
INDEX TO FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

December 31, 2012, 2011 and 2010

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MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of W.W. Grainger, Inc. (Grainger) is responsible for establishing and maintaining adequate internal control over financial reporting. Grainger's internal control system was designed to provide reasonable assurance to Grainger's management and Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements under all potential conditions. Therefore, effective internal control over financial reporting provides only reasonable, and not absolute, assurance with respect to the preparation and presentation of financial statements.

Grainger's management assessed the effectiveness of Grainger's internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Based on its assessment under that framework and the criteria established therein, Grainger's management concluded that Grainger's internal control over financial reporting was effective as of December 31, 2012.

Ernst & Young LLP, an independent registered public accounting firm, has audited Grainger's internal control over financial reporting as of December 31, 2012, as stated in their report, which is included herein.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited W.W. Grainger, Inc. and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). W.W. Grainger, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, W.W. Grainger, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of W.W. Grainger, Inc. and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of earnings, comprehensive earnings, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2012 of W.W. Grainger, Inc. and subsidiaries and our report dated February 27, 2013 expressed an unqualified opinion thereon.

Ernst & Young LLP

Chicago, Illinois
February 27, 2013

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of W.W. Grainger, Inc. and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of earnings, comprehensive earnings, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of W.W. Grainger, Inc. and subsidiaries at December 31, 2012 and 2011, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), W.W. Grainger Inc. and subsidiaries' internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2013 expressed an unqualified opinion thereon.

Ernst & Young LLP

Chicago, Illinois
February 27, 2013

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF EARNINGS

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

	For the Years Ended December 31,		
	2012	2011	2010
Net sales	\$8,950,045	\$8,078,185	\$7,182,158
Cost of merchandise sold	5,033,885	4,567,393	4,176,474
Gross profit	3,916,160	3,510,792	3,005,684
Warehousing, marketing and administrative expenses	2,785,035	2,458,363	2,145,209
Operating earnings	1,131,125	1,052,429	860,475
Other income and (expense):			
Interest income	2,660	2,068	1,215
Interest expense	(16,078)	(9,091)	(8,187)
Equity in net income (loss) of unconsolidated entities	—	314	(182)
Gain on sale of investment in unconsolidated entity	—	7,639	—
Other non-operating income	1,866	709	1,608
Other non-operating expense	(1,784)	(2,541)	(1,151)
Total other income and (expense)	(13,336)	(902)	(6,697)
Earnings before income taxes	1,117,789	1,051,527	853,778
Income taxes	418,940	385,115	340,196
Net earnings	698,849	666,412	513,582
Less: Net earnings attributable to noncontrolling interest	8,968	7,989	2,717
Net earnings attributable to W.W. Grainger, Inc.	<u>\$ 689,881</u>	<u>\$ 658,423</u>	<u>\$ 510,865</u>
Earnings per share:			
Basic	<u>\$ 9.71</u>	<u>\$ 9.26</u>	<u>\$ 7.05</u>
Diluted	<u>\$ 9.52</u>	<u>\$ 9.07</u>	<u>\$ 6.93</u>
Weighted average number of shares outstanding:			
Basic	<u>69,811,881</u>	<u>69,690,854</u>	<u>70,836,945</u>
Diluted	<u>71,181,733</u>	<u>71,176,158</u>	<u>72,138,858</u>

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

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

(In thousands of dollars)

	For the Years Ended December 31,		
	2012	2011	2010
Net earnings	\$698,849	\$666,412	\$513,582
Other comprehensive earnings (losses):			
Foreign currency translation adjustments, net of tax (expense) benefit of \$(1,653), \$1,325 and \$(3,397), respectively	7,344	(36,117)	46,450
Reclassification of cumulative currency translation gain	—	525	—
Defined postretirement benefit plan, net of tax (expense) benefit of \$(47,948), \$18,725 and \$1,821, respectively	75,625	(30,038)	(2,874)
Other employment-related benefit plans and derivatives, net of tax benefit of \$2,825, \$89 and \$2,321, respectively ..	(9,519)	(1,932)	(4,287)
Total other comprehensive earnings (losses)	73,450	(67,562)	39,289
Comprehensive earnings, net of tax	772,299	598,850	552,871
Less: Comprehensive earnings attributable to noncontrolling interest:			
Net earnings	8,968	7,989	2,717
Foreign currency translation adjustments	(8,866)	4,127	8,712
Comprehensive earnings attributable to W.W. Grainger, Inc.	<u>\$772,197</u>	<u>\$586,734</u>	<u>\$541,442</u>

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

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

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

ASSETS	As of December 31,	
	2012	2011
CURRENT ASSETS		
Cash and cash equivalents	\$ 452,063	\$ 335,491
Accounts receivable (less allowances for doubtful accounts of \$19,449 and \$18,801, respectively)	940,020	888,697
Inventories – net	1,301,935	1,268,647
Prepaid expenses and other assets	110,414	100,081
Deferred income taxes	55,967	47,410
Prepaid income taxes	40,241	54,574
Total current assets	2,900,640	2,694,900
PROPERTY, BUILDINGS AND EQUIPMENT		
Land	265,224	252,161
Buildings, structures and improvements	1,224,044	1,186,002
Furniture, fixtures, machinery and equipment	1,271,166	1,127,159
	2,760,434	2,565,322
Less: Accumulated depreciation and amortization	1,615,861	1,505,027
Property, buildings and equipment – net	1,144,573	1,060,295
DEFERRED INCOME TAXES	51,536	100,830
GOODWILL	543,670	509,183
OTHER ASSETS AND INTANGIBLES – NET	374,179	350,854
TOTAL ASSETS	<u>\$5,014,598</u>	<u>\$4,716,062</u>

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS – CONTINUED

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

LIABILITIES AND SHAREHOLDERS' EQUITY	As of December 31,	
	2012	2011
CURRENT LIABILITIES		
Short-term debt.....	\$ 79,071	\$ 119,970
Current maturities of long-term debt	18,525	221,539
Trade accounts payable	428,782	477,648
Accrued compensation and benefits	165,450	207,010
Accrued contributions to employees' profit sharing plans	170,434	159,950
Accrued expenses	204,800	178,652
Income taxes payable	12,941	23,156
Total current liabilities	1,080,003	1,387,925
LONG-TERM DEBT (less current maturities).....	467,048	175,055
DEFERRED INCOME TAXES AND TAX UNCERTAINTIES	119,280	100,218
EMPLOYMENT-RELATED AND OTHER NONCURRENT LIABILITIES.....	230,901	328,585
SHAREHOLDERS' EQUITY		
Cumulative Preferred Stock – \$5 par value – 12,000,000 shares authorized; none issued or outstanding	—	—
Common Stock – \$0.50 par value – 300,000,000 shares authorized; issued 109,659,219 shares.....	54,830	54,830
Additional contributed capital	812,573	700,826
Retained earnings	5,278,577	4,806,110
Accumulated other comprehensive earnings (losses)	53,578	(28,738)
Treasury stock, at cost – 40,180,724 and 39,696,367 shares, respectively.....	(3,175,646)	(2,904,243)
Total W.W. Grainger, Inc. shareholders' equity	3,023,912	2,628,785
Noncontrolling interest.....	93,454	95,494
Total shareholders' equity	3,117,366	2,724,279
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$5,014,598	\$4,716,062

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

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of dollars)

	For the Years Ended December 31,		
	2012	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net earnings	\$698,849	\$ 666,412	\$ 513,582
Provision for losses on accounts receivable	9,504	4,761	6,718
Deferred income taxes and tax uncertainties.....	12,343	1,666	(5,553)
Depreciation and amortization.....	159,049	149,200	149,678
Stock-based compensation.....	55,500	54,020	49,796
Gain on investment in unconsolidated entities.....	—	(7,639)	—
Change in operating assets and liabilities – net of business acquisitions:			
Accounts receivable	(45,953)	(85,083)	(127,790)
Inventories	(14,872)	(219,680)	(80,545)
Prepaid expenses and other assets	8,346	(24,228)	(8,806)
Trade accounts payable	(54,314)	86,395	36,219
Other current liabilities.....	(58,673)	50,718	49,576
Current income taxes payable.....	(9,349)	16,827	(1,503)
Accrued employment-related benefits costs.....	45,795	45,680	18,128
Other – net	9,970	7,059	(3,055)
Net cash provided by operating activities.....	<u>816,195</u>	<u>746,108</u>	<u>596,445</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to property, buildings and equipment	(249,860)	(196,942)	(127,124)
Proceeds from sale of property, buildings and equipment	8,530	7,278	6,508
Cash paid for business acquisitions, net of cash acquired.....	(64,808)	(359,296)	(62,072)
Other – net	482	13,892	13,529
Net cash used in investing activities	<u>\$(305,656)</u>	<u>\$(535,068)</u>	<u>\$(169,159)</u>

W.W. Grainger, Inc. and Subsidiaries**CONSOLIDATED STATEMENTS OF CASH FLOWS – CONTINUED**

(In thousands of dollars)

	For the Years Ended December 31,		
	<u>2012</u>	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Borrowings under lines of credit	\$ 161,160	\$ 218,885	\$ 35,297
Payments against lines of credit	(205,006)	(194,325)	(29,799)
Proceeds from issuance of long-term debt	300,000	172,464	200,000
Payments of long-term debt and commercial paper	(219,950)	(179,296)	(239,122)
Proceeds from stock options exercised	72,084	84,337	86,528
Excess tax benefits from stock-based compensation	57,885	52,098	25,650
Purchase of treasury stock	(340,532)	(151,082)	(504,803)
Cash dividends paid	(220,077)	(180,527)	(152,338)
Net cash used in financing activities	<u>(394,436)</u>	<u>(177,446)</u>	<u>(578,587)</u>
Exchange rate effect on cash and cash equivalents	<u>469</u>	<u>(11,557)</u>	<u>4,884</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS:	<u>116,572</u>	<u>22,037</u>	<u>(146,417)</u>
Cash and cash equivalents at beginning of year	<u>335,491</u>	<u>313,454</u>	<u>459,871</u>
Cash and cash equivalents at end of year	<u>\$ 452,063</u>	<u>\$ 335,491</u>	<u>\$ 313,454</u>
Supplemental cash flow information:			
Cash payments for interest (net of amounts capitalized) ...	\$ 16,028	\$ 8,996	\$ 8,188
Cash payments for income taxes	383,698	312,616	319,754

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

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

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

	W.W. Grainger, Inc. Shareholders' Equity					
	Common Stock	Additional Contributed Capital	Retained Earnings	Accumulated Other Comprehensive Earnings (Losses)	Treasury Stock	Noncontrolling Interest
Balance at January 1, 2010.....	\$54,830	\$596,358	\$3,966,508	\$ 12,374	\$(2,466,350)	\$63,479
Exercise of stock options	—	(11,211)	—	—	98,052	171
Tax benefits on stock-based compensation awards	—	28,225	—	—	—	—
Stock option expense.....	—	17,163	—	—	—	333
Amortization of other stock-based compensation awards	—	29,725	—	—	—	—
Settlement and vesting of other stock-based compensation awards ...	—	(22,090)	—	—	9,297	—
Purchase of treasury stock.....	—	(484)	—	—	(498,011)	(428)
Net earnings.....	—	—	510,865	—	—	2,717
Other comprehensive earnings.....	—	—	—	30,577	—	8,712
Cash dividends paid (\$2.08 per share)	—	—	(150,612)	—	—	(1,726)
Fair value at acquisition	—	—	—	—	—	9,196
Balance at December 31, 2010	\$54,830	\$637,686	\$4,326,761	\$ 42,951	\$(2,857,012)	\$82,454
Exercise of stock options	—	(11,506)	—	—	95,384	459
Tax benefits on stock-based compensation awards	—	55,824	—	—	—	—
Stock option expense.....	—	16,838	—	—	—	294
Amortization of other stock-based compensation awards	—	33,162	—	—	—	—
Settlement and vesting of other stock-based compensation awards ...	—	(31,067)	—	—	8,257	—
Purchase of treasury stock.....	—	(111)	—	—	(150,872)	(99)
Net earnings.....	—	—	658,423	—	—	7,989
Other comprehensive earnings.....	—	—	—	(71,689)	—	4,127
Cash dividends paid (\$2.52 per share)	—	—	(179,074)	—	—	(1,453)
Fair value at acquisition.....	—	—	—	—	—	1,723
Balance at December 31, 2011	\$54,830	\$700,826	\$4,806,110	\$ (28,738)	\$(2,904,243)	\$95,494
Exercise of stock options	—	(927)	—	—	72,502	564
Tax benefits on stock-based compensation awards	—	60,122	—	—	—	—
Stock option expense.....	—	17,898	—	—	—	105
Amortization of other stock-based compensation awards	—	35,125	—	—	—	—
Settlement and vesting of other stock-based compensation awards ...	—	(31,175)	—	—	1,452	—
Director's stock compensation	—	30,867	—	—	—	—
Purchase of treasury stock.....	—	(163)	—	—	(345,357)	(148)
Net earnings.....	—	—	689,881	—	—	8,968
Other comprehensive earnings.....	—	—	—	82,316	—	(8,866)
Cash dividends paid (\$3.06 per share)	—	—	(217,414)	—	—	(2,663)
Balance at December 31, 2012	\$54,830	\$812,573	\$5,278,577	\$ 53,578	\$(3,175,646)	\$93,454

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