
INDEX TO FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

December 31, 2013, 2012 and 2011

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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, 2013, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (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, 2013.

Ernst & Young LLP, an independent registered public accounting firm, has audited Grainger's internal control over financial reporting as of December 31, 2013, 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, 2013, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (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, 2013, 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, 2013 and 2012, 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, 2013 of W.W. Grainger, Inc. and subsidiaries and our report dated February 27, 2014 expressed an unqualified opinion thereon.

Ernst & Young LLP

Chicago, Illinois
February 27, 2014

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, 2013 and 2012, 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, 2013. 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, 2013 and 2012, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, 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, 2013, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated February 27, 2014 expressed an unqualified opinion thereon.

Ernst & Young LLP

Chicago, Illinois
February 27, 2014

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,		
	2013	2012	2011
Net sales	\$9,437,758	\$8,950,045	\$8,078,185
Cost of merchandise sold	5,301,275	5,033,885	4,567,393
Gross profit	4,136,483	3,916,160	3,510,792
Warehousing, marketing and administrative expenses	2,839,629	2,785,035	2,458,363
Operating earnings	1,296,854	1,131,125	1,052,429
Other income and (expense):			
Interest income	3,234	2,660	2,068
Interest expense	(13,225)	(16,078)	(9,091)
Equity in net income of unconsolidated entity	—	—	314
Gain on sale of investment in unconsolidated entity	—	—	7,639
Other non-operating income	2,732	1,866	709
Other non-operating expense	(1,996)	(1,784)	(2,541)
Total other income and (expense)	(9,255)	(13,336)	(902)
Earnings before income taxes	1,287,599	1,117,789	1,051,527
Income taxes	479,850	418,940	385,115
Net earnings	807,749	698,849	666,412
Less: Net earnings attributable to noncontrolling interest	10,713	8,968	7,989
Net earnings attributable to W.W. Grainger, Inc.	<u>\$ 797,036</u>	<u>\$ 689,881</u>	<u>\$ 658,423</u>
Earnings per share:			
Basic	<u>\$ 11.31</u>	<u>\$ 9.71</u>	<u>\$ 9.26</u>
Diluted	<u>\$ 11.13</u>	<u>\$ 9.52</u>	<u>\$ 9.07</u>
Weighted average number of shares outstanding:			
Basic	<u>69,455,507</u>	<u>69,811,881</u>	<u>69,690,854</u>
Diluted	<u>70,576,432</u>	<u>71,181,733</u>	<u>71,176,158</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,		
	2013	2012	2011
Net earnings	\$807,749	\$698,849	\$666,412
Other comprehensive earnings (losses):			
Foreign currency translation adjustments, net of tax benefit (expense) of \$4,078, \$(1,653) and \$1,325, respectively	(78,253)	7,344	(36,117)
Reclassification of cumulative currency translation	—	—	525
Defined postretirement benefit plan, net of tax (expense) benefit of \$(20,188), \$(47,948) and \$18,725, respectively ..	32,658	75,625	(30,038)
Other employment-related benefit plans and derivatives, net of tax (expense) benefit of \$(3,080), \$2,825 and \$89, respectively	5,309	(9,519)	(1,932)
Total other comprehensive earnings (losses).....	(40,286)	73,450	(67,562)
Comprehensive earnings, net of tax.....	767,463	772,299	598,850
Less: Comprehensive earnings attributable to noncontrolling interest:			
Net earnings	10,713	8,968	7,989
Foreign currency translation adjustments	(15,622)	(8,866)	4,127
Comprehensive earnings attributable to W.W. Grainger, Inc.	<u>\$772,372</u>	<u>\$772,197</u>	<u>\$586,734</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,	
	2013	2012
CURRENT ASSETS		
Cash and cash equivalents	\$ 430,644	\$ 452,063
Accounts receivable (less allowances for doubtful accounts of \$20,096 and \$19,449, respectively)	1,101,656	940,020
Inventories – net	1,305,520	1,301,935
Prepaid expenses and other assets	115,331	110,414
Deferred income taxes	75,819	55,967
Prepaid income taxes	15,315	40,241
Total current assets	3,044,285	2,900,640
PROPERTY, BUILDINGS AND EQUIPMENT		
Land	277,256	265,224
Buildings, structures and improvements	1,259,237	1,224,044
Furniture, fixtures, machinery and equipment	1,404,597	1,271,166
	2,941,090	2,760,434
Less: Accumulated depreciation and amortization	1,732,528	1,615,861
Property, buildings and equipment – net	1,208,562	1,144,573
DEFERRED INCOME TAXES	16,209	51,536
GOODWILL	525,467	543,670
OTHER ASSETS AND INTANGIBLES – NET	471,805	374,179
TOTAL ASSETS	<u>\$5,266,328</u>	<u>\$5,014,598</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,	
	2013	2012
CURRENT LIABILITIES		
Short-term debt.....	\$ 66,857	\$ 79,071
Current maturities of long-term debt	30,429	18,525
Trade accounts payable	510,634	428,782
Accrued compensation and benefits	185,905	165,450
Accrued contributions to employees' profit sharing plans	176,800	170,434
Accrued expenses	218,835	204,800
Income taxes payable	6,330	12,941
Total current liabilities	1,195,790	1,080,003
 LONG-TERM DEBT (less current maturities).....	 445,513	 467,048
 DEFERRED INCOME TAXES AND TAX UNCERTAINTIES	 113,585	 119,280
 EMPLOYMENT-RELATED AND OTHER NONCURRENT LIABILITIES.....	 184,604	 230,901
 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	893,055	812,573
Retained earnings	5,822,612	5,278,577
Accumulated other comprehensive earnings	28,914	53,578
Treasury stock, at cost – 40,805,281 and 40,180,724 shares, respectively.....	(3,548,973)	(3,175,646)
Total W.W. Grainger, Inc. shareholders' equity	3,250,438	3,023,912
Noncontrolling interest.....	76,398	93,454
Total shareholders' equity	3,326,836	3,117,366
 TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	 \$5,266,328	 \$5,014,598

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,		
	2013	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net earnings	\$ 807,749	\$ 698,849	\$ 666,412
Provision for losses on accounts receivable	8,855	9,504	4,761
Deferred income taxes and tax uncertainties.....	(9,319)	12,343	1,666
Depreciation and amortization.....	180,613	159,049	149,200
Impairment of goodwill and other intangible assets.....	26,284	4,945	—
(Gains) losses from sales of assets	(22,155)	2,609	8,069
Stock-based compensation.....	55,590	55,500	54,020
Gain on sale of investment in unconsolidated entity	—	—	(7,639)
Change in operating assets and liabilities – net of business acquisitions and divestitures:			
Accounts receivable	(126,465)	(45,953)	(85,083)
Inventories	(23,636)	(14,872)	(219,680)
Prepaid expenses and other assets	16,873	8,346	(24,228)
Trade accounts payable	71,118	(54,314)	86,395
Other current liabilities.....	(707)	(58,673)	50,718
Current income taxes payable.....	(4,813)	(9,349)	16,827
Accrued employment-related benefits costs.....	9,872	45,795	45,680
Other – net	(3,361)	2,416	(1,010)
Net cash provided by operating activities.....	986,498	816,195	746,108
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to property, buildings and equipment	(272,145)	(249,860)	(196,942)
Proceeds from sales of property, buildings and equipment.....	26,701	8,530	7,278
Cash paid for business acquisitions, net of cash acquired.....	(153,915)	(64,808)	(359,296)
Other – net	(68)	482	13,892
Net cash used in investing activities	\$(399,427)	\$(305,656)	\$(535,068)

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

(In thousands of dollars)

	For the Years Ended December 31,		
	<u>2013</u>	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Borrowings under lines of credit	\$ 144,805	\$ 161,160	\$ 218,885
Payments against lines of credit	(154,450)	(205,006)	(194,325)
Proceeds from issuance of long-term debt	—	300,000	172,464
Payments of long-term debt and commercial paper	(16,681)	(219,950)	(179,296)
Proceeds from stock options exercised	69,412	72,084	84,337
Excess tax benefits from stock-based compensation	59,984	57,885	52,098
Purchase of treasury stock	(438,473)	(340,532)	(151,082)
Cash dividends paid	(255,466)	(220,077)	(180,527)
Net cash used in financing activities	<u>(590,869)</u>	<u>(394,436)</u>	<u>(177,446)</u>
Exchange rate effect on cash and cash equivalents	<u>(17,621)</u>	<u>469</u>	<u>(11,557)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS:	<u>(21,419)</u>	<u>116,572</u>	<u>22,037</u>
Cash and cash equivalents at beginning of year	<u>452,063</u>	<u>335,491</u>	<u>313,454</u>
Cash and cash equivalents at end of year	<u>\$ 430,644</u>	<u>\$ 452,063</u>	<u>\$ 335,491</u>
Supplemental cash flow information:			
Cash payments for interest (net of amounts capitalized) ...	\$ 12,954	\$ 16,028	\$ 8,996
Cash payments for income taxes	414,363	383,698	312,616

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, 2011.....	\$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	<u>\$54,830</u>	<u>\$700,826</u>	<u>\$4,806,110</u>	<u>\$ (28,738)</u>	<u>\$(2,904,243)</u>	<u>\$95,494</u>
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	<u>\$54,830</u>	<u>\$812,573</u>	<u>\$5,278,577</u>	<u>\$ 53,578</u>	<u>\$(3,175,646)</u>	<u>\$93,454</u>
Exercise of stock options	—	4,035	—	—	64,140	583
Tax benefits on stock-based compensation awards	—	62,385	—	—	—	—
Stock option expense.....	—	17,373	—	—	—	72
Amortization of other stock-based compensation awards	—	34,049	—	—	—	—
Settlement and vesting of other stock-based compensation awards ...	—	(37,851)	—	—	(3,709)	—
Purchase of treasury stock.....	—	—	—	—	(433,758)	(183)
Purchase of noncontrolling interest – Colombia	—	(51)	—	—	—	(9,612)
Net earnings.....	—	—	797,036	—	—	10,713
Other comprehensive earnings.....	—	—	—	(24,664)	—	(15,622)
Cash dividends paid (\$3.59 per share)	—	542	(253,001)	—	—	(3,007)
Balance at December 31, 2013	<u>\$54,830</u>	<u>\$893,055</u>	<u>\$5,822,612</u>	<u>\$ 28,914</u>	<u>\$(3,548,973)</u>	<u>\$76,398</u>

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