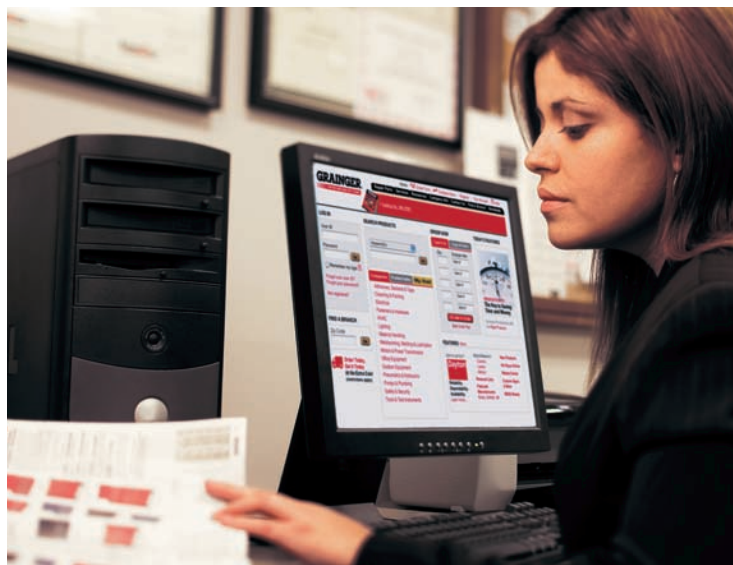
Operating Margins



In 2005, Grainger raised its long-term operating margin growth goal to 10 to 12 percent. Grainger is targeting an operating margin around 10 percent for 2006. The company looks to improve its operating margin by implementing efficient systems and processes that drive down costs. To do that, Grainger plans to:

- Increase the use of electronic ordering
- Improve productivity in its supply chain
- Source products globally and improve costs with all suppliers
- Gain the benefits of its integrated information systems

Grainger seeks ways to deliver higher levels of service more profitably. Grainger's operating margin expansion demonstrates improvements in the company's operations and marketing strategy. For 2006, Grainger expects continued performance driven by its efforts to enhance its ERP system and continue other gross margin improvement programs, including increased global sourcing and the impact of exiting lower-margin integrated supply contracts.



Grainger's Web site is a profitable channel because the customer is inputting the orders and nearly 90 percent are shipped, the company's most cost-effective delivery method. The Web site offers 24/7 self-service with real-time product availability, customer-specific pricing, multiple product search capability, customer personalization and links to customer support and fulfillment.

Ordering options

Maintaining a facility is a 24/7 job. Grainger installed a phone system in 2004 that enables the company to handle after-hours requests for products that can be shipped the next business day. Use of the system added \$60 million to sales in 2005. With a comprehensive menu of e-Commerce solutions, Grainger facilitates customer Internet ordering.

Grainger began offering customers the option of ordering online in 1996. Today, its state-of-the-art capabilities continue to lead the industry, providing customers fast and easy access to facilities maintenance products through:

- grainger.com and other Web sites in Mexico, Canada and Lab Safety Supply (LSS)
- Electronic data interchange (EDI)
- Electronic marketplaces
- Direct connections to customers' Enterprise Resource Planning (ERP) systems
- CD-ROM

Sales through Grainger's Internet channels grew by roughly 20 percent and represented approximately 15 percent of total sales in 2005. On average, operating margins through electronic channels are higher than phone or branch orders. Customers who buy from Grainger online have shown incremental sales growth across the other channels, branch and telephone, as well.

Efficient supply chain

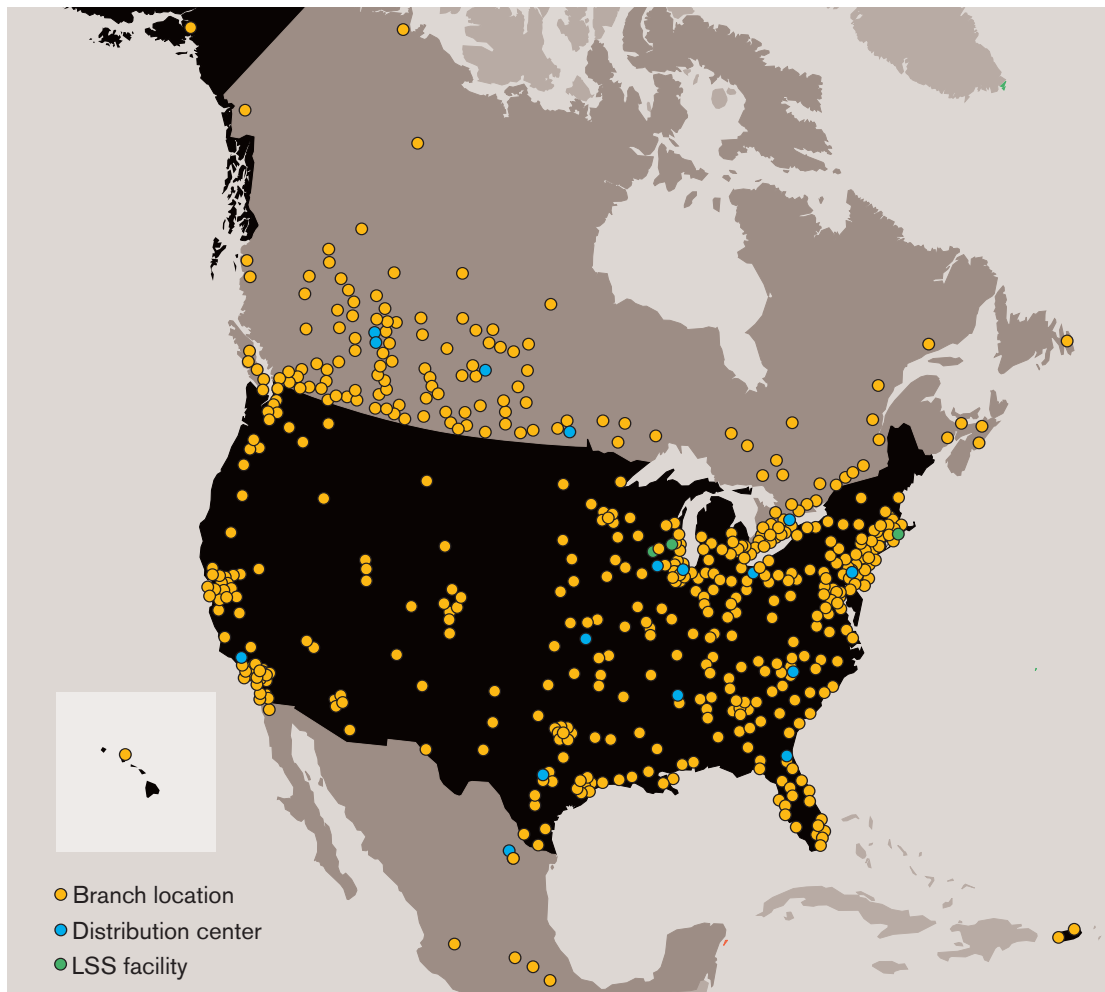
Grainger uniquely provides value to customers by being their one-stop solution for their unplanned purchases. Customers have told Grainger that they want a broad product offering in close proximity and quick, reliable service. In North America, Grainger has developed a supply chain that efficiently delivers the products that customers need.

Customers in the United States access one of some 400 branches to buy more frequently needed products, knowing that Grainger's distribution centers can supply the rest the next day, shipped either to the customers' facilities or to a branch. Customers experience exceptional service levels for all products, even those they may need only once or twice a year. Grainger's size, scale and locations allow it to aggregate demand across the entire network, fulfilling random demand better than its smaller competitors.

Five distribution centers in Canada ship products to customers and replenish branches. Customers and branches in Mexico are served by a distribution center in Monterrey. Customers and branches located near the Mexico/U.S. border are served by the U.S. logistics network.

In 2004, Grainger completed a reconfiguration of its U.S. logistics network to increase capacity, improve product availability and enhance productivity. Nearly 99 percent of customers can receive orders shipped from Grainger's distribution centers or selected branches next day, an achievement no other national industrial distributor can match. In markets where sales volume does not yet warrant a distribution center, Grainger has master branches that ship to customers as well as provide counter and will-call sales.

Grainger's overall productivity in its distribution centers has improved. The network redesign from 2001 to 2004 reduced overall inventory by \$115 million; in 2005 the network contributed approximately \$20 million to operating earnings.



The Distribution Flow



1. Inventory enters Grainger when suppliers ship product in bulk. The company has worked with suppliers to improve purchase order communication to avoid costly one-off shipments.



2. Inventory leaves one of Grainger's distribution centers when it ships product directly to customers – about half of all customer orders are shipped. Grainger has contracts with dedicated national shippers to reduce costs.



3. Inventory also leaves Grainger's distribution centers to replenish branches each day. This reduces the inventory depth that branches must stock, leaving space for a broad line of products.



4. Inventory leaves branches when customers pick up orders at the will-call counter or make spot purchases – about half of all branch sales are will-call orders, while the other half are spot purchases. Growing spot purchase sales requires having the right products in the branch, which the logistics network ensures each and every day.

Supplier relationships

Grainger works with approximately 1,200 suppliers to provide customers with the products they need and the brands they want.

Grainger negotiates with suppliers to help reduce total product cost. In 2004, Grainger reduced product costs by 150 basis points over 2003. This was achieved through an aggressive line review process, an increase in the global sourcing and private label product sales, and continued work with suppliers to reduce costs in the supply chain. In 2005, Grainger was able to offset its product cost inflation with an average 2 percent increase in product prices.

Information is critical to supplier relationships. Through its supplier management process, Grainger has a continuous flow of accurate and timely performance information to monitor the supply chain, helping to maximize efficiency.

Over the past year, Grainger and its suppliers have reduced product cycle time from supplier to available for sale by nearly 5 percent. This enables Grainger to drive higher levels of product availability without increasing its inventory investment.

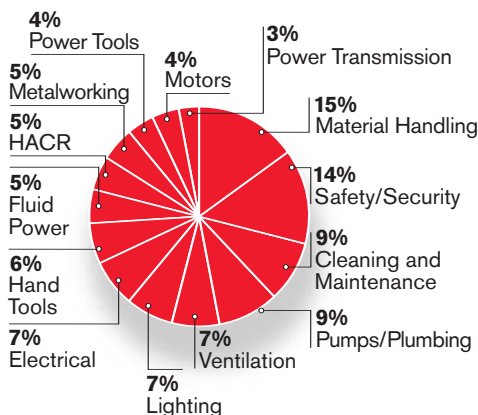


Grainger customers use different types of facilities maintenance products every day. One project can require products from several categories to get the job done. Grainger works with approximately 1,200 suppliers to provide the broad range of products customers need.

Grainger has strong relationships with its suppliers. With its 1,200 key suppliers across North America, Grainger works to lower overall costs and improve availability. In 2006, Grainger recognized top suppliers whose efforts to meet these goals have benefited customers:

- 3M Mexico S.A. de C.V.**
- Advance Transformer Company**
- Aero Technology**
- Akro-Mils, Inc.**
- Albion Industries, Inc.**
- Arrow Pneumatics, Inc.**
- Bradley Corporation**
- Brady Corporation**
- E.R. Wagner Manufacturing Company**
- Elkay Sales, Inc.**
- Enerpac**
- Grane Transportation Lines, Ltd.**
- Halsey Taylor**
- ITW Red Head**
- Justrite Manufacturing Company LLC**
- Lift-All**
- Loctite Industrial Group**
- Mi-T-M Corporation**
- Motorola**
- Norgren, Inc.**
- Nupla Corporation**
- Reelcraft Industries, Inc.**
- Schneider Electric**
- Spectrum Brands, Inc.**
- The M. K. Morse Company**
- Weiler Corporation**
- Wells Lamont Industry Group**
- Wiremold Legrand**

United States – 2005 Sales by Product Line

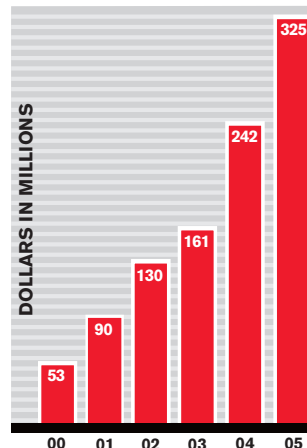


Global sourcing

Grainger sources 5 percent of its products directly from outside the United States, mostly from Asia. These products are sold under private label brands that cover a broad spectrum of categories, including tools, material handling, motors and safety equipment.

With procurement offices in the United States, Hong Kong and Shanghai, Grainger selects suppliers that meet stringent quality requirements. These products represented \$325 million in sales in 2005 and are projected to grow in 2006 by approximately 30 percent. Because the company manages the sourcing process and sells them under various private label brands, these quality products carry attractive gross profit margins.

Globally Sourced Products Sales



Integrated systems

Grainger's information systems need to handle hundreds of thousands of products, 1.7 million customers, hundreds of physical locations, and 115,000+ transactions per day in a way that makes \$185 orders profitable. That's why in January 2006, Grainger implemented an integrated end-to-end system for its U.S. branch-based business. The Enterprise Resource Planning (ERP) system should make the company more efficient.

With this implementation, Grainger is upgrading the technology throughout its U.S. branches and moving business support functions, such as finance, marketing and human resources, onto an integrated platform. Grainger expects the new SAP system to provide the tools needed to be more efficient at saving customers time and money and plans to roll out the system to other areas, including its operations in Mexico and Canada.

Benefits of the new system include:

- Having the ability to more efficiently track order histories and customer preferences.
- Updating company information in real time. This means customers will be able to get answers on product specifications and inventory availability more quickly. Returned products will be available for sale immediately. Customer orders and billing records will be updated quickly.
- Providing better visibility to the different ways its customers interact with the company, improving its sales coverage and marketing efforts.
- Decommissioning antiquated legacy systems, saving about \$15 million annually.

Grainger expects to see \$50 to \$60 million in benefits from this project, including the \$15 million from decommissioning, by the end of 2007.



Grainger's distribution centers use automated equipment and processes to ship orders, including Internet orders, directly to customers for all branches located in their service areas.

Exiting less profitable business

In 2005, Grainger discontinued its fee-for-service integrated supply business, which had been a separate segment for reporting purposes. The business was folded into Grainger's U.S. business, offering customers a range of outsourcing alternatives that leverage Grainger's branch, service and sourcing capabilities.

Throughout 2005, Grainger disengaged from lower-margin integrated supply contracts representing approximately one third of the \$211 million in integrated supply sales reported in 2004. Grainger will continue to exit these contracts over the next few years. Grainger anticipates these disengagements to continue to benefit gross profit margins.

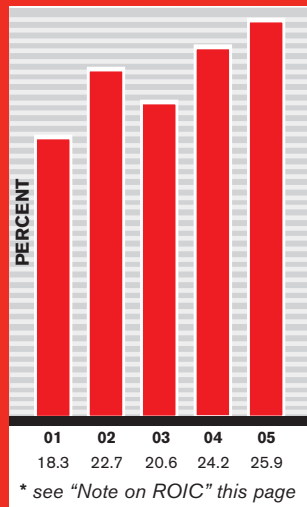
CASH FLOW

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.

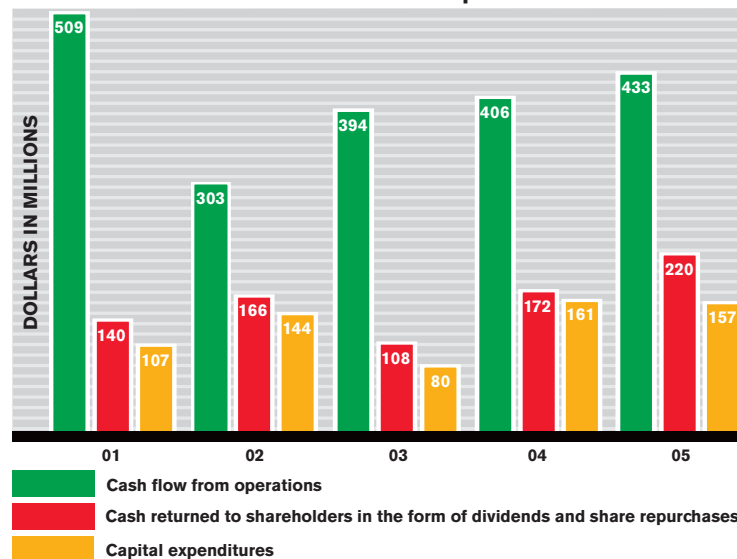
Grainger's primary source of cash generation comes from operating activities. In 2005, operating cash flow was \$433 million. Grainger used the cash to fund the Lab Safety Supply acquisition program, the market and product line expansions, and the SAP initiative as well as ongoing maintenance projects.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

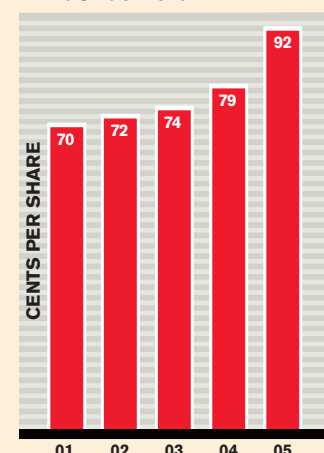
Sources and Uses of Cash Flow from Operations



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

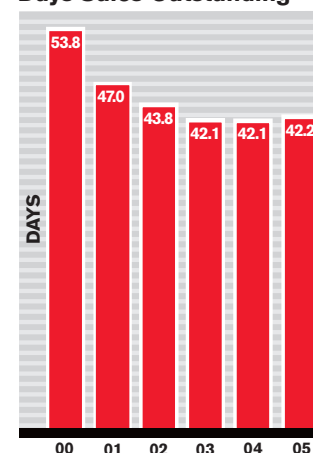
The GAAP financial statements are the source for all amounts used in the Return on Invested Capital (ROIC) calculation. ROIC is calculated using annualized operating earnings based on year-to-date operating earnings divided by a 13-point average for net working assets. Net working assets are working 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

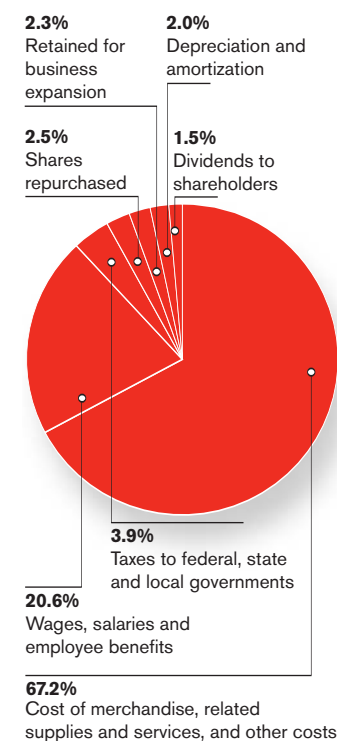


Grainger has continuously improved its cash processing techniques for more than 18 years. The cash processing system is integrated with accounts receivable, immediately updating customer accounts.

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

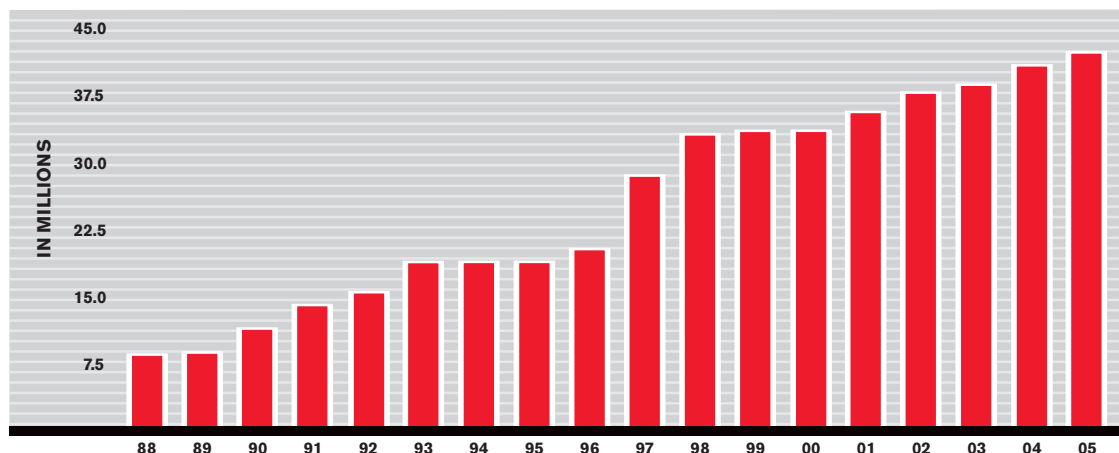
One of Grainger's key uses of cash is repurchasing shares in order to reduce the number of shares of stock outstanding, thereby enhancing shareholder value.

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.

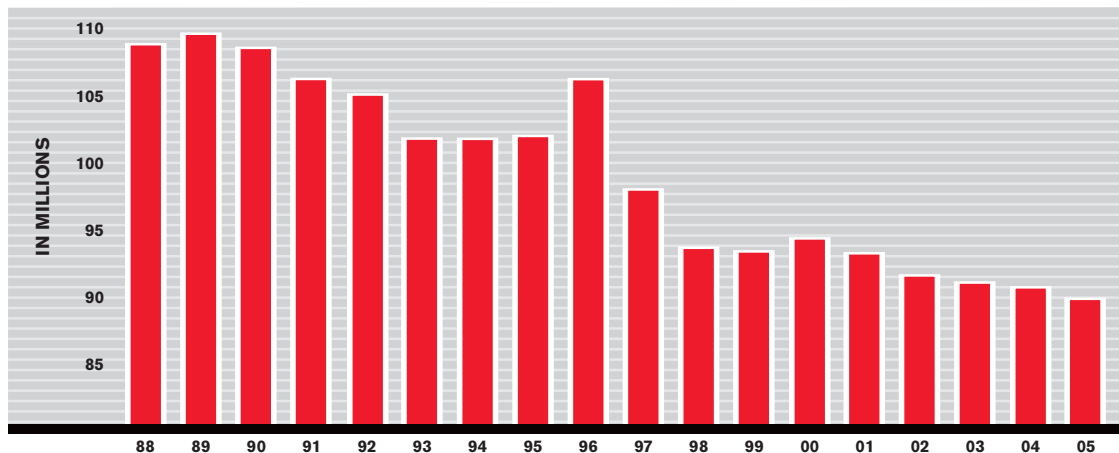
In 2006, Grainger expects to spend in the range of \$150 million to \$200 million on share repurchases.

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



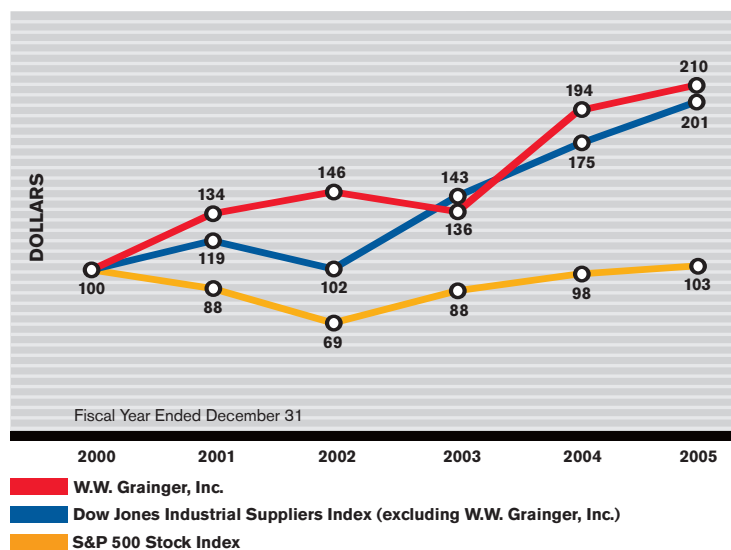
Shares Outstanding



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

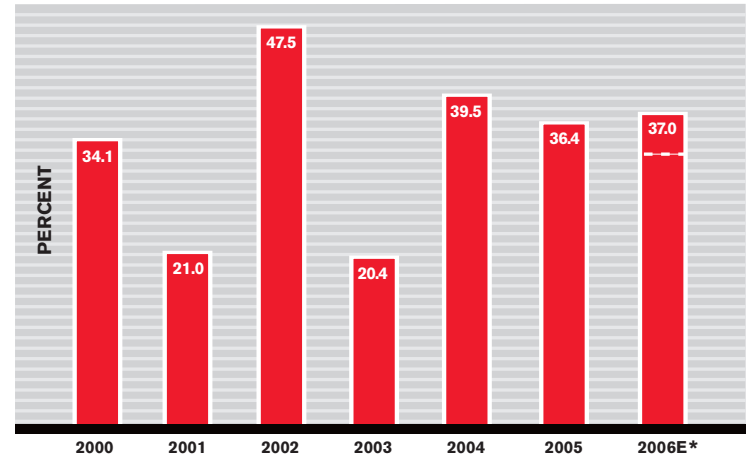
Grainger uses cash to fund initiatives that grow the business and improve efficiencies, resulting in greater profitability. In recent years, Grainger has invested in its logistics network and information systems to improve productivity and its branch network to realign its locations to new and changing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

Corporate Social Responsibility

A LEGACY OF ACHIEVEMENTS

- 1927**
Company founded in Chicago, Ill.; generates sales through an eight-page catalog – The Motorbook
- 1928**
Incorporated in the state of Illinois
- 1933**
Opens first branch in Philadelphia, Pa.
- 1942**
Expands to 24 branches and 24 territory sales representatives
- 1952**
Celebrates 25th anniversary with 46 branches, 54 territory sales representatives and 104-page catalog
- 1967**
Becomes publicly traded company under the symbol GWW
- 1975**
Lists on New York Stock Exchange
- 1977**
Celebrates 50th anniversary with \$499 million in sales
- 1984**
Achieves more than \$1 billion in annual sales
- 1992**
Acquires Lab Safety Supply
- 1995**
Launches Web site, www.grainger.com
- 1996**
Acquires Acklands Limited
- 2002**
Celebrates 75 years of serving customers
- 2004**
Breaks \$5 billion annual sales mark
- 2005**
Sets records in customer service levels



Grainger is committed to conducting business honestly and accepts the responsibility to protect and respect its employees, suppliers, customers, shareholders and the communities in which the company conducts business.

Customers want to do business with companies they can depend on. Employees want to work for companies that reward them appropriately, that allow them to contribute and grow, and that are involved in their communities. Shareholders want to invest in companies that are financially sound.

Grainger has built trust with customers, employees and shareholders by upholding the highest ethical standards and forging strong relationships with community partners. The fundamental management principles upon which the company was founded still govern Grainger today. Conservative financial practices, open and honest communication and an easily understood operating model remain the hallmarks of how Grainger does business.

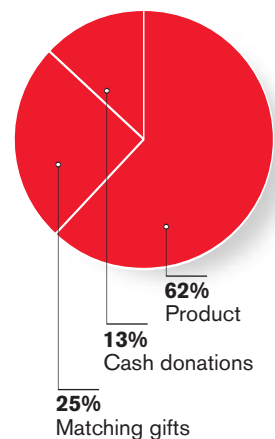
Community involvement

For the past 79 years, Grainger has contributed to local communities. In 2005, Grainger gave more than \$15.7 million to not-for-profit organizations. In addition, Grainger enabled employees to significantly help their communities by donating \$3.9 million through its matching charitable gifts program. The company is among less than 1 percent of U.S. companies that match employee contributions three-for-one.

In January 2005, Grainger expanded its matching charitable gifts program to provide a four-for-one match for employees who contributed to the American Red Cross International Response Fund following the tsunami in Southeast Asia. Grainger employees and the company contributed more than \$300,000 to this fund. In September 2005, Grainger once again expanded its matching charitable gifts program to provide a four-for-one match following Hurricane Katrina, contributing \$1.2 million to the American Red Cross Disaster Relief Fund.

Beyond financial contributions, Grainger employees volunteer their time to their communities. Grainger encourages this by working hand-in-hand with select organizations and donating time off to allow employees to participate.

2005 Charitable Contributions



Partnership by the numbers

1,800+

Number of employees and retirees who participated in Grainger's match of donations to the American Red Cross' International Response Fund and Disaster Relief Fund.

100+

Number of Grainger volunteers trained to respond to emergencies through the *Ready When the Time Comes*, the Chicago Red Cross' workplace disaster relief program that engages corporations in providing trained disaster-relief volunteers who are ready to respond quickly in the wake of a local or national disaster. Since 2000, Grainger volunteers in Chicago and Denver have manned shelters, fireproofed homes, staffed phone banks and participated in the Top-Off II national preparedness exercise. In 2006, Grainger will expand the program across the United States as the National Founding Sponsor.

450+

Number of hours Grainger volunteers have spent taking calls from individuals seeking American Red Cross aid in response to 2005's hurricanes.

300+

Number of Red Cross volunteer resource managers who attended the 2005 Volunteer Administration Institute sponsored by Grainger.

Disaster relief

In addition to helping customers save time and money by providing the products they need to maintain their facilities, Grainger helps ensure they're prepared to withstand and recover from a disaster. Grainger's partnership with the American Red Cross makes that possible. Grainger received the American Red Cross Circle of Humanitarians Award in both 2004 and 2005 for its disaster relief efforts throughout the United States.



Through the American Red Cross *Ready When the Time Comes* program, Grainger employees volunteer time to staff emergency phone centers, staff shelters and distribute aid supplies to areas affected by natural disasters.

When natural disasters strike, Grainger helps businesses recover by funding development grants through not-for-profit organizations.



Grainger Rebuilding America® program

Through the Grainger Rebuilding America® program, the company awards grants to not-for-profit organizations in communities severely affected by natural disasters. The contribution is disbursed to small, independent businesses in the devastated community as seed money to begin rebuilding. Grainger launched this program in 2003 and has assisted Jackson, Tenn., following a severe tornado that destroyed the downtown area, and the Utica, Ill., downtown district following a severe tornado.

Corporate Social Responsibility (continued)

Product donations

In 2005, Grainger donated more than \$9.7 million in product for disaster relief and educational efforts. The company created special accounts at local branches in Baton Rouge, La., Mobile, Ala., and Jackson, Miss., to ensure that local Red Cross volunteer units serving the hardest hit areas got product donations quickly.

Other product donations went to The National Association for the Exchange of Industrial Resources, which helps Grainger make the best use of any overstocked inventory by distributing the products to schools and other organizations; and Educational Assistance, Ltd., which offers the inventory to colleges and universities in exchange for scholarships for thousands of needy students.

Grainger's distribution center in Jacksonville, Fla., provided essential support to branches and communities following the hurricanes that devastated the Southeast in 2005.



Vocational support and education

Grainger is committed to helping several vocational and educational programs and is providing the resources students need to succeed. Each year Grainger provides more than a dozen internships and two scholarships to exceptional students through its affiliation with INROADS, a not-for-profit career development organization for minorities. In Atlanta, Grainger supports the Construction and Education Foundation of Georgia, which provides vocational training at the high school level. Lab Safety Supply provides similar support to the Blackhawk Technical College in Janesville, Wis.

In addition, Grainger supports i.c.stars and the Hispanic Alliance for Career Enhancement (HACE). i.c.stars is a Chicago-based nonprofit organization offering an educational program in technology for inner-city young adults. HACE helps Latinos through every stage of their career paths – from high school through college and into their professional careers.

A healthy environment

More than 1.7 million customers trust that Grainger has the right products to keep their facilities up and running. That trust is the foundation of 79 years of success, and maintaining that trust is what every Grainger employee does. Grainger's Environment, Health and Safety guidelines support employees in their efforts.

Grainger offers customers the products and services needed to support their facilities environmental programs. From the manufacture of the product until its useful life is complete, Grainger offers solutions that consider the total environmental impact, including Energy Star®, Green Seal Certified, Recycled Content and Nema Premium™ Efficient products.

In addition, Grainger has a supplier approval process that is among the most comprehensive and stringent in the industry. Suppliers are required to be in compliance with relevant environmental regulations governing the manufacture and sale of their products.



Ethical workplace principles

As a condition of employment, each year every Grainger employee commits to a set of conduct guidelines. These guidelines require all employees to operate with the highest moral, ethical and legal standards, which apply to all areas of Grainger's business. In addition, employees are provided with both ethics and diversity training to ensure compliance with the standards.

Grainger focuses on partnering with suppliers who not only provide quality products, but also help customers meet diversity requirements. Grainger is committed to promoting diversity with its supplier base. In 2005, Grainger increased the use of minority-owned, women-owned, and small business suppliers in the company's daily operations by more than 30 percent over 2004. Grainger purchases products and services for internal use, as well as to market throughout Grainger's sales channels.



Grainger employees annually commit to Grainger's conduct guidelines as a condition of employment.

Corporate governance at a glance

Grainger continually reviews, evaluates and modifies its governance program to ensure the highest standards. Corporate governance policies are designed to strengthen the ability of the Board of Directors to provide counsel to management and to monitor performance, thereby helping to ensure long-term shareholder value.

Grainger believes that corporate governance is an important component of a company's overall performance. Recent corporate governance ratings place Grainger at the upper end of the top quartile.

BOARD ACCOUNTABILITY

Size of Board	12
Number of Independent Directors	10
Separate Chairman and CEO	No
Independent Director with leadership role	Yes
Independent Compensation Committee	Yes
Independent Board Affairs and Nominating Committee	Yes
Number of Board meetings held or scheduled	5
Annual Board elections	Yes
Corporate governance guidelines approved by the Board	Yes
Outside Directors hold meetings without management present	Yes
There is a Board-approved succession plan in place for the CEO	Yes
Directors are required to submit a resignation upon a substantive change in career or vocation	Yes
The performance of the Board is reviewed regularly	Yes
The performance of each Committee is reviewed regularly	Yes
Board members conduct periodic individual self-evaluations	No
A former CEO of the company serves on the Board	Yes
Board orientation/education program	Yes
Board is elected by majority vote	Yes
All directors attended at least 75 percent of Board meetings	Yes
Each director serves on fewer than six boards of directors	Yes
Audit Committee members serve on three or fewer public companies' audit committees	Yes

FINANCIAL DISCLOSURE AND INTERNAL CONTROLS

Charters for Audit, Compensation and Board Affairs and Nominating Committees	Yes
Disclosure Committee function for financial reporting	Yes
Independent Audit Committee	Yes
Audit Committee has a financial expert	Yes
Auditors elected at most recent annual meeting	Yes
Company discloses financial performance targets	Yes

SHAREHOLDER RIGHTS

Shareholders have cumulative voting rights	Yes
Shareholders may call special meetings	Yes
Employees may vote their shares in company-sponsored plans	Yes
All stock-based incentive plans have been approved by shareholders	Yes
An independent vote tabulator is engaged to tabulate shareholder votes	Yes
Company has a poison pill in place	Yes

CORPORATE BEHAVIOR

Company has employee tasked with environmental responsibilities	Yes
Company publishes core vision and values statement	Yes
Company compares its governance policies to an external code of best practices	Yes
Company has program in place to monitor its policies on corruption and bribery	Yes
Company has environmental, health and safety guidelines	Yes
Company has code of ethics	Yes
Company has an ethics officer function	Yes
Training on ethical behavior is required for all employees	Yes
Environmental and workplace safety policy is disclosed	Yes
Environmental performance is audited by an independent outside firm	No

Historical Financial Summary

		2005	2004	2003
Financial Summary (\$000)	Net sales	\$5,526,636	\$5,049,785	\$4,667,014
	Earnings before income taxes and cumulative effect of accounting change	532,674	445,139	381,090
	Income taxes	186,350	158,216	154,119
	Earnings before cumulative effect of accounting change	346,324	286,923	226,971
	Cumulative effect of accounting change	—	—	—
	Net earnings	346,324	286,923	226,971
	Working capital	1,270,904	1,092,279	926,773
	Additions to property, buildings and equipment – net	112,297	128,276	74,064
	Depreciation and amortization of property, buildings and equipment	98,087	85,566	74,583
	Current assets	1,997,868	1,754,713	1,633,413
	Total assets	3,107,921	2,809,573	2,624,678
	Shareholders' equity	2,288,976	2,067,970	1,845,135
	Cash dividends paid	82,663	71,243	67,281
	Long-term debt (less current maturities)	4,895	—	4,895
Per Share (\$)	Earnings – basic	3.87	3.18	2.50
	Earnings – diluted	3.78	3.13	2.46
	Cash dividends paid	0.920	0.785	0.735
	Book value	25.51	22.83	20.27
	Year-end stock price	71.10	66.62	47.39
Ratios	Percent of return on average shareholders' equity	15.9	14.7	12.9
	Percent of return on average total capitalization	15.9	14.2	12.3
	Earnings before income taxes and cumulative effect of accounting change as a percent of net sales	9.6	8.8	8.2
	Earnings before cumulative effect of accounting change as a percent of net sales	6.3	5.7	4.9
	Cash dividends paid as a percent of net earnings	23.9	24.8	29.6
	Total debt as a percent of total capitalization	0.4	0.5	7.5
	Current assets as a percent of total assets	64.3	62.5	62.2
	Current assets to current liabilities	2.7	2.6	2.3
Average inventory turnover	4.5	4.6	4.4	
Other Data	Average number of shares outstanding – basic	89,568,746	90,206,773	90,731,013
	Average number of shares outstanding – diluted	91,588,295	91,673,375	92,394,085
	Number of employees	16,732	15,523	14,701
	Number of account managers	2,507	2,154	1,741
	Number of branches	589	582	575
Number of products in the Grainger catalog	82,400	82,300	88,400	

Note: 2002 net earnings include a charge for the cumulative effect of accounting change of \$23,921,000, or \$0.26 per share, and special credits of \$4,458,000, or \$0.05 per share, for gains on sales of investment securities and \$1,183,000, or \$0.01 per diluted share, for the reduction of the reserves established in 2001.

2002	2001	2000	1999	1998	1997	1996	1995
\$4,643,898	\$4,754,317	\$4,977,044	\$4,636,275	\$4,438,975	\$4,226,941	\$3,616,640	\$3,344,064
397,837	297,280	331,595	303,750	400,847	389,636	348,888	312,149
162,349	122,750	138,692	123,019	162,343	157,803	140,362	125,484
235,488	174,530	192,903	180,731	238,504	231,833	208,526	186,665
(23,921)	—	—	—	—	—	—	—
211,567	174,530	192,903	180,731	238,504	231,833	208,526	186,665
898,681	838,800	735,678	600,611	541,872	649,107	704,175	618,524
133,978	100,451	65,507	111,900	132,857	105,756	62,051	111,935
75,226	77,737	81,898	72,446	58,256	63,257	61,585	57,760
1,484,947	1,392,611	1,483,002	1,471,145	1,206,429	1,185,283	1,320,243	1,062,660
2,437,448	2,331,246	2,459,601	2,564,826	2,103,966	2,000,116	2,119,021	1,669,243
1,667,698	1,603,189	1,537,386	1,480,529	1,278,741	1,294,661	1,462,662	1,179,109
66,467	65,445	62,863	58,817	56,683	53,934	50,035	45,227
119,693	118,219	125,258	124,928	122,883	131,201	6,152	8,713
2.30	1.87	2.07	1.95	2.48	2.30	2.04	1.84
2.24	1.84	2.05	1.92	2.44	2.27	2.02	1.82
0.715	0.695	0.670	0.630	0.585	0.530	0.490	0.445
18.21	17.17	16.37	15.85	13.68	13.25	13.82	11.59
51.55	48.00	36.50	47.81	41.63	48.59	40.13	33.13
12.9	11.1	12.8	13.1	18.5	16.8	15.8	16.9
13.6	10.2	11.2	11.0	16.3	15.2	14.6	16.4
8.6	6.3	6.7	6.6	9.0	9.2	9.6	9.3
5.1	3.7	3.9	3.9	5.4	5.5	5.8	5.6
31.4	37.5	32.6	32.5	23.8	23.3	24.0	24.2
7.2	7.8	17.3	23.3	15.5	10.9	10.2	4.5
60.9	59.7	60.3	57.4	57.3	59.3	62.3	63.7
2.5	2.5	2.0	1.7	1.8	2.2	2.1	2.4
4.5	4.7	4.6	4.1	4.4	4.1	3.5	3.7
91,982,430	93,189,132	93,003,813	92,836,696	96,231,829	100,604,518	102,295,506	101,630,162
94,303,497	94,727,868	94,223,815	94,315,479	97,846,658	102,178,952	103,272,408	102,482,434
15,236	15,385	16,192	16,730	15,270	15,154	14,601	11,853
1,650	1,641	1,708	1,879	1,887	1,947	1,906	1,496
576	579	572	562	532	522	527	344
98,700	99,900	85,200	81,100	78,400	78,100	67,600	61,800

Notes: 2001 net earnings include a special charge of \$36,650,000, or \$0.39 per share, to establish a reserve related to the shutdown of Material Logic.

2000 net earnings include gains on the sales of investment securities of \$17,860,000, or \$0.19 per share.

Consolidated Statements of Earnings

<i>(In thousands of dollars, except for per share amounts)</i>	For the Years Ended December 31,		
	2005	2004	2003
Net sales	\$5,526,636	\$5,049,785	\$4,667,014
Cost of merchandise sold	3,365,095	3,143,133	2,975,513
Gross profit	2,161,541	1,906,652	1,691,501
Warehousing, marketing and administrative expenses	1,642,552	1,465,624	1,303,197
Restructuring charge	—	(226)	(564)
Total operating expenses	1,642,552	1,465,398	1,302,633
Operating earnings	518,989	441,254	388,868
Other income and (expense):			
Interest income	12,882	6,376	3,347
Interest expense	(1,863)	(4,388)	(6,015)
Equity in income (loss) of unconsolidated entities – net	2,809	996	(2,288)
Write-off of investments in unconsolidated entities	—	—	(1,921)
Gain on sale of unconsolidated entity	—	750	—
Unclassified – net	(143)	151	(901)
Total other income and (expense)	13,685	3,885	(7,778)
Earnings before income taxes	532,674	445,139	381,090
Income taxes	186,350	158,216	154,119
Net earnings	\$ 346,324	\$ 286,923	\$ 226,971
Earnings per share:			
Basic	\$ 3.87	\$ 3.18	\$ 2.50
Diluted	\$ 3.78	\$ 3.13	\$ 2.46
Weighted average number of shares outstanding:			
Basic	89,568,746	90,206,773	90,731,013
Diluted	91,588,295	91,673,375	92,394,085

Consolidated Balance Sheets

<i>(In thousands of dollars)</i>	As of December 31,		
	2005	2004	2003
Assets			
Current Assets			
Cash and cash equivalents	\$ 544,894	\$ 429,246	\$ 402,824
Accounts receivable (less allowances for doubtful accounts of \$18,401, \$23,375 and \$24,736, respectively)	518,625	480,893	431,896
Inventories	791,212	700,559	661,247
Prepaid expenses and other assets	54,334	47,086	37,947
Deferred income taxes	88,803	96,929	99,499
Total current assets	1,997,868	1,754,713	1,633,413
Property, Buildings and Equipment			
Land	162,123	154,673	153,357
Buildings, structures and improvements	841,031	804,317	785,890
Furniture, fixtures, machinery and equipment	716,497	679,141	605,903
	1,719,651	1,638,131	1,545,150
Less accumulated depreciation and amortization	949,026	876,558	813,158
Property, buildings and equipment – net	770,625	761,573	731,992
Deferred income taxes	4,373	18,871	20,296
Investments in unconsolidated entities	25,155	26,126	22,822
Goodwill	182,726	165,011	156,269
Other assets and intangibles – net	127,174	83,279	59,886
Total Assets	\$3,107,921	\$2,809,573	\$2,624,678
Liabilities and Shareholders' Equity			
Current Liabilities			
Current maturities of long-term debt	\$ 4,590	\$ 9,485	\$ 144,135
Trade accounts payable	319,254	289,388	257,806
Accrued compensation and benefits	164,574	138,143	121,550
Accrued contributions to employees' profit sharing plans	106,825	89,878	58,100
Accrued expenses	107,167	100,287	81,359
Income taxes	24,554	35,253	43,690
Total current liabilities	726,964	662,434	706,640
Long-term debt (less current maturities)	4,895	—	4,895
Deferred income taxes	7,019	4,482	—
Accrued employment-related benefits costs	80,067	74,687	68,008
Shareholders' equity			
Cumulative preferred stock – \$5 par value – 12,000,000 shares authorized; none issued nor outstanding	—	—	—
Common stock – \$0.50 par value – 300,000,000 shares authorized; issued, 109,667,938, 109,672,938 and 109,377,216 shares, respectively	54,834	54,836	54,689
Additional contributed capital	451,578	432,171	394,409
Retained earnings	2,722,103	2,458,442	2,242,762
Unearned restricted stock compensation	(17,280)	(14,463)	(11,471)
Accumulated other comprehensive earnings	27,082	18,052	2,594
Treasury stock, at cost – 19,952,297, 19,075,511 and 18,356,227 shares, respectively	(949,341)	(881,068)	(837,848)
Total shareholders' equity	2,288,976	2,067,970	1,845,135
Total Liabilities and Shareholders' Equity	\$3,107,921	\$2,809,573	\$2,624,678

Consolidated Statements of Cash Flows

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

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

Management



Richard L. Keyser

Chairman of the Board and Chief Executive Officer

Richard L. Keyser was elected Chief Executive Officer in September 1995 and then Chairman of the Board in September 1997. He is responsible for the strategic direction and overall leadership of the company. Prior to this appointment, Mr. Keyser served as President and Chief Executive Officer and as President and Chief Operating Officer. Mr. Keyser currently serves on the board of directors for the Rohm and Haas Company, The Principal Financial Group and Evanston Northwestern Healthcare. He is a trustee of the John G. Shedd Aquarium and a member of the Economic Club of Chicago, the Commercial Club of Chicago and the Business Roundtable.



James T. Ryan

Group President

James T. Ryan was elected Group President in April 2004. He is responsible for driving sales and service growth across all of the company's businesses operating under the Grainger brand in the United States. Mr. Ryan has served Grainger in increasingly responsible roles since 1980, including President, grainger.com, President, Grainger Parts and most recently Executive Vice President, Marketing, Sales and Service. Mr. Ryan is a member of the Economic Club of Chicago.



P. Ogden Loux

Senior Vice President, Finance and Chief Financial Officer

P. Ogden Loux was elected Senior Vice President, Finance and Chief Financial Officer in December 1997. His responsibilities include financial planning and analysis, financial process planning and control, financial reporting, internal audit, treasury operations and administrative services. Since 1987, when he joined Grainger, Mr. Loux has served in increasingly responsible roles, including Vice President and Controller, Vice President, Business Support and Vice President, Finance.



Timothy M. Ferrarell

Senior Vice President, Enterprise Systems

Timothy M. Ferrarell was named Senior Vice President, Enterprise Systems, in June 2001. He is responsible for enhancing customers' experiences through the company's process improvement and business system integration efforts. Prior to this role, Mr. Ferrarell served as Vice President, Marketing. Mr. Ferrarell serves on the board of directors for the Lincoln Foundation for Performance Excellence and is on the Board of Trustees for Lewis University.



Douglas J. Harrison

President, Acklands – Grainger Inc.

Douglas J. Harrison was named President, Acklands – Grainger Inc., a subsidiary of Grainger, in September 1999. In this role, he is responsible for the Canadian company in its entirety, including its sales, operations and general management. The Acklands – Grainger branch network is located throughout Canada and serves a wide range of customers. Mr. Harrison serves on the board of Livingston International Inc., Canada's largest customs broker.



Nancy A. Hobor

Senior Vice President, Communications and Investor Relations

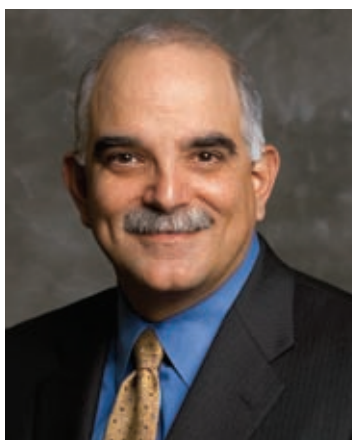
Nancy A. Hobor was named Senior Vice President, Communications and Investor Relations in March 2003. She has been responsible for Grainger's internal and external communications, community relations and investor relations since 1999. Ms. Hobor serves as Adjunct Professor of Investor Relations at Northwestern University. She is a member of the board of Arthur W. Page Society, the Visiting Committee of the Division of the Social Sciences for the University of Chicago, head of the Advisory Committee of the National Investor Relations Institute Center for Strategic Communications and a member of the Senior Roundtable.



John L. Howard

Senior Vice President and General Counsel

John L. Howard joined Grainger and was elected Senior Vice President and General Counsel in January 2000. His responsibilities include supporting all of the company's legal functions. He serves on the Wilson Council of the Woodrow Wilson Center for International Scholars and on the Council of Legal Advisors of the National Legal Center for the Public Interest, both in Washington, D.C. He also serves on the board of directors of the Chicago Botanic Garden.



Larry J. Loizzo

Senior Vice President, President, Lab Safety Supply, Inc.

Larry J. Loizzo was named President, Lab Safety Supply, Inc., a subsidiary of Grainger, in June 1996. He is responsible for the overall management and operations of Lab Safety Supply. Mr. Loizzo has been with Lab Safety Supply since 1987. Mr. Loizzo serves on the board of directors of the Safety Equipment Distributors Association and the Blackhawk Technical College Foundation. He is also a member of the University of Wisconsin at Whitewater Marketing Advisory Committee and the Forward Janesville Major Industries Council.



Lawrence J. Pilon

Senior Vice President, Human Resources

Lawrence J. Pilon was named Senior Vice President of Human Resources in February 2005. He is responsible for providing strategic direction and leadership for the design, development and execution of Grainger's human resource initiatives. Prior to joining Grainger, Mr. Pilon served as Executive Vice President, Human Resources for the Kellogg Company, where he was responsible for the worldwide human resource function.



John A. Schweig

Senior Vice President, Strategy and Development

John A. Schweig was elected Senior Vice President, Strategy and Development in March 2003. Mr. Schweig is responsible for Grainger's international distribution and sourcing activities, and for identifying and capitalizing on other strategic opportunities for company growth. Mr. Schweig joined Grainger in 1990 as Vice President, Marketing. Mr. Schweig serves on the board of the Chicago Youth Centers. He is also an Advisory Board Member of the University of Wisconsin-Madison School of Business' Center for Brand and Product Management.



William D. Chapman

Director, Investor Relations

William D. Chapman was named Director, Investor Relations in October 1999. In this role, he serves as the company's primary contact with the investment community. Mr. Chapman is Executive Vice President for the Chicago Chapter of the National Investor Relations Institute and is a member of the Manufacturers Alliance Investor Relations Council. He also serves as a Director, past President and Scholarship Chairman of the Wisconsin Alumni Association-Chicago Chapter and is a Director of the National Wisconsin Alumni Association.

Board of Directors

Independent Members and Grainger's Senior Chairman



Brian P. Anderson is the former Executive Vice President and Chief Financial Officer of OfficeMax Incorporated, a retail and business-to-business office products distributor. Mr. Anderson was first elected a director of Grainger in 1999 and is Chairman of the Audit Committee, Grainger's Audit Committee Financial Expert, and a member of the Board Affairs and Nominating Committee.



Wilbur H. Gantz is Executive Chairman of Ovation Pharmaceuticals, Inc., a specialty pharmaceutical company that focuses on under-promoted and late-stage development products. Mr. Gantz is also a director of Gambro AB and Harris Financial Corp. Mr. Gantz was first elected a director of Grainger in 1985 and is a member of the Audit Committee and the Board Affairs and Nominating Committee.



David W. Grainger is the company's Senior Chairman of the Board, a position assumed in 1997 after serving as Chairman of the Board. He was the company's Chief Executive Officer until 1995. Mr. Grainger joined the company in 1952 and was first elected a director in 1953.



William K. Hall is the co-founder and Chairman of Procyon Technologies, Inc., a privately owned, Chicago-based holding company that focuses on the acquisition and growth of suppliers to the global aerospace and defense industry. Mr. Hall currently serves on the boards of Actuant Corporation, Great Plains Energy Incorporated and A. M. Castle & Co. Mr. Hall was first elected a director of Grainger in 2005 and is a member of the Audit Committee and the Board Affairs and Nominating Committee.



Stuart L. Levenick is a Group President of Caterpillar Inc., a manufacturer of construction and mining equipment, diesel and natural gas engines and industrial turbines. He has been with Caterpillar since 1977. Mr. Levenick serves on the board of Entergy Corporation and is a member of the US-China Business Council. Mr. Levenick was appointed a director of Grainger in October 2005 and is a member of the Board Affairs and Nominating Committee and the Compensation Committee.



John W. McCarter, Jr., is President and Chief Executive Officer of The Field Museum of Natural History, a position assumed in 1996. Mr. McCarter is also a director of Divergence, Inc. and Janus Funds. He was first elected a director of Grainger in 1990 and is Chairman of the Board Affairs and Nominating Committee and a member of the Compensation Committee.



Neil S. Novich is Chairman, President and Chief Executive Officer, as well as a director, of Ryerson Inc., the largest metal distributor and processor in North America. Mr. Novich was first elected a director of Grainger in 1999 and is a member of the Board Affairs and Nominating Committee and the Compensation Committee.



Michael J. Roberts is President and Chief Operating Officer of McDonald's Corporation, the leading global foodservice retailer. He serves on the Chicago Council on Foreign Relations and the Kellogg School of Management CEO Perspective Program at Northwestern University. He was first appointed a director of Grainger in 2006 and is a member of the Board Affairs and Nominating Committee and the Compensation Committee.



Gary L. Rogers was most recently Vice Chairman of General Electric Company from 2001 until his retirement in December of 2003. Mr. Rogers is a director of Wyeth and the Rohm and Haas Company and is a trustee of the Florida State University Foundation. Mr. Rogers was first elected a director of Grainger in 2004 and is a member of the Board Affairs and Nominating Committee and the Compensation Committee.



James D. Slavik is Chairman (formerly President) and a director of Mark IV Capital, Inc., an investment company dealing in real estate and corporate investments. He was first elected a director of Grainger in 1987 and is a member of the Audit Committee and the Board Affairs and Nominating Committee.



Harold B. Smith is Chairman of the Executive Committee and a director of Illinois Tool Works Inc., a manufacturer and marketer of engineered components and industrial systems and consumables. He is also a director of Northern Trust Corporation. Mr. Smith was first elected a director of Grainger in 1981 and is Chairman of the Compensation Committee and a member of the Board Affairs and Nominating Committee.

Committees of the Board

The Board has three standing committees: Audit, Board Affairs and Nominating, and Compensation. All members of these committees are required to be “independent” directors. Committee memberships are shown in the following table:

Name	Audit Committee	Board Affairs and Nominating Committee	Compensation Committee
Brian P. Anderson	Chair	Member	
Wilbur H. Gantz	Member	Member	
William K. Hall	Member	Member	
Stuart L. Levenick		Member	Member
John W. McCarter, Jr.		Chair	Member
Neil S. Novich		Member	Member
Michael J. Roberts		Member	Member
Gary L. Rogers		Member	Member
James D. Slavik	Member	Member	
Harold B. Smith		Member	Chair

Director Ownership

The following chart shows the “beneficial ownership” of Grainger common stock as of January 31, 2006, by David W. Grainger and by all directors and executive officers as a group:

David W. Grainger	9.7%
Directors and executive officers as a group	16.1%

On February 21, 2006, the Board of Directors nominated V. Ann Hailey, Executive Vice President of Limited Brands, Inc., along with all incumbent directors, to stand for election to the company’s Board at the 2006 Annual Meeting of Shareholders.

Company Information

Headquarters

W.W. Grainger, Inc.
100 Grainger Parkway
Lake Forest, IL 60045-5201
847.535.1000 Phone
847.535.0878 Fax
www.grainger.com

Investor Relations Contacts

Nancy A. Hobor
Senior Vice President, Communications and Investor Relations
847.535.0065
William D. Chapman
Director, Investor Relations
847.535.0881

Media Contact Information

Ernest L. Duplessis
Director, External Communications
847.535.4356
Michael E. McGrew
Regional Communications Director, Eastern Region
847.535.4196
Erin Ptacek
Regional Communications Director, Western Region
949.255.1368
Robb M. Kristopher
Manager, External Communications
847.535.0879

Analyst Coverage

Electrical Equipment

Buckingham Research – Edward Wheeler
Cathay Financial – John Baliotti
CIBC World Markets Corp. – Robert McCarthy
J.P. Morgan – C. Stephen Tusa
Lehman Brothers – Daniel Whang
Merrill Lynch – John Inch
Morgan Stanley – Scott Davis

Industrial Distribution

BB&T Capital Markets – Holden Lewis
FTN Midwest Research – Mark Koznarek
Robert W. Baird & Co. – David Manthey
Morgan, Keegan & Company, Inc. – Brent Rakers
William Blair & Co., L.L.C. – Jeffrey Germanotta

Annual Meeting

The 2006 Annual Meeting of Shareholders will be held at the company's headquarters in Lake Forest, Ill., at 10:00 a.m. CDT on Wednesday, April 26, 2006.

Expected Earnings Release Dates

First Quarter	April 17, 2006
Second Quarter	July 17, 2006
Third Quarter	October 16, 2006
Fourth Quarter	January 25, 2007

Issuance of Preferred Share Purchase Rights

Grainger has adopted a shareholder rights plan, under which there is outstanding one preferred share purchase right for each outstanding share of Grainger common stock. Under certain circumstances – after a person or a group (unless exempt under the plan) acquires or announces a tender offer for 15 percent or more of Grainger's common stock – each right would entitle the holder to purchase, at the then-current exercise price, stock and/or other securities or assets of the company. The rights expire on May 15, 2009, unless earlier redeemed. The rights do not have voting or dividend rights and, until they become exercisable, have no dilutive effect on the earnings of Grainger.

Auditors

Ernst & Young LLP
Sears Tower
233 South Wacker Drive
Chicago, IL 60606-6301

Common Stock Listing

The company's common stock is listed on the New York and Chicago stock exchanges under the trading symbol GWW.

Transfer Agent, Registrar and Dividend Disbursing Agent

Instructions and inquiries regarding transfers, certificates, changes of title or address, lost or missing dividend checks, consolidation of accounts and elimination of multiple mailings should be directed to:

Computershare Investor Services
P.O. Box 43023
Providence, RI 02940-3023
Telephone 781.575.2879

Dividend Direct Deposit

Shareholders of record have the opportunity to have their quarterly dividends electronically deposited directly into their checking, money market or savings accounts at financial institutions that participate in the automated clearinghouse system.

Shareholders of record who take advantage of dividend direct deposit will have their Grainger dividend payments deposited into the specified accounts on the dividend payment dates.

Shareholders who are interested in taking advantage of this service or would like more information on the program should contact Computershare Investor Services.

Forward-Looking Statements

Throughout this Fact Book are forward-looking statements under the federal securities laws. The forward-looking statements relate to the company's expected future financial results and business plans, strategies, and objectives and are not historical facts. They are often identified by qualifiers such as "aims," "anticipated," "believes," "estimated," "expects," "goals," "intends," "looks to," "opportunity," "plans," "potential," "projected," "should," "targeting," "will" or similar expressions. There are risks and uncertainties whose outcome could cause the company's results to differ materially from what is projected.

Factors that may affect forward-looking statements include the following: higher product costs or other expenses; a major loss of customers; increased competitive pricing pressure on the company's businesses; failure to develop or implement new technologies or other business strategies; the outcome of pending and future litigation and governmental proceedings; changes in laws and regulations; facilities disruptions or shutdowns; disruption in transportation services; natural and other catastrophes; unanticipated weather conditions and other difficulties in achieving or improving margins or financial performance.

Trends and projections could also be affected by general industry and market conditions, gross domestic product growth rates, general economic conditions including interest rate and currency rate fluctuations, employment levels, global and other conflicts, and other factors.

Trademarks

ACKLANDS – GRAINGER, FOR THE ONES WHO GET IT DONE, GRAINGER, the GRAINGER CATALOG DESIGN, the GRAINGER logo, GRAINGER REBUILDING AMERICA, GRAINGER SHIPPING BOX DESIGN, GRAINGER.COM, GRAINGER.COM.MX, and TU SOLICIÓN EN SUMINISTROS INDUSTRIALES are trademarks or service marks of W.W. Grainger, Inc., which may be registered in the United States and/or other countries.

AW DIRECT, BEN MEADOWS, GEMPLER'S, LAB SAFETY, LAB SAFETY SUPPLY, LSS, and RAND MATERIALS HANDLING EQUIPMENT are trademarks or service marks of Lab Safety Supply, Inc. which may be registered in the United States and/or other countries.

All other trademarks and service marks are the property of their respective owners.



Grainger customers have different needs, from service technicians looking for a repair part to facilities maintenance supervisors in search of the right light bulb, but they have one thing in common: when they need a product, they often need it fast. With nearly 600 branches across North America, catalogs, call centers and Web sites offering more than 800,000 products, Grainger provides solutions customers need when and where they need them.

Grainger at a Glance

Headquarters

W.W. Grainger, Inc.
100 Grainger Parkway
Lake Forest, IL 60045-5201
847.535.1000
www.grainger.com

Key Facts

2005 Sales: \$5.5 billion

Number of employees: 16,732

Number of branches: 589 throughout
North America

Stock Trading: The company's common stock
is listed on the New York and Chicago stock
exchanges under the trading symbol GWW.

