

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2014

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number 1-5684

W.W. Grainger, Inc.

(Exact name of registrant as specified in its charter)

Illinois

(State or other jurisdiction of incorporation or organization)

36-1150280

(I.R.S. Employer Identification No.)

100 Grainger Parkway, Lake Forest, Illinois

(Address of principal executive offices)

60045-5201

(Zip Code)

(847) 535-1000

(Registrant's telephone number including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Common Stock \$0.50 par value

Name of each exchange on which registered

New York Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. []

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer [] Non-accelerated filer [] Smaller reporting company []

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

The aggregate market value of the voting common equity held by nonaffiliates of the registrant was \$16,485,186,075 as of the close of trading as reported on the New York Stock Exchange on June 30, 2014. The Company does not have nonvoting common equity.

The registrant had 67,442,179 shares of the Company's common stock outstanding as of January 31, 2015.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement relating to the annual meeting of shareholders of the registrant to be held on April 29, 2015, are incorporated by reference into Part III hereof.

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PART I

Item 1: Business

The Company

W.W. Grainger, Inc., incorporated in the State of Illinois in 1928, is a broad-line distributor of maintenance, repair and operating (MRO) supplies and other related products and services used by businesses and institutions primarily in the United States and Canada, with presence also in Europe, Asia and Latin America. In this report, the words “Grainger” or “Company” mean W.W. Grainger, Inc. and its subsidiaries.

Grainger uses a combination of multichannel and single channel online business models to provide customers with a range of options for finding and purchasing products, utilizing sales representatives, contact centers, direct marketing materials, catalogs and eCommerce. Grainger serves more than 2 million customers worldwide through a network of highly integrated branches, distribution centers and websites.

Grainger’s Canadian subsidiary, Acklands–Grainger, acquired WFS Enterprises, Inc. (WFS) in the third quarter of 2014. WFS is a distributor of tools and supplies to industrial markets in Southern Ontario and select U.S. locations. Results for the business are consolidated with Grainger from the acquisition date. In 2014, Grainger also announced the decision to close the business in Brazil and operations will cease during 2015. During 2014, Grainger continued to invest in the single channel online business model, which has experienced strong growth in recent years.

Grainger’s centralized business support functions provide coordination and guidance in the areas of accounting and finance, business development, communications and investor relations, compensation and benefits, information systems, health and safety, global supply chain functions, human resources, risk management, internal audit, legal, real estate, security, tax and treasury. These services are provided in varying degrees to all business units.

Products are regularly added to and deleted from Grainger’s product lines on the basis of customer demand, market research, recommendations of suppliers, sales volumes and other factors.

Grainger’s two reportable segments are the United States and Canada and they are described further below. Other businesses include Zoro, the single channel online business in the United States, and operations in Europe, Asia and Latin America. These businesses generate revenue through the distribution of maintenance, repair and operating supplies and products and provide related services. For segment and geographical information and consolidated net sales and operating earnings, see “Item 7: Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Note 16 to the Consolidated Financial Statements.

United States

The United States business offers a broad selection of maintenance, repair and operating supplies and other related products and services through local branches, sales representatives, catalogs and eCommerce. A combination of product breadth, local availability, speed of delivery, detailed product information and competitively priced products and services is provided by this business. Products offered include material handling equipment, safety and security supplies, lighting and electrical products, power and hand tools, pumps and plumbing supplies, cleaning and maintenance supplies, building and home inspection supplies, vehicle and fleet components and many other items primarily focused on the facilities maintenance market. Services offered primarily relate to inventory management solutions. In 2014, service fee revenue represented less than 1% of sales.

The majority of the products sold by the United States business are well-recognized national branded products. In addition, 22% of 2014 sales were private label items bearing Grainger’s registered trademarks, such as DAYTON[®] motors, power transmission, HVAC and material handling equipment, SPEEDAIRE[®] air compressors, AIR HANDLER[®] air filtration equipment, TOUGH GUY[®] cleaning products, WESTWARD[®] tools, CONDOR[®] safety products and LUMAPRO[®] lighting products. Grainger has taken steps to protect these trademarks against infringement and believes that they will remain available for future use in its business. The United States business purchases products for sale from more than 2,500 key suppliers, most of which are manufacturers. Through a global sourcing operation, the business procures competitively priced, high-quality products produced outside the United States from approximately 400 suppliers. Grainger sells these items primarily under the private label brands listed above. No single supplier comprised more than 5% of total purchases and no significant difficulty has been encountered with respect to sources of supply.

Customers range from small and medium-sized businesses to large corporations, government entities and other institutions. They are primarily represented by purchasing managers or workers in facilities maintenance departments and service shops across a wide range of industries such as manufacturing, hospitality, transportation, government, retail, healthcare and education. Sales in 2014 were made to approximately 1.2 million customers averaging 106,000 daily transactions. Approximately 75% of sales are concentrated with large customers and no single customer accounted for more than 3% of total sales.

The United States business operates in all 50 states through a network of 19 distribution centers (DCs), 377 branches and 51 contact centers. DCs range in size from 45,000 square feet to 1.3 million square feet, the largest of which can stock up to 500,000 products. Automated equipment and processes in the larger DCs allow them to handle the majority of the customer shipping for next-day product availability and replenish the branches that provide same-day availability. The DC network increasingly fulfills a larger portion of customer orders, especially as customers migrate to online and electronic purchasing. In 2014, Grainger announced a plan to build a new 1.3 million square-foot DC in New Jersey, scheduled to open in 2016.

The branches are located in close proximity to the majority of U.S. businesses and serve the immediate needs of customers in their local markets by allowing them to pick up items directly from the branches. The branch network has approximately 3,800 employees who primarily fulfill counter and will-call product purchases and provide customer service. An average branch is 22,000 square feet in size and has 10 employees. In the normal course of business, Grainger regularly reviews the effectiveness of its branch network and closed 21 branches in 2014, 11 of which were related to the recently acquired businesses.

Grainger's contact center network consists of approximately 1,900 employees who handle about 36,000 orders per day from customer orders via phone, e-mail and fax. In 2014, the contact center network was regionalized to leverage the scale of the organization and deliver exceptional customer service.

The business has a sales force of approximately 3,500 professionals who help businesses and institutions select the right products to find immediate solutions to maintenance problems and reduce operating expenses by utilizing Grainger as a consistent source of supply across multiple locations. In 2014, Grainger continued to expand its sales force to facilitate growth with targeted segments and provide more specialized support.

Another area in which the United States business helps customers be more productive is through inventory management services. KeepStock® inventory solutions is a comprehensive program that includes vendor-managed inventory, customer-managed inventory and on-site vending machines. Grainger's KeepStock program currently provides services to more than 18,000 customers and completed over 13,000 installations in 2014.

Customers can also purchase products through Grainger.com®. Customers continue to migrate to online and electronic purchasing. eCommerce revenues were \$2.8 billion in 2014, an increase of 13% versus 2013. Grainger.com provides access to approximately 1.5 million products and serves as a prominent channel for the United States business. Grainger.com provides real-time price and product availability and detailed product information, and offers advanced features such as product search and compare capabilities. For customers with sophisticated electronic purchasing platforms, Grainger utilizes technology that allows these systems to communicate directly with Grainger.com. Customers can also purchase products through other branded websites. In 2014, Grainger completed transitioning to a new web platform and made improvements to search capabilities on the website.

The Grainger catalog, most recently issued in February 2015, offers approximately 590,000 facilities maintenance and other products, and is used by customers to assist in product selection. The 2015 catalog includes over 32,000 new items and approximately 1.5 million copies of the catalog were produced.

Grainger estimates the United States market for facilities maintenance and related products to be approximately \$126 billion, of which Grainger's share is approximately 6%.

Canada

Acklands—Grainger is Canada's leading broad-line distributor of industrial and safety supplies. A combination of product breadth, local availability, speed of delivery, detailed product information and competitively priced products and services is provided by this business.

Acklands—Grainger distributes tools, fasteners, safety supplies, instruments, welding and shop equipment, and many other items. The Canadian business serves customers through 181 branches, sales and service representatives and 6 DCs across Canada. During 2014, approximately 15,700 sales transactions were completed daily. A comprehensive catalog, printed in both English and French, was most recently issued in February 2015. The catalog has more than 153,000 products and is used by customers to assist in product selection. In addition, customers can purchase products through Acklandsgrainger.com, a fully bilingual website. In early 2015, the Canadian business opened a 535,000 square-foot DC in the Toronto area. Grainger estimates the Canadian market for facilities maintenance and related products to be approximately \$13 billion, of which Acklands—Grainger's share is approximately 8%.

Other Businesses

Included in other businesses is Zoro and operations in Europe, Asia and Latin America. The more significant businesses in this group, those with revenues of more than \$100 million in 2014, are described below.

Fabory

Fabory is a European distributor of fasteners, tools and industrial supplies. Fabory is headquartered in Tilburg, the Netherlands, and has more than 100 locations in 13 countries. Customers have access to more than 100,000 products through a catalog and through Fabory.com. Grainger estimates the European market (in which Fabory has its primary operations) for facilities maintenance and related products, including fasteners, to be approximately \$40 billion, of which Grainger's share is approximately 1%.

Japan

Grainger operates in Japan through its 51% interest in MonotaRO Co. MonotaRO provides small and mid-sized Japanese businesses with products that help them operate and maintain their facilities. MonotaRO is a catalog and web-based direct marketer with approximately 86% of orders being conducted through Monotaro.com, through which customers have access to approximately 8 million products. MonotaRO has no branches or sales force and fulfills all orders from two DCs. Grainger estimates the Japanese market for facilities maintenance and related products to be approximately \$43 billion, of which Grainger's share is approximately 1%.

Mexico

Grainger's operations in Mexico provide local businesses with maintenance, repair and operating supplies and other related products primarily from Mexico and the United States. The business in Mexico distributes products through a network of branches and two DCs where customers have access to approximately 148,000 products through a Spanish-language catalog and through Grainger.com.mx.[®] Grainger estimates the Mexican market for facilities maintenance and related products to be approximately \$11 billion, of which Grainger's share is approximately 1%.

Zoro

Zoro is an online distributor of MRO products serving U.S. businesses and consumers through its website Zoro.com. Zoro offers a broad selection of approximately 760,000 items at single, competitive prices. Zoro has no branches or sales force, and customer orders are fulfilled through the Grainger U.S. supply chain. In 2014, Zoro began serving customers in Canada through ZoroCanada.com.

Seasonality

Grainger's business in general is not seasonal, however, there are some products that typically sell more often during the winter or summer season. In any given month, unusual weather patterns, i.e., unusually hot or cold weather, could impact the sales volumes of these products, either positively or negatively.

Competition

Grainger faces competition in all markets it serves, from manufacturers (including some of its own suppliers) that sell directly to certain segments of the market, wholesale distributors, catalog houses, retail enterprises and Internet-based businesses. Grainger provides local product availability, a broad product line, sales representatives, competitive pricing, catalogs (which include product descriptions and, in certain cases, extensive technical and application data), and electronic and Internet commerce technology. Other services, such as inventory management, are also offered. Grainger believes that it can effectively compete with manufacturers on small orders, but manufacturers may have an advantage in filling large orders. There are several large competitors, although the majority of the market is served by small local and regional competitors.

Employees

As of December 31, 2014, Grainger had approximately 23,600 employees, of whom approximately 22,300 were full-time and 1,300 were part-time or temporary. Grainger has never had a major work stoppage and considers employee relations to be good.

Website Access to Company Reports

Grainger makes available, through its website, free of charge, its Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and amendments to those reports, as soon as reasonably practicable after this material is electronically filed with or furnished to the Securities and Exchange Commission. This material may be accessed by visiting www.grainger.com/investor.

Item 1A: Risk Factors

The following is a discussion of significant risk factors relevant to Grainger's business that could adversely affect its financial position or results of operations.

Weakness in the economy could negatively impact Grainger's sales growth. Economic and industry trends affect Grainger's business environments. Economic downturns can cause customers, both domestic and international, to idle or close facilities, delay purchases and otherwise reduce their purchases of Grainger's products and services as well as their ability to make full and timely payments. Thus, a significant or prolonged slowdown in economic activity in the United States, Canada or any other major world economy could negatively impact Grainger's sales growth and results of operations.

The facilities maintenance industry is highly fragmented, and changes in competition could result in decreased demand for Grainger's products and services. There are several large competitors in the industry, although most of the market is served by small local and regional competitors. Grainger faces competition in all markets it serves, from manufacturers (including some of its own suppliers) that sell directly to certain segments of the market, wholesale distributors, catalog houses, retail enterprises and Internet-based businesses. The industry is also consolidating as customers are increasingly aware of the total costs of fulfillment and of the need to have consistent sources of supply at multiple locations. These customer needs could result in fewer suppliers as the remaining suppliers become larger and capable of consistent sources of supply. Competitive pressures could adversely affect Grainger's sales and profitability.

Changes in inflation may adversely affect gross margins. Inflation impacts the costs at which Grainger can procure product and the ability to increase prices to customers over time. Prolonged periods of low inflation could adversely affect the degree to which Grainger is able to recover inflationary costs or increase sales through price escalation.

Volatility in commodity prices may adversely affect gross margins. Some of Grainger's products contain significant amounts of commodity-priced materials, such as steel, copper, petroleum derivatives or rare earth minerals, and are subject to price changes based upon fluctuations in the commodities market. Increases in the price of fuel could also drive up transportation costs. Grainger's ability to pass on such increases in costs in a timely manner depends on market conditions. The inability to pass along cost increases could result in lower gross margins. In addition, higher prices could impact demand for these products, resulting in lower sales volumes.

Unexpected product shortages could negatively impact customer relationships, resulting in an adverse impact on results of operations. Grainger's competitive strengths include product selection and availability. Products are purchased from more than 4,500 key suppliers located in various countries around the world, no one of which accounted for more than 5% of total purchases. Historically, no significant difficulty has been encountered with respect to sources of supply; however, disruptions could occur due to factors beyond Grainger's control, such as economic downturns, political unrest, port slowdowns, trade issues, etc., any of which could adversely affect a supplier's ability to manufacture or deliver products. As Grainger continues to source lower cost products from Asia and other areas of the world, the risk for disruptions has increased due to the additional lead time required and distances involved. If Grainger was to experience difficulty in obtaining products, there could be a short-term adverse effect on results of operations and a longer-term adverse effect on customer relationships and Grainger's reputation. In addition, Grainger has strategic relationships with key vendors. In the event Grainger was unable to maintain those relations, there might be a loss of competitive pricing advantages which could, in turn, adversely affect results of operations.

Changes in customer or product mix could cause the gross margin percentage to decline. From time to time, Grainger experiences changes in customer and product mix that effect gross margin. Changes in customer and product mix result primarily from business acquisitions, changes in customer demand, customer acquisitions, selling and marketing activities and competition. If rapid growth with large customers continues, Grainger will face pressure to maintain current gross margins, as this customer segment receives discounted pricing due to their higher sales volume. There can be no assurance that Grainger will be able to maintain historical gross margins in the future.

Disruptions in Grainger's supply chain could result in an adverse impact on results of operations. A disruption within Grainger's logistics or supply chain network, including damage, destruction, extreme weather and other events which would cause one or more of the distribution centers to become non-operational, could adversely affect Grainger's ability to deliver inventory in a timely manner, impair Grainger's ability to meet customer demand for products and result in lost sales or damage to Grainger's reputation. Grainger's ability to provide same-day shipping and next-day delivery is an integral component of the business strategy and any such disruption could adversely impact the results of operations.

Interruptions in the proper functioning of information systems could disrupt operations and cause unanticipated increases in costs and/or decreases in revenues. The proper functioning of Grainger's information systems, including its websites, is critical to the successful operation of its business. Grainger continues to invest in software, hardware and network infrastructures in order to effectively manage its information systems and websites. Although Grainger's information systems are protected with robust backup and security systems, including physical and software safeguards and remote processing capabilities, information systems are still vulnerable to natural disasters, power losses, computer viruses, telecommunication failures and other problems. If critical information systems fail or otherwise become unavailable, among other things, Grainger's ability to process orders, maintain proper levels of inventories, collect accounts receivable and disburse funds could be adversely affected. Any such interruption of Grainger's information systems could also subject Grainger to additional costs.

Breaches of information systems security could damage Grainger's reputation, disrupt operations, increase costs and/or decrease revenues. Through Grainger's sales and eCommerce channels, Grainger collects and stores confidential information that customers provide to, among other things, purchase products or services, enroll in promotional programs and register on the website. Grainger also acquires and retains information about suppliers and employees in the normal course of business. Despite instituted safeguards for the protection of such information, computer hackers may attempt to penetrate Grainger's or its vendors' information systems and, if successful, misappropriate confidential customer, supplier, employee or other business information. In addition, a Grainger employee, contractor or other third party with whom Grainger does business may attempt to circumvent security measures in order to obtain such information or inadvertently cause a breach involving such information. Loss of customer, supplier, employee or other business information could disrupt operations, damage Grainger's reputation and expose Grainger to claims from customers, suppliers, financial institutions, regulators, payment card associations, employees and other persons, any of which could have an adverse effect on Grainger, its financial condition and results of operations. In addition, compliance with tougher privacy and information security laws and standards may result in significant additional expense due to increased investment in technology and the development of new operational processes.

Fluctuations in foreign currency have an effect on reported results of operations. Grainger's exposure to fluctuations in foreign currency rates results primarily from the translation exposure associated with the preparation of the Consolidated Financial Statements, as well as from transaction exposure associated with transactions in currencies other than an entity's functional currency. While the Consolidated Financial Statements are reported in U.S. dollars, the financial statements of Grainger's subsidiaries outside the United States are prepared using the local currency as the functional currency and translated into U.S. dollars. As a result, fluctuations in the exchange rate of the U.S. dollar relative to the local currencies of Grainger's international subsidiaries could cause fluctuations in reported results. Grainger also has foreign currency exposure to the extent receipts and expenditures are not denominated in the subsidiary's functional currency, and could have an impact on sales, costs and cash flows.

Acquisitions involve a number of inherent risks, any of which could result in the benefits anticipated not being realized and could have an adverse effect on results of operations. Acquisitions, both foreign and domestic, involve various inherent risks, such as uncertainties in assessing the value, strengths, weaknesses, liabilities and potential profitability of acquired companies. There is a risk of potential loss of key employees of an acquired business and of an inability to achieve identified operating and financial synergies anticipated to result from an acquisition. Additionally, problems could arise from the integration of the acquired business including unanticipated changes in the business or industry, or general economic conditions that affect the assumptions underlying the acquisition. Any one or more of these factors could cause Grainger to not realize the benefits anticipated to result from the acquisitions or have a negative impact on the fair value of the reporting units. Accordingly, goodwill and intangible assets recorded as a result of acquisitions could become impaired.

In order to compete, Grainger must attract, retain and motivate key employees, and the failure to do so could have an adverse effect on results of operations. In order to compete and have continued growth, Grainger must attract, retain and motivate executives and other key employees, including those in managerial, technical, sales, marketing and support positions. Grainger competes to hire employees and then must train them and develop their skills and competencies. Grainger's operating results could be adversely affected by increased costs due to increased competition for employees, higher employee turnover or increased employee benefit costs.

Grainger's continued success is substantially dependent on positive perceptions of Grainger's reputation. One of the reasons why customers choose to do business with Grainger and why employees choose Grainger as a place of employment is the reputation that Grainger has built over many years. To be successful in the future, Grainger must continue to preserve, grow and leverage the value of Grainger's brand. Reputational value is based in large part on perceptions of subjective qualities. Even an isolated incident, or the aggregate effect of individually insignificant incidents, can erode trust and confidence, particularly if they result in adverse publicity, governmental investigations or litigation, and as a result, could tarnish Grainger's brand and lead to adverse effects on Grainger's business.

Grainger's business is subject to various government regulations. Grainger's business is subject to a wide array of laws and regulations in every jurisdiction where it operates, and compliance with these laws and regulations increases the cost of doing business. Grainger is subject to a variety of laws and regulations, including without limitation import and export requirements, the Foreign Corrupt Practices Act, tax laws (including U.S. taxes on foreign subsidiaries), foreign exchange controls and cash repatriation restrictions, data privacy requirements, regulations and potential expansion of regulations on suppliers regarding the sources of supplies or products, labor laws and anti-competition regulations, and is also subject to audits and inquiries in the ordinary course of business. As a government contractor selling to federal, state and local government entities, Grainger is also subject to a wide variety of additional laws and regulations. Changes to the legal and regulatory environments could increase the cost of doing business, and such costs may increase in the future as a result of changes in these laws and regulations or in their interpretation. Furthermore, Grainger has implemented policies and procedures designed to facilitate compliance with these laws and regulations, but there can be no assurance that employees, contractors or agents will not violate such laws and regulations or Grainger's policies. Any such violations could individually or in the aggregate materially adversely affect Grainger's financial condition or operating results.

Item 1B: Unresolved Staff Comments

None.

Item 2: Properties

As of December 31, 2014, Grainger's owned and leased facilities totaled approximately 27 million square feet. The United States business and Acklands–Grainger accounted for the majority of the total square footage. Grainger believes that its properties are generally in excellent condition, well maintained and suitable for the conduct of business.

A brief description of significant facilities follows:

Location	Facility and Use (6)	Size in Square Feet (in 000's)
United States (1)	377 United States branch locations	8,310
United States (2)	19 Distribution Centers	7,020
United States (3)	Other facilities	3,189
Canada (4)	191 Acklands–Grainger facilities	3,050
Other Businesses (5)	Other facilities	3,800
Chicago Area (2)	Headquarters and General Offices	1,616
	Total Square Feet	26,985

- (1) United States branches consist of 268 owned and 109 leased properties located throughout the U.S. Branches range in size from approximately 1,000 to 109,000 square feet. Most leases expire between 2015 and 2020.
- (2) These facilities are primarily owned. Distribution Centers range in size from approximately 45,000 square feet to 1,300,000 square feet.
- (3) These facilities include both owned and leased locations, consisting of storage facilities, office space and idle properties.
- (4) Acklands–Grainger facilities consist of general offices, distribution centers and branches located throughout Canada, of which 69 are owned and 122 leased.
- (5) These facilities include owned and leased locations in Europe, Asia, Latin America and other U.S. operations.
- (6) Owned facilities are not subject to any mortgages.

Item 3: Legal Proceedings

Information on specific and significant legal proceedings is set forth in Note 18 to the Consolidated Financial Statements included under Item 8.

Item 4: Mine Safety Disclosures

Not applicable.

PART II

Item 5: Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

Market Information and Dividends

Grainger's common stock is listed on the New York Stock Exchange, with the ticker symbol GWW. Effective January 1, 2015, Grainger voluntarily delisted its common stock from the Chicago Stock Exchange to eliminate duplicative administrative requirements. The high and low sales prices for the common stock and the dividends declared and paid for each calendar quarter during 2014 and 2013 are shown below.

	Quarters	Prices		Dividends
		High	Low	
2014	First	\$267.49	\$228.19	\$0.93
	Second	269.69	245.23	1.08
	Third	256.42	231.21	1.08
	Fourth	261.57	223.92	1.08
	Year	\$269.69	\$223.92	\$4.17
2013	First	\$233.95	\$201.49	\$0.80
	Second	269.17	216.64	0.93
	Third	276.38	245.01	0.93
	Fourth	274.37	246.86	0.93
	Year	\$276.38	\$201.49	\$3.59

Grainger expects that its practice of paying quarterly dividends on its common stock will continue, although the payment of future dividends is at the discretion of Grainger's Board of Directors and will depend upon Grainger's earnings, capital requirements, financial condition and other factors.

Holders

The approximate number of shareholders of record of Grainger's common stock as of January 31, 2015, was 767 with approximately 208,500 additional shareholders holding stock through nominees.

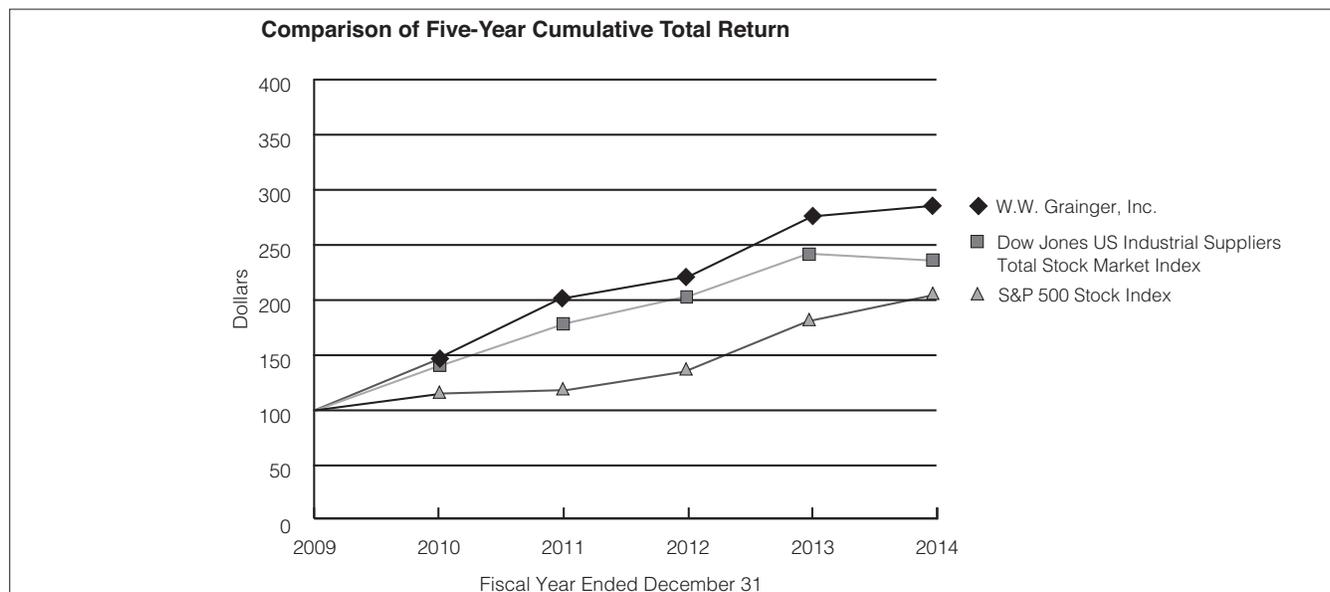
Issuer Purchases of Equity Securities – Fourth Quarter

Period	Total Number of Shares Purchased (A)	Average Price Paid Per Share (B)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (C)	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
Oct. 1 – Oct. 31.....	82,500	238.19	82,500	9,305,286 shares
Nov. 1 – Nov. 30	220,030	247.05	220,030	9,085,256 shares
Dec. 1 – Dec. 31	539,375	247.86	539,375	8,545,881 shares
Total	841,905	246.70	841,905	

- (A) There were no shares withheld to satisfy tax withholding obligations.
- (B) Average price paid per share includes any commissions paid and includes only those amounts related to purchases as part of publicly announced plans or programs.
- (C) Purchases were made pursuant to a share repurchase program approved by Grainger's Board of Directors on April 30, 2014. The program has no specified expiration date. Activity is reported on a trade date basis.

Company Performance

The following 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 Dow Jones US Industrial Suppliers Total Stock Market Index and the S&P 500 Stock Index. It covers the period commencing December 31, 2009, and ending December 31, 2014. The graph assumes that the value for the investment in Grainger common stock and in each index was \$100 on December 31, 2009, and that all dividends were reinvested.



	December 31,					
	2009	2010	2011	2012	2013	2014
W.W. Grainger, Inc.....	\$100	\$145	\$200	\$220	\$282	\$286
Dow Jones US Industrial Suppliers Total Stock Market Index.....	100	140	180	203	242	237
S&P 500 Stock Index.....	100	115	117	136	180	205

Item 6: Selected Financial Data

	2014	2013	2012	2011	2010
	(In thousands of dollars, except for per share amounts)				
Net sales	\$9,964,953	\$9,437,758	\$8,950,045	\$8,078,185	\$7,182,158
Net earnings attributable to W.W. Grainger, Inc.	801,729	797,036	689,881	658,423	510,865
Net earnings per basic share	11.59	11.31	9.71	9.26	7.05
Net earnings per diluted share	11.45	11.13	9.52	9.07	6.93
Total assets.....	5,284,252	5,266,328	5,014,598	4,716,062	3,904,377
Long-term debt (less current maturities) and other long-term liabilities	738,435	743,702	817,229	603,858	747,404
Cash dividends paid per share	\$ 4.17	\$ 3.59	\$ 3.06	\$ 2.52	\$ 2.08

Net earnings for 2014 included a \$0.40 per share expense related to closing the business in Brazil, a \$0.15 per share non-cash charge due to the retirement plan transition in Europe and a \$0.15 per share expense related to restructuring the business in Europe. Results also included a \$0.11 per share expense related to a non-cash goodwill impairment charge. When combined, these items had a net expense effect of \$0.81 per share.

Net earnings for 2013 included a \$0.29 per share expense related to non-cash impairment charges, primarily for goodwill. Results also included a \$0.10 per share expense related to restructuring the businesses in Europe and China. When combined, these items had a net expense effect of \$0.39 per share.

Net earnings for 2012 included a \$0.66 per share expense related to the settlement of disputes involving the General Services Administration (GSA) and United States Postal Service (USPS) contracts. Results also included a \$0.18 per share expense related to restructuring the businesses in Europe, India and China, a \$0.04 per share expense due to

an impairment charge and a \$0.03 per share expense related to U.S. branch closures. When combined, these items had a net expense effect of \$0.91 per share.

Net earnings for 2011 included a \$0.16 per share expense for U.S. branch closures, a \$0.12 per share benefit related to the settlement of prior year tax reviews and a \$0.07 per share benefit from a gain on the sale of the MRO Korea Co., Ltd. joint venture, which when combined, resulted in a net benefit of \$0.03 per share.

There were two non-cash items included in 2010 earnings, a \$0.28 per share benefit from a change to the paid time off policy and a \$0.15 per share tax expense related to the tax treatment of retiree healthcare benefits following the passage of the Patient Protection and Affordable Care Act, which when combined, resulted in a net benefit of \$0.13 per share.

Grainger completed several acquisitions for the years presented above, all of which were immaterial individually and in the aggregate. Operating results have included the results of each business acquired since the respective acquisition dates.

For further information see “Item 7: Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Item 7: Management’s Discussion and Analysis of Financial Condition and Results of Operations

Overview

General. Grainger is a broad-line distributor of maintenance, repair and operating supplies, and other related products and services used by businesses and institutions. Grainger’s operations are primarily in the United States and Canada, with presence also in Europe, Asia and Latin America. Grainger uses a combination of multichannel and single channel online business models to provide customers with a range of options for finding and purchasing products, utilizing sales representatives, catalogs, direct marketing materials and eCommerce. Grainger serves more than 2 million customers worldwide through a network of highly integrated branches, distribution centers and websites.

Grainger’s two reportable segments are the United States and Canada. The United States segment reflects the results of Grainger’s U.S. operating segment. The Canada segment reflects the results for Acklands–Grainger, Grainger’s Canadian operating segment. Other businesses, which include Zoro and operations in Europe, Asia and Latin America, are not material individually.

Business Environment. Given Grainger’s large number of customers and the diverse industries it serves, several economic factors and industry trends tend to shape Grainger’s business environment. The overall economy and leading economic indicators provide general insight into projecting Grainger’s growth. Grainger’s sales in the United States and Canada tend to positively correlate with Gross Domestic Product (GDP), Industrial Production, Exports and Business Investment. In the United States, sales also tend to positively correlate with Business Inventory. In Canada, sales also tend to positively correlate with oil prices. The table below provides these estimated indicators for 2014 and 2015:

	United States		Canada	
	Estimated 2014	Forecasted 2015	Estimated 2014	Forecasted 2015
GDP	2.4%	3.0%	2.4%	1.9%
Industrial Production	4.3%	3.0%	3.7%	(0.2)%
Exports	3.1%	3.3%	5.1%	3.9%
Business Investment	6.3%	8.4%	0.3%	(0.8)%
Business Inventory	3.8%	3.7%	—	—
Oil Prices	—	—	\$93/barrel	\$42/barrel

Source: Global Insight (February 2015)

In the United States, business investment and exports are two major indicators of MRO spend. After growing 11% for two straight quarters, business investment slowed to 1% in the fourth quarter of 2014, according to Global Insight. However, given the economy’s momentum at the end of 2014, as demonstrated through the November and December employment reports, business spending is expected to rebound in the first quarter of 2015. However, investment in equipment is expected to face headwinds if weak foreign demand continues. Export growth is expected to remain in the low single-digits due to subpar world growth and a strong U.S. dollar.

The light and heavy manufacturing customer sectors, which comprised approximately 30% of Grainger’s total 2014 sales, have historically correlated with manufacturing employment levels and manufacturing production. The United States Department of Labor reported an increase of 1.5% in manufacturing employment levels from December 2013 to December 2014. According to the Federal Reserve, manufacturing output increased 4.9% from December 2013 to December 2014. These increases contributed to a high single-digit percent sales increase in the heavy manufacturing customer sector and a mid single-digit percent sales increase in the light manufacturing customer sector for Grainger in 2014.

While full year 2014 economic growth for Canada was positive, the Canadian economy experienced pressure throughout the year as the Canadian dollar weakened to new five-year lows versus the U.S. dollar. The weak Canadian dollar, combined with a 1% drop in the commodity price index for metals and minerals from December 2013 to December 2014, have impacted the performance of the Canadian business, which is heavily dependent on the natural resources sector. These market factors led to declines in the agriculture and mining sectors for the Canadian business in 2014. In addition, the recent decline of oil prices has caused investment in Canada's oil and gas industries to slow, according to the Royal Bank of Canada.

Outlook. In 2015, Grainger plans to continue to make investments in its supply chain, information systems, eCommerce, sales force and inventory management services. These investments are expected to accelerate market share growth and increase Grainger's size and scale.

On January 26, 2015, Grainger revised its 2015 earnings per share guidance from a range of \$12.90 to \$13.80 to a range of \$12.60 to \$13.60 and also revised its 2015 sales guidance from a range of 5 to 9 percent to a range of 3 to 7 percent. This change is driven by unfavorable foreign exchange and the weak economy in Canada.

Matters Affecting Comparability. Grainger completed several acquisitions throughout 2014, 2013 and 2012, all of which were immaterial individually and in the aggregate. Grainger's operating results have included the results of each business acquired since the respective acquisition dates.

Results of Operations

The following table is included as an aid to understanding changes in Grainger's Consolidated Statements of Earnings: For the Years Ended December 31,

	As a Percent of Net Sales			Percent Increase/(Decrease) from Prior Year	
	2014	2013	2012	2014	2013
Net sales.....	100.0%	100.0%	100.0%	5.6%	5.4%
Cost of merchandise sold	56.7	56.2	56.2	6.6	5.3
Gross profit	43.3	43.8	43.8	4.3	5.6
Operating expenses	29.8	30.1	31.2	4.5	2.0
Operating earnings	13.5	13.7	12.6	3.9	14.7
Other income (expense).....	(0.1)	(0.1)	(0.1)	37.6	(30.6)
Income taxes	5.2	5.1	4.7	8.8	14.5
Noncontrolling interest	0.1	0.1	0.1	(1.4)	19.5
Net earnings attributable to W.W. Grainger, Inc.	8.1%	8.4%	7.7%	0.6%	15.5%

2014 Compared to 2013

Grainger's net sales of \$9,965 million for 2014 increased 6% when compared with net sales of \$9,438 million for 2013. The 6% increase for the year consisted of the following contributors:

	Percent Increase/(Decrease)
Volume	5
Business acquisition, net of divestitures	1
Price.....	1
Foreign exchange.....	(1)
Total	6%

Net sales to most customer end markets increased for 2014. The increase in net sales was led by growth in sales to heavy and light manufacturing customers, as well as diversified commercial services customers. Refer to the *Segment Analysis* below for further details.

Gross profit of \$4,314 million for 2014 increased 4%. The gross profit margin for 2014 was 43.3%, down 0.5 percentage point versus 2013, primarily driven by lower margins from the newly acquired businesses, faster growth with lower margin customers, charges related to closing the business in Brazil and restructuring the business in Europe, partially offset by price inflation exceeding cost inflation.

Operating expenses of \$2,967 million for 2014 increased 4% from \$2,840 million for 2013. The increase was primarily driven by an incremental \$78 million in growth-related spending on eCommerce, new sales representatives, supply chain and inventory management solutions, as well as charges related to closing the business in Brazil, restructuring costs and the transition of the retirement plan in Europe, and an impairment charge for the business in Colombia.

Operating earnings of \$1,347 million for 2014 increased 4% from \$1,297 million for 2013. Operating earnings in 2014 included a \$29 million charge related to closing the business in Brazil, a \$14 million charge related to the transition of the employee retirement plan in Europe, a \$12 million impairment charge for the business in Colombia and \$10 million in restructuring costs for the business in Europe. Operating earnings in 2013 included a \$26 million expense related to impairment charges for the business in Brazil and Grainger Lighting Services, as well as \$10 million of restructuring costs for the businesses in Europe and China. Excluding these charges from both years, operating earnings increased 6%, primarily due to higher sales and operating expenses increasing at a slower rate than sales.

Net earnings attributable to Grainger for 2014 increased by 1% to \$802 million from \$797 million in 2013. The increase in net earnings primarily resulted from an increase in operating earnings. Diluted earnings per share of \$11.45 in 2014 were 3% higher than \$11.13 for 2013, due to increased net earnings and lower average shares outstanding.

The table below reconciles reported diluted earnings per share determined in accordance with generally accepted accounting principles (GAAP) in the United States to adjusted diluted earnings per share, a non-GAAP measure. Management believes adjusted diluted earnings per share is an important indicator of operations because it excludes items that may not be indicative of core operating results. Because non-GAAP financial measures are not standardized, it may not be possible to compare this financial measure with other companies' non-GAAP financial measures having the same or similar names.

	Twelve Months Ended December 31,		Percent
	2014	2013	
Diluted earnings per share reported.....	\$11.45	\$11.13	3%
Brazil business shutdown	0.40	—	
Pension change	0.15	—	
Restructuring.....	0.15	0.10	
Goodwill impairment	0.11	0.29	
Subtotal	0.81	0.39	
Diluted earnings per share adjusted	\$12.26	\$11.52	6%

Segment Analysis

The following comments at the reportable segment and other business unit level include external and intersegment net sales and operating earnings. See Note 16 to the Consolidated Financial Statements.

United States

Net sales were \$7,926 million for 2014, an increase of \$512 million, or 7%, when compared with net sales of \$7,414 million for 2013. The 7% increase for the year consisted of the following contributors:

	Percent Increase
Volume.....	4
Business acquisition, net of divestitures	2
Price.....	1
Total.....	7%

Net sales to most customer end markets increased for 2014. The increase was led by low double-digit growth to the natural resources end market, followed by high single-digit growth to heavy manufacturing customers and mid-single digit growth to light manufacturing, commercial services, retail and government customers. Resellers were up in the low single digits and contractors were down in the low single digits.

The segment gross profit margin decreased 0.4 percentage point in 2014 compared to 2013, primarily driven by lower margins from the acquired businesses and faster growth with lower margin customers, partially offset by price increases exceeding product cost increases.

Operating expenses were up 3% for 2014 versus 2013. Operating expenses in 2013 included a \$13 million expense related to goodwill impairment charges for Grainger Lighting Services. Excluding this expense from the prior year, the growth in operating expenses was primarily driven by an incremental \$57 million in growth-related spending on new sales representatives, supply chain and inventory management solutions.

For the segment, operating earnings of \$1,444 million for 2014 increased 11% over \$1,304 million in 2013. Excluding the expense mentioned above in the prior year, operating earnings were up 10%. The improvement in operating earnings for 2014 was due to an increase in net sales and operating expenses increasing at a slower rate than sales.

Canada

Net sales were \$1,076 million for 2014, a decrease of \$38 million, or 3%, when compared with \$1,114 million for 2013. In local currency, sales increased 4% for 2014. The 3% decrease for the year consisted of the following contributors:

	<u>Percent Increase/(Decrease)</u>
Business acquisition.....	2
Volume.....	1
Price.....	1
Foreign exchange.....	(7)
Total.....	<u>(3)%</u>

Sales performance in Canada was driven by double-digit growth in the utilities market, followed by high single-digit growth in the forestry market and mid-single digit growth to commercial services and heavy manufacturing customers. Net sales in the construction, agriculture and mining end markets were down in the high single digits.

The segment gross profit margin decreased 1.7 percentage points in 2014 versus 2013, primarily driven by product cost inflation exceeding price inflation driven by unfavorable foreign exchange, higher freight costs and lower supplier rebates as well as negative mix from the WFS acquisition.

Operating expenses increased 3% in 2014. In local currency, operating expenses increased 10%, primarily due to the WFS acquisition, higher payroll and information technology expenses, as well as costs associated with opening a new DC.

Operating earnings of \$88 million for 2014 decreased \$41 million, or 32%, versus 2013. In local currency, operating earnings decreased 27%. The decrease in earnings was due to operating expenses increasing at a faster rate than sales and lower gross profit margins.

Other Businesses

Net sales were \$1,182 million for 2014, an increase of \$142 million, or 14%, when compared with \$1,040 million for 2013. The net sales increase was primarily due to incremental sales from Zoro and the businesses in Japan and Mexico. The 14% increase for the year consisted of the following contributors:

	<u>Percent Increase/(Decrease)</u>
Volume/Price.....	18
Foreign exchange.....	(4)
Total.....	<u>14%</u>

Operating earnings for other businesses were a loss of \$38 million for 2014 compared to earnings of \$8 million for 2013. The year 2014 included a \$29 million charge related to closing the business in Brazil, a \$14 million charge related to the transition of the employee retirement plan in Europe, a \$12 million impairment charge for the business in Colombia and \$10 million in restructuring costs for the business in Europe. The year 2013 included \$13 million of expense related to impairment charges for the business in Brazil and \$10 million of expense in structural changes to the businesses in Europe and China. Excluding these charges in both years, operating earnings decreased \$3 million, or 10%, primarily driven by incremental expenses associated with the start-up of the single channel online business model in Europe.

Other Income and Expense

Other income and expense was \$13 million of expense in 2014 compared with \$9 million of expense in 2013. The following table summarizes the components of other income and expense (in thousands of dollars):

	<u>For the Years Ended</u> <u>December 31,</u>	
	<u>2014</u>	<u>2013</u>
Interest income (expense) – net.....	\$(8,025)	\$(9,991)
Other non-operating income.....	483	2,732
Other non-operating expense.....	(5,189)	(1,996)
Total.....	<u>\$(12,731)</u>	<u>\$(9,255)</u>

Other non-operating expense increased in 2014 due to higher foreign exchange transaction losses.

Income Taxes

Income taxes of \$522 million in 2014 increased 9% as compared with \$480 million in 2013. Grainger's reported tax rates were 39.1% and 37.3% in 2014 and 2013, respectively. Excluding the effect of the separately identified charges reported in both 2014 and 2013, Grainger's reported tax rate was 38.2% and 37.3% in 2014 and 2013, respectively. The increase in the reported tax rate in 2014 was primarily due to a higher proportion of earnings in the United States versus geographies with lower tax rates and losses with no tax benefit.

2013 Compared to 2012

Grainger's net sales of \$9,438 million for 2013 increased 5% when compared with net sales of \$8,950 million for 2012. The 5% increase for the year consisted of the following contributors:

	Percent Increase/(Decrease)
Volume	3
Business acquisitions	2
Price	1
Foreign exchange	(1)
Total	5%

Net sales to most customer end markets increased for 2013. The increase in net sales was led by growth in sales to heavy and light manufacturing customers, followed by diversified commercial services customers. Refer to the *Segment Analysis* below for further details.

Gross profit of \$4,136 million for 2013 increased 6%. The gross profit margin for 2013 was 43.8%, flat versus 2012, primarily driven by price increases exceeding product cost increases, offset by lower margins from the acquired businesses and faster growth with lower margin customers.

Operating expenses of \$2,840 million for 2013 increased 2% from \$2,785 million for 2012. Operating expenses in 2013 included a \$26 million expense related to the impairment charges for the business in Brazil and Grainger Lighting Services in the United States. Also included was \$10 million of expense related to restructuring charges for improving the long-term performance of the businesses in Europe and China. Operating expenses in 2012 included a \$76 million expense related to the settlement of disputes involving the GSA and USPS contracts. Also included in 2012 was \$24 million of expense related to branch closure costs, restructuring charges related to improving the long-term performance of the businesses in Europe, India and China and an impairment charge for Grainger Lighting Services. Excluding these expenses from both years, operating expenses increased 4%, primarily driven by the acquisitions and an incremental \$132 million in growth-related spending on new sales representatives, eCommerce and inventory management solutions, primarily in the United States.

Operating earnings of \$1,297 million for 2013 increased 15% from \$1,131 million for 2012. Excluding the expenses mentioned above for both years, operating earnings increased 8%, primarily due to higher sales and operating expenses increasing at a slower rate than sales.

Net earnings attributable to Grainger for 2013 increased by 16% to \$797 million from \$690 million in 2012. The increase in net earnings primarily resulted from an increase in operating earnings. Diluted earnings per share of \$11.13 in 2013 were 17% higher than \$9.52 for 2012, due to increased net earnings and lower average shares outstanding.

The table below reconciles reported diluted earnings per share determined in accordance with GAAP in the United States to adjusted diluted earnings per share, a non-GAAP measure. Management believes adjusted diluted earnings per share is an important indicator of operations because it excludes items that may not be indicative of core operating results. Because non-GAAP financial measures are not standardized, it may not be possible to compare this financial measure with other companies' non-GAAP financial measures having the same or similar names.

	Twelve Months Ended December 31,		Percent
	2013	2012	
Diluted earnings per share reported	\$11.13	\$ 9.52	17%
GSA/USPS settlement	—	0.66	
Goodwill impairment	0.29	0.04	
Restructuring	0.10	0.18	
Charge for U.S. branch closures	—	0.03	
Subtotal	0.39	0.91	
Diluted earnings per share adjusted	\$11.52	\$10.43	10%

Segment Analysis

The following comments at the reportable segment and other business unit level include external and intersegment net sales and operating earnings. See Note 16 to the Consolidated Financial Statements.

United States

Net sales were \$7,414 million for 2013, an increase of \$488 million, or 7%, when compared with net sales of \$6,926 million for 2012. The 7% increase for the year consisted of the following contributors:

	Percent Increase
Volume	4
Business acquisitions	2
Price.....	1
Total	7%

Net sales to most customer end markets increased for 2013. The increase was led by high single-digit growth to light manufacturing customers, followed by mid-single digit growth to heavy manufacturing, commercial services, contractors and natural resources customers. Government was up in the low single digits and net sales to resellers were down in the low single digits.

The segment gross profit margin decreased 0.3 percentage point in 2013 compared to 2012, primarily driven by lower margins from the acquired businesses and faster growth with lower margin customers, partially offset by price increases exceeding product cost increases.

Operating expenses were up 1% for 2013 versus 2012. Operating expenses in 2013 included a \$13 million expense related to goodwill impairment charges for Grainger Lighting Services. The 2012 year included a \$76 million expense related to the settlement of disputes involving the GSA and USPS contracts. Also included in 2012 was \$10 million of expense primarily related to branch closure costs and a goodwill impairment charge for Grainger Lighting Services. Excluding these expenses from both years, operating expenses increased 5%, primarily driven by an incremental \$118 million in growth-related spending on new sales representatives, eCommerce and inventory management solutions.

For the segment, operating earnings of \$1,304 million for 2013 increased 15% over \$1,133 million in 2012. Excluding the expenses mentioned above in both years, operating earnings were up 8%. The improvement in operating earnings for 2013 was due to an increase in net sales and operating expenses increasing at a slower rate than sales.

Canada

Net sales were \$1,114 million for 2013, an increase of \$8 million, or 1%, when compared with \$1,106 million for 2012. In local currency, sales increased 4% for 2013. The 1% increase for the year consisted of the following contributors:

	Percent Increase/(Decrease)
Volume	4
Foreign exchange.....	(3)
Total	1%

Sales performance in Canada was driven by double-digit growth in the forestry market, followed by high single-digit growth to the light manufacturing, commercial services and oil and gas end markets. Net sales to heavy manufacturing customers were down in the mid-single digits and the government end market was down in the low single digits.

The segment gross profit margin increased 0.4 percentage point in 2013 over 2012, primarily driven by price increases exceeding product cost increases and favorable freight rates, partially offset by the unfavorable effect of foreign exchange on purchases.

Operating expenses increased 2% in 2013. In local currency, operating expenses increased 5%, primarily due to higher volume-related payroll, occupancy and technology investments, partially offset by lower warehouse expenses.

Operating earnings of \$129 million for 2013 were up \$1 million, or 1%, versus 2012. In local currency, operating earnings increased 4%. The increase in earnings was due to sales growth and improved gross profit margins, partially offset by operating expenses increasing at a faster rate than sales.

Other Businesses

Net sales were \$1,040 million for 2013, an increase of \$33 million, or 3%, when compared with \$1,007 million for 2012. The net sales increase was primarily due to incremental sales from Zoro, Brazil and Mexico, partially offset by lower sales

in India due to a change in its business model. Higher sales in Japan were offset by unfavorable foreign exchange. The 3% increase for the year consisted of the following contributors:

	Percent Increase/(Decrease)
Volume/Price.....	10
Foreign exchange.....	(7)
Total	3%

Operating earnings for other businesses were \$8 million for 2013 compared to \$20 million for 2012. The year 2013 included \$13 million of expense related to impairment charges for the business in Brazil and \$10 million of expense in structural changes to the businesses in Europe and China. The year 2012 included \$14 million of charges related to restructuring the businesses in Europe, India and China. Excluding these charges, operating earnings decreased \$4 million, or 11%, primarily driven by lower earnings from the businesses in Latin America, partially offset by higher earnings at Zoro and Japan.

Other Income and Expense

Other income and expense was \$9 million of expense in 2013 compared with \$13 million of expense in 2012. The following table summarizes the components of other income and expense (in thousands of dollars):

	For the Years Ended December 31,	
	2013	2012
Interest income (expense) – net	\$(9,991)	\$(13,418)
Other non-operating income	2,732	1,866
Other non-operating expense	(1,996)	(1,784)
Total	<u>\$(9,255)</u>	<u>\$(13,336)</u>

Net interest expense decreased in 2013 due to lower average interest rates, partially offset by higher average outstanding debt.

Income Taxes

Income taxes of \$480 million in 2013 increased 15% as compared with \$419 million in 2012. Grainger's reported tax rates were 37.3% and 37.5% in 2013 and 2012, respectively.

Financial Condition

Grainger expects its strong working capital position, cash flows from operations and borrowing capacity to continue, allowing it to fund its operations, including growth initiatives, capital expenditures, acquisitions and repurchase of shares, as well as to pay cash dividends.

Cash Flow

2014 Compared to 2013

Cash from operating activities continues to serve as Grainger's primary source of liquidity. Net cash flows from operations in 2014 were \$960 million versus \$986 million in 2013. Cash flows from operations were lower in 2014 primarily due to higher inventory purchases in 2014 compared to 2013. In 2013, the inventory position at the start of the year was higher due to lower sales in December 2012 as well as an inventory build to facilitate the move of Grainger's Chicago-area distribution center.

Net cash used in investing activities was \$384 million and \$399 million in 2014 and 2013, respectively. The lower use of cash was primarily driven by acquisition activity. Less cash was spent on acquisitions in 2014 versus 2013. The lower use of cash from acquisition activity in 2014 was partially offset by more cash expended in 2014 for additions to property, buildings and equipment, primarily related to supply chain investments.

Net cash used in financing activities of \$758 million in 2014 increased \$167 million from \$591 million in 2013. The increase was primarily due to a partial repayment of the term loan in the United States as well as an increase in the purchase of treasury stock and dividends paid. This was partially offset by proceeds from the new revolving credit facility in the Canadian business.

2013 Compared to 2012

Cash from operating activities served as Grainger's primary source of liquidity. Net cash flows from operations in 2013 were \$986 million and increased \$170 million from \$816 million in 2012. The primary driver of the improvement was an

increase in net earnings of \$109 million. In addition, changes in operating assets and liabilities resulted in a net use of cash of \$58 million for 2013 compared to \$129 million for 2012. The lower use of cash for operating assets and liabilities was driven primarily by higher trade accounts payable due to higher inventory purchases at year-end in 2013 compared to 2012, partially offset by higher accounts receivable from increased sales.

Net cash used in investing activities was \$399 million and \$306 million in 2013 and 2012, respectively. The higher use of cash in 2013 compared to 2012 was primarily driven by the increased cash paid for acquisitions and cash expended for property, buildings, equipment and software.

Net cash used in financing activities of \$591 million in 2013 increased \$197 million from \$394 million in 2012. The increase was primarily due to higher treasury share repurchases. Cash paid for treasury share purchases was \$438 million in 2013 versus \$341 million in 2012, an increase of \$97 million. The prior year also included \$300 million in proceeds from the issuance of long-term debt.

Working Capital

Internally generated funds are the primary source of working capital and funds used in business expansion, supplemented by debt. In addition, funds are expended to support growth initiatives, as well as for business and systems development and other infrastructure improvements.

Working capital consists of current assets (less non-operating cash) and current liabilities (less short-term debt and current maturities of long-term debt). Working capital was \$1,697 million at December 31, 2014, compared with \$1,621 million at December 31, 2013. At these dates, the ratio of current assets to current liabilities was 2.4 and 2.5, respectively. The increase in working capital was primarily related to higher receivable balances driven by sales volume and an increase in extended terms given to customers.

Capital Expenditures

In each of the past three years, a portion of operating cash has been used for additions to property, buildings, equipment and capitalized software as summarized in the following table (in thousands of dollars):

	For the Years Ended December 31,		
	2014	2013	2012
Land, buildings, structures and improvements.....	\$159,793	\$ 60,419	\$ 57,929
Furniture, fixtures, machinery and equipment.....	140,358	152,328	145,483
Subtotal	300,151	212,747	203,412
Capitalized software.....	87,239	59,398	46,448
Total.....	<u>\$387,390</u>	<u>\$272,145</u>	<u>\$249,860</u>

In 2014, Grainger made significant capital investments to build new distribution centers in the United States and Canada. In the United States, Grainger began construction of a new 1.3 million square-foot distribution center in New Jersey. In Canada, Grainger continued construction of the new distribution center in the Toronto area. Grainger also invested in technology infrastructure, vending machines for the KeepStock program and normal recurring replacement of equipment.

In 2013 and 2012, significant capital expenditures included investments in the distribution center network in the United States and Canada. In the United States, Grainger opened a new 1 million square-foot and highly automated Chicago-area distribution center in 2013. In Canada, Grainger began construction of the 535,000 square-foot distribution center in the Toronto area. Other significant investments in 2013 and 2012 included investing in a new eCommerce platform, sustaining capital investments for Grainger's branches and distribution centers and other technology infrastructure.

In 2015, capital expenditures are expected to range from \$375 million to \$425 million. Projected spending includes continued investments in the supply chain, technology infrastructure, eCommerce and in support of sales initiatives. Grainger expects to fund 2015 capital spending from operating cash.

Debt

Grainger maintains a debt ratio and liquidity position that provides flexibility in funding working capital needs and long-term cash requirements. In addition to internally generated funds, Grainger has various sources of financing available, including bank borrowings under lines of credit. Refer to Note 6 and Note 7 to the Consolidated Financial Statements included in Item 8. Total debt as a percent of total capitalization was 12.9% and 14.0% as of December 31, 2014 and 2013, respectively. The reduction in total debt as a percent of total capitalization was primarily due to the partial repayment of the term loan in the United States in 2014. Grainger believes any circumstances that would trigger early payment or acceleration with respect to any outstanding debt obligations would not have a material impact on its results of operations or financial position.

Commitments and Other Contractual Obligations

At December 31, 2014, Grainger's contractual obligations, including estimated payments due by period, are as follows (in thousands of dollars):

	Payments Due by Period				
	Total Amounts Committed	Less than 1 Year	1-3 Years	4-5 Years	More than 5 Years
Debt obligations.....	\$ 484,836	\$ 80,300	\$250,494	\$149,826	\$ 4,216
Interest on debt.....	27,270	9,557	10,869	6,834	10
Operating lease obligations.....	186,153	65,901	80,702	31,737	7,813
Purchase obligations:					
Uncompleted additions to property, buildings and equipment.....	116,839	116,839	—	—	—
Commitments to purchase inventory	415,582	415,582	—	—	—
Other purchase obligations	307,948	190,559	101,646	15,743	—
Other liabilities	359,039	187,117	25,717	26,397	119,808
Total	<u>\$1,897,667</u>	<u>\$1,065,855</u>	<u>\$469,428</u>	<u>\$230,537</u>	<u>\$131,847</u>

Purchase obligations for inventory are made in the normal course of business to meet operating needs. While purchase orders for both inventory purchases and non-inventory purchases are generally cancelable without penalty, certain vendor agreements provide for cancellation fees or penalties depending on the terms of the contract.

Other liabilities represent future payments for profit sharing and employee benefits plans as determined by actuarial projections, and other employee benefit plans. Other employment-related benefits costs of \$59 million have not been included in this table as the timing of benefit payments is not predictable. See Note 9 to the Consolidated Financial Statements.

See also Note 7 and Note 10 to the Consolidated Financial Statements for further detail related to the interest on long-term debt and operating lease obligations, respectively.

Grainger has recorded a noncurrent liability of approximately \$49 million for tax uncertainties and interest at December 31, 2014. This amount is excluded from the table above, as Grainger cannot make reliable estimates of these cash flows by period. See Note 14 to the Consolidated Financial Statements.

Off-Balance Sheet Arrangements

Grainger does not have any material exposures to off-balance sheet arrangements. Grainger does not have any variable interest entities or activities that include non-exchange-traded contracts accounted for at fair value.

Critical Accounting Estimates

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses in the financial statements. Management bases its estimates on historical experience and other assumptions, which it believes are reasonable. If actual amounts are ultimately different from these estimates, the revisions are included in Grainger's results of operations for the period in which the actual amounts become known.

Accounting policies are considered critical when they require management to make assumptions about matters that are highly uncertain at the time the estimates are made and when there are different estimates that management reasonably could have made, which would have a material impact on the presentation of Grainger's financial condition, changes in financial condition or results of operations.

Note 1 to the Consolidated Financial Statements describes the significant accounting policies used in the preparation of the Consolidated Financial Statements. The most significant areas involving management judgments and estimates follow. Actual results in these areas could differ materially from management's estimates under different assumptions or conditions.

Allowance for Doubtful Accounts. Grainger considers several factors to estimate the allowance for uncollectible accounts receivable including the age of the receivables, the percent past due and the historical ratio of actual write-offs to the age of the receivables. The analyses performed also take into consideration economic conditions that may have an impact on a specific industry, group of customers or a specific customer. Based on analysis of actual historical write-offs of uncollectible accounts receivable, Grainger's estimates and assumptions have been materially

accurate in regards to the valuation of its allowance for doubtful accounts. However, write-offs could be materially different than the reserves established if business or economic conditions change or actual results deviate from historical trends, and Grainger's estimates and assumptions may be revised as appropriate to reflect these changes. For fiscal years 2014, 2013 and 2012, actual results did not vary materially from estimated amounts.

Inventory Reserves. Grainger establishes inventory reserves for obsolete inventory. Grainger regularly reviews inventory to evaluate continued demand and identify any obsolete or excess quantities. Grainger records provisions for the difference between excess and obsolete inventory and its estimated realizable value. Estimated realizable value is based on anticipated future product demand, market conditions and liquidation values. As Grainger's inventory consists of approximately 1.4 million stocked products, it is not practical to quantify the actual disposition of excess and obsolete inventory against estimated amounts at a stock keeping unit (SKU) level and no individual SKU is material. There were no material differences noted between reserve levels compared to the level of write-offs historically. Grainger's methodology for estimating reserves is continually evaluated based on current experience and the methodology provides for a materially accurate level of reserves at any reporting date. Actual results could differ materially from projections and require changes to reserves which could have a material effect on Grainger's results of operations based on significant changes in product demand, market conditions or liquidation value. If business or economic conditions change, Grainger's estimates and assumptions may be revised as appropriate. For fiscal years 2014, 2013 and 2012, actual results did not vary materially from estimated amounts.

Goodwill and Indefinite Lived Intangible Assets. Business acquisitions result in the recording of goodwill and identified intangible assets which affect the amount of amortization expense and possible impairment write-downs that may occur in future periods. Grainger annually reviews goodwill and intangible assets with indefinite lives for impairment in the fourth quarter and when events or changes in circumstances indicate the carrying value of these assets might exceed their current fair values. Grainger tests for goodwill impairment at the reporting unit level and performs a qualitative assessment of factors such as a reporting unit's current performance and overall economic factors to determine if it is more likely than not that the goodwill might be impaired and whether it is necessary to perform the two-step quantitative goodwill impairment test. In the two-step test, Grainger compares the carrying value of assets of the reporting unit to its calculated fair value. If the carrying value of assets of the reporting unit exceeds its calculated fair value, the second step is performed, where the implied fair value of goodwill is compared to the carrying value of assets, to determine the amount of impairment.

The fair value of reporting units is calculated primarily using the discounted cash flow (DCF) method and incorporating value indicators from a market approach to evaluate the reasonableness of the resulting fair values. The DCF method incorporates various assumptions including the amount and timing of future expected cash flows, including revenues, gross margins, operating expenses, capital expenditures and working capital based on operational budgets, long range strategic plans and other estimates. The terminal value growth rate is used to calculate the value of cash flows beyond the last projected period and reflects management's best estimates for perpetual growth for the reporting units. Estimates of market-participant risk-adjusted weighted average cost of capital (WACC) are used as a basis for determining the discount rates to apply to the reporting units' future expected cash flows and terminal value.

Grainger completed the annual impairment testing during the fourth quarter of 2014, and identified two reporting units for which it could not determine whether or not the fair value would be less than the carrying value. For one of these reporting units, Grainger Colombia, the two-step quantitative test indicated that the carrying value of assets exceeded the calculated fair value and step two impairment calculations were required. During the testing in the fourth quarter, Grainger considered management's revised outlook on the business, which included lower projected sales growth and incremental investment necessary to execute on the strategy. Grainger incorporated this revised outlook into the two-step quantitative test, resulting in lowered projected sales growth, operating earnings and cash flows. Grainger recorded a full goodwill impairment charge of \$12 million on the Grainger Colombia reporting unit.

Fabry, with \$118 million of goodwill, had a calculated fair value which exceeded the carrying value of assets by 31%, and step two calculations were not required for this reporting unit. The risk of potential failure of step one of the impairment test for Fabry in future reporting periods is highly dependent upon key assumptions including the amount and timing of future expected cash flows, sales growth rates, gross margins, capital expenditures, discount rates and estimates of market-participant risk-adjusted WACC. These assumptions require considerable management judgment and are subject to uncertainty. Grainger performed a sensitivity analysis to determine the reasonableness of the step one results, and evaluated the impact of a 100 basis point increase in the discount rate or a 100 basis point decrease in the terminal growth rate. No indications of impairment resulted from this sensitivity analysis. Changes in assumptions regarding future performance and a continued unfavorable economic environment in Europe may also have a significant impact on cash flows in the future. Given the sensitivity of the calculated fair value to changes in these key assumptions, Grainger may be required to recognize an impairment for Fabry's goodwill in the future due to changes in market conditions or other factors related to these key assumptions.

For Grainger's remaining reporting units, the estimated fair values substantially exceeded the carrying values.

Stock Incentive Plans. Grainger maintains stock incentive plans under which a variety of incentive grants may be awarded to employees and directors. Grainger uses a binomial lattice option pricing model to estimate the fair value of stock option grants. The model requires projections of the risk-free interest rate, expected life, volatility, dividend yield and forfeiture rate of the stock option grants. The fair value of options granted used the following assumptions:

	For the Years Ended December 31,		
	2014	2013	2012
Risk-free interest rate.....	2.0%	0.9%	1.1%
Expected life.....	6 years	6 years	6 years
Expected volatility.....	25.0%	25.5%	25.9%
Expected dividend yield.....	1.7%	1.5%	1.6%

The risk-free interest rate is selected based on yields from U.S. Treasury zero-coupon issues with a remaining term approximately equal to the expected term of the options being valued. The expected life selected for options granted during each year presented represents the period of time that the options are expected to be outstanding based on historical data of option holders' exercise and termination behavior. Expected volatility is based upon implied and historical volatility of the closing price of Grainger's stock over a period equal to the expected life of each option grant. Historical information is also the primary basis for selection of the expected dividend yield assumptions. Because stock option compensation expense is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures, using historical forfeiture experience. The amount of stock option compensation expense is significantly affected by the valuation model and these assumptions. If a different valuation model or different assumptions were used, the stock option compensation expense could be significantly different from what is recorded in the current period.

Compensation expense for other stock-based awards is based upon the closing market price on the last trading date preceding the date of the grant. Because the expense for other stock-based awards should reflect the awards ultimately expected to vest, it has been reduced for estimated forfeitures, using historical forfeiture experience.

For additional information concerning stock incentive plans, see Note 11 to the Consolidated Financial Statements.

Postretirement Healthcare Benefits. The postretirement healthcare obligation and net periodic cost are dependent on assumptions and estimates used in calculating such amounts. The assumptions used include, among others, discount rates, assumed rates of return on plan assets and healthcare cost trend rates, and certain employee-related factors, such as turnover, retirement age and mortality rates. Changes in these and other assumptions (caused by conditions in equity markets or plan experience, for example) could have a material effect on Grainger's postretirement benefit obligation and expense, and could affect its results of operations and financial condition. These changes in assumptions may also affect voluntary decisions to make additional contributions to the trust established for funding the postretirement benefit obligation.

The discount rate assumptions used by management reflect the rates available on high-quality fixed income debt instruments as of December 31, the measurement date, of each year. A higher discount rate reduces the present value of benefit obligations and net periodic benefit costs. As of December 31, 2014, Grainger decreased the discount rate used in the calculation of the postretirement plan obligation from 4.90% to 3.89% to reflect the decrease in market interest rates. Grainger estimates that this decrease could decrease 2015 pretax earnings by approximately \$4.4 million. However, other changes in assumptions may increase, decrease or eliminate this effect.

Grainger considers the long-term historical actual return on plan assets and the historical performance of the Standard & Poor's 500 Index and the Total International Composite Index in developing its expected long-term return on plan assets. In 2014, Grainger increased the expected long-term rate of return on plan assets from 5.70% (net of tax) to 6.65% (net of tax) based on the historical average of long-term rates of return net of estimated tax rates. Grainger estimates this change could increase 2015 pretax earnings by approximately \$1.5 million.

A 1 percentage point change in assumed healthcare cost trend rates would have had the following effects on December 31, 2014 results (in thousands of dollars):

	1 Percentage Point	
	Increase	(Decrease)
Effect on total of service and interest cost.....	\$ 1,978	\$ (1,613)
Effect on postretirement benefit obligation.....	36,470	(29,404)

Grainger changed the mortality improvement table used to project mortality rates into the future from Mortality Table RP-2000 with Mortality Improvement Scale BB to Mortality Table RP-2014 with Mortality Improvement Scale MP 2014 at December 31, 2014, which was published by the Society of Actuaries in October 2014, and reflects longer life expectancies than under the previous table and scale. Grainger estimates this change could reduce 2015 pretax earnings by approximately \$0.9 million.

Grainger may terminate or modify the postretirement plan at any time, subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code, as amended. In the event the postretirement plan is terminated, all assets of the Group Benefit Trust inure to the benefit of the participants. The foregoing assumptions are based on the presumption that the postretirement plan will continue. Were the postretirement plan to terminate, different actuarial assumptions and other factors might be applicable.

Grainger has used its best judgment in making assumptions and estimates and believes such assumptions and estimates used are appropriate. Changes to the assumptions may be required in future years as a result of actual experience or new trends or plan changes and, therefore, may affect Grainger's retirement plan obligations and future expense. For additional information concerning postretirement healthcare benefits, see Note 9 to the Consolidated Financial Statements.

Insurance Reserves. Grainger retains a significant portion of the risk of certain losses related to workers' compensation, auto liability, general liability and property losses through the utilization of high deductibles and self-insured retentions. There are also certain other risk areas for which Grainger does not maintain insurance.

Grainger is responsible for establishing accounting policies on insurance reserves. Although it relies on outside parties to project future claims costs, it retains control over actuarial assumptions, including loss development factors and claim payment patterns. Grainger performs ongoing reviews of its insured and uninsured risks, which it uses to establish the appropriate reserve levels. In calculating the liability, historical trends, claims experience and loss development patterns are analyzed and appropriate loss development factors are applied to the incurred costs associated with the claims made.

The use of assumptions in the analysis leads to fluctuations in required reserves over time. Any change in the required reserve balance is reflected in the current period's results of operations. Grainger believes its estimates are reasonable based on the information currently available and the methodology used to estimate these reserves has been consistently applied. There were no material adjustments based on Grainger's historical experience in 2014, 2013 and 2012. If actual trends, including the nature, severity or frequency of claims differ from Grainger's estimates, or if business or economic conditions change, Grainger's estimates and assumptions may be revised as appropriate and the results of operations could be materially impacted.

Income Taxes. Grainger recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. The tax balances and income tax expense recognized by Grainger are based on management's interpretations of the tax laws of multiple jurisdictions. Income tax expense reflects Grainger's best estimates and assumptions regarding, among other items, the level of future taxable income, interpretation of tax laws and tax planning opportunities, plans for reinvestment of cash overseas and uncertain tax positions. Future rulings by tax authorities and future changes in tax laws and their interpretation, changes in projected levels of taxable income, changes in planned need for cash overseas and future tax planning strategies could impact the actual effective tax rate and tax balances recorded by Grainger.

Contingent Liabilities. At any time, Grainger may be subject to investigations, legal proceedings, or claims related to the ongoing operation of its business, including claims both by and against Grainger. Such proceedings typically involve claims related to product liability, general negligence, contract disputes, environmental issues, wage and hour laws, intellectual property, employment practices, regulatory compliance or other matters and actions brought by employees, consumers, competitors, suppliers or governmental entities. Grainger routinely assesses the likelihood of any adverse outcomes related to these matters on a case by case basis, as well as the potential ranges of losses and fees. Grainger establishes accruals for its potential exposure, as appropriate, for claims against Grainger when losses become probable and reasonably estimable. Where Grainger is able to reasonably estimate a range of potential losses, Grainger records the amount within that range that constitutes Grainger's best estimate. Grainger also discloses the nature of and range of loss for claims against Grainger when losses are reasonably possible and material. These accruals and disclosures are determined based on the facts and circumstances related to the individual cases and require estimates and judgments regarding the interpretation of facts and laws, as well as the effectiveness of strategies or other factors beyond Grainger's control.

Other. Other significant accounting policies, not involving the same level of measurement uncertainties as those discussed above, are nevertheless important to an understanding of the financial statements. Policies such as revenue recognition, depreciation, intangibles, long-lived assets, fair value measurements and valuations, and warranties require judgments on complex matters that are often subject to multiple external sources of authoritative guidance such as the Financial Accounting Standards Board and the Securities and Exchange Commission. Possible changes in estimates or assumptions associated with these policies are not expected to have a material effect on the financial condition or results of operations of Grainger. More information on these additional accounting policies can be found in Note 1 to the Consolidated Financial Statements.

Effects of Inflation and Changing Prices

Grainger is affected by inflation through increased product and operating costs, and the ability to pass on cost increases to customers over time is dependent upon market conditions. The ability to achieve sales growth through increased prices is also subject to inflation and normal competitive conditions. The predominant use of the last-in, first-out (LIFO) method of accounting for inventories and accelerated depreciation methods for financial reporting and income tax purposes result in a substantial recognition of the effects of inflation in the financial statements.

Some of Grainger's products contain significant amounts of commodity-priced materials, such as steel, copper, petroleum derivatives or rare earth minerals, and are subject to price changes based upon fluctuations in the commodities market. Grainger has been able to successfully pass on cost increases to its customers minimizing the effect of inflation on results of operations.

Grainger believes the most positive means to combat inflation and advance the interests of investors lie in the continued application of basic business principles, which include improving productivity, maintaining working capital turnover and offering products and services that can command appropriate prices in the marketplace.

Forward-Looking Statements

This Form 10-K contains statements that are not historical in nature but concern future results and business plans, strategies and objectives and other matters that may be deemed to be "forward-looking statements" under the federal securities laws. Such forward-looking statements are identified by words such as "anticipate, estimate, expect, forecast, intend, plan, predict" and "project" or similar expressions, and include Grainger's expected earnings per share, sales growth and capital expenditures.

Grainger cannot guarantee that any forward-looking statement will be realized, although Grainger does believe that its assumptions underlying its forward-looking statements are reasonable. Achievement of future results is subject to risks and uncertainties that could cause Grainger's results to differ materially from those which are presented.

Factors that could cause actual results to differ materially from those presented or implied in a forward-looking statement include, without limitation: higher product costs or other expenses; a major loss of customers; loss or disruption of source of supply; increased competitive pricing pressures; failure to develop or implement new technologies or business strategies; the outcome of pending and future litigation or governmental or regulatory proceedings; investigations, inquiries, audits and changes in laws and regulations; disruption of information technology or data security systems; general industry or market conditions; general global economic conditions; currency exchange rate fluctuations; market volatility; commodity price volatility; labor shortages; litigation involving appropriate payment for wages; facilities disruptions or shutdowns; higher fuel costs or disruptions in transportation services; natural and other catastrophes; unanticipated weather conditions; and the factors identified in Item 1A: Risk Factors.

Caution should be taken not to place undue reliance on Grainger's forward-looking statements and Grainger undertakes no obligation to publicly update the forward-looking statements, whether as a result of new information, future events or otherwise.

Item 7A: Quantitative and Qualitative Disclosures About Market Risk

Grainger may use financial instruments to reduce its exposure to adverse fluctuations in foreign currency exchange rates and interest rates as part of its overall risk management strategy. The derivative positions reduce risk by hedging certain underlying economic exposures. Because of the high correlation between the hedging instrument and the underlying exposure, fluctuations in the value of the instruments are generally offset by reciprocal changes in the value of the underlying exposure. Grainger does not enter into derivative financial instruments for trading or speculative purposes. See Note 8 and Note 13 to the Consolidated Financial Statements for additional information on Grainger's derivative activities.

Foreign Currency Exchange Rates

Grainger's financial results, including the value of assets and liabilities, are exposed to foreign currency exchange rate risk when the financial statements of the international subsidiaries, as stated in their local currencies, are translated into U.S. dollars. While it is difficult to quantify any particular impact of changes in exchange rates, a uniform 10% strengthening in the U.S. dollar (whereby all other variables are held constant and unusual expense items described in "Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations" are excluded) would have resulted in a decrease in net earnings of \$4 million and \$8 million for the years ended December 31, 2014 and 2013, respectively. Comparatively, a 10% weakening of the U.S. dollar would have resulted in an increase in net earnings of \$5 million and \$10 million for the years ended December 31, 2014 and 2013, respectively. This sensitivity analysis of the effects of changes in foreign currency exchange rates does not factor in future potential changes in sales levels or local currency prices or costs.

Interest Rates

Grainger is subject to interest rate risk related to its variable rate debt portfolio. Grainger may enter into interest rate swap agreements to manage those risks. Based on Grainger's variable rate debt and derivative instruments outstanding, a 1 percentage point increase in interest rates paid by Grainger would have resulted in a decrease to net earnings of approximately \$2 million for 2014 and \$3 million for 2013. A 1 percentage point decrease in interest rates would have resulted in an increase to net earnings of approximately \$2 million for 2014 and \$3 million for 2013. This sensitivity analysis of the effects of changes in interest rates on long-term debt does not factor in future potential changes in long-term debt levels.

Commodity Price Risk

Grainger has limited primary exposure to commodity price risk on certain products for resale, but does not purchase commodities directly.

Item 8: Financial Statements and Supplementary Data

The financial statements and supplementary data are included on pages 29 to 63. See the Index to Financial Statements and Supplementary Data on page 28.

Item 9: Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A: Controls and Procedures

Disclosure Controls and Procedures

Grainger carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of Grainger's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that Grainger's disclosure controls and procedures were effective as of the end of the period covered by this report.

Internal Control Over Financial Reporting

(A) Management's Annual Report on Internal Control Over Financial Reporting

Management's report on Grainger's internal control over financial reporting is included on page 29 of this Report under the heading Management's Annual Report on Internal Control Over Financial Reporting.

(B) Attestation Report of the Registered Public Accounting Firm

The report from Ernst & Young LLP on its audit of the effectiveness of Grainger's internal control over financial reporting as of December 31, 2014, is included on page 30 of this Report under the heading Report of Independent Registered Public Accounting Firm.

(C) Changes in Internal Control Over Financial Reporting

There have been no changes in Grainger's internal control over financial reporting during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, Grainger's internal control over financial reporting.

Item 9B: Other Information

None.

PART III

Item 10: Directors, Executive Officers and Corporate Governance

The information required by this item is incorporated by reference to Grainger's proxy statement relating to the annual meeting of shareholders to be held April 29, 2015, under the captions "Directors," "Board of Directors and Board Committees" and "Section 16(a) Beneficial Ownership Reporting Compliance." Information required by this item regarding executive officers of Grainger is set forth below under the caption "Executive Officers."

Grainger has adopted a code of ethics that applies to the principal executive officer, principal financial officer and principal accounting officer. This code of ethics is incorporated into Grainger's business conduct guidelines for directors, officers and employees. Grainger intends to satisfy the disclosure requirement under Item 5.05 of Form 8-K relating to its code of ethics by posting such information on its website at www.grainger.com/investor. A copy of the code of ethics incorporated into Grainger's business conduct guidelines is also available in print without charge to any person upon request to Grainger's Corporate Secretary. Grainger has also adopted Operating Principles for the Board of Directors, which are available on its website and are available in print to any person who requests them.

Executive Officers

Following is information about the Executive Officers of Grainger including age as of March 1, 2015. Executive Officers of Grainger generally serve until the next annual election of officers, or until earlier resignation or removal.

Name and Age	Positions and Offices Held and Principal Occupation and Employment During the Past Five Years
Michael S. Ali (53)	Senior Vice President and Chief Information Officer, a position assumed in July 2013. Prior to joining Grainger, Dr. Ali was Senior Vice-President, Application Services and PMO at U.S. Foods, a position assumed in 2012 after serving as CIO at Harman, a position assumed in 2010. Prior to this position, Dr. Ali held several management roles in Ford Motor Company from 2000 to 2010.
Laura D. Brown (51)	Senior Vice President, Communications and Investor Relations, a position assumed in 2010 after serving as Vice President, Global Business Communications, a position assumed in 2009 and Vice President, Investor Relations, a position assumed in 2008.
Court D. Carruthers (42)	Senior Vice President and Group President, Americas, a position assumed in 2013 after serving as Senior Vice President and President, Grainger U.S., a position assumed in 2012, President, Grainger International, a position assumed in 2009, and Senior Vice President of Grainger, a position assumed in 2007.
Joseph C. High (60)	Senior Vice President and Chief People Officer, a position assumed in June 2011. Prior to joining Grainger, Mr. High was the Senior Vice President of Human Resources at Owens Corning in Toledo, Ohio, a position assumed in 2004.
John L. Howard (57)	Senior Vice President and General Counsel, a position assumed in 2000.
Ronald L. Jadin (54)	Senior Vice President and Chief Financial Officer, a position assumed in 2008. Previously, Mr. Jadin served as Vice President and Controller, a position assumed in 2006 after serving as Vice President, Finance.
William Lomax (51)	Vice President and Controller, a position assumed in 2014. Previously, Mr. Lomax served as Vice President, Global Supply Chain and International, a position assumed in 2013; Vice President, Grainger International and Chief Risk Officer, positions assumed in 2010 and 2013, respectively; and Vice President, Finance and Chief Financial Officer of Acklands–Grainger Inc., a position assumed in 2008.
Donald G. Macpherson (47)	Senior Vice President and Group President, Global Supply Chain and International, a position assumed in 2013 after serving as Senior Vice President and President, Global Supply Chain and Corporate Strategy, a position assumed in 2012, and Senior Vice President, Global Supply Chain, a position assumed in 2008.
James T. Ryan (56)	Chairman of the Board, President and Chief Executive Officer of Grainger, positions assumed in 2009, 2006 and 2008, respectively.

Item 11: Executive Compensation

The information required by this item is incorporated by reference to Grainger's proxy statement relating to the annual meeting of shareholders to be held April 29, 2015, under the captions "Board of Directors and Board Committees," "Director Compensation," "Report of the Compensation Committee of the Board" and "Compensation Discussion and Analysis."

Item 12: Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item is incorporated by reference to Grainger's proxy statement relating to the annual meeting of shareholders to be held April 29, 2015, under the captions "Ownership of Grainger Stock" and "Equity Compensation Plans."

Item 13: Certain Relationships and Related Transactions, and Director Independence

The information required by this item is incorporated by reference to Grainger's proxy statement relating to the annual meeting of shareholders to be held April 29, 2015, under the captions "Election of Directors" and "Transactions with Related Persons."

Item 14: Principal Accounting Fees and Services

The information required by this item is incorporated by reference to Grainger's proxy statement relating to the annual meeting of shareholders to be held April 29, 2015, under the caption "Audit Fees and Audit Committee Pre-Approval Policies and Procedures."

PART IV

Item 15: Exhibits and Financial Statement Schedules

- (a) 1. Financial Statements. See Index to Financial Statements and Supplementary Data.
2. Financial Statement Schedules. The schedules listed in Reg. 210.5-04 have been omitted because they are either not applicable or the required information is shown in the consolidated financial statements or notes thereto.
3. Exhibits
- (3) (a) Restated Articles of Incorporation, incorporated by reference to Exhibit 3(i) to Grainger's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998.
- (b) Bylaws, as amended February 17, 2010, incorporated by reference to Exhibit 3(b) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2009.
- (4) Instruments Defining the Rights of Security Holders, Including Indentures
- (a) No instruments which define the rights of holders of Grainger's Industrial Development Revenue Bonds are filed herewith, pursuant to the exemption contained in Regulation S-K, Item 601(b)(4)(iii). Grainger hereby agrees to furnish to the Securities and Exchange Commission, upon request, a copy of any such instrument.
- (10) Material Contracts
- (a) (i) A Credit Agreement with U.S. Bank National Association, as administrative agent, and other lenders, incorporated by reference to Exhibit 10.1 to Grainger's Form 8-K dated May 8, 2012.
- (b) Compensatory Plans or Arrangements
- (i) Director Stock Plan, as amended, incorporated by reference to Exhibit 10(c) to Grainger's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006.
- (ii) 1990 Long-Term Stock Incentive Plan, as amended, incorporated by reference to Exhibit 10(a) to Grainger's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006.
- (iii) 2001 Long-Term Stock Incentive Plan, as amended, incorporated by reference to Exhibit 10(b) to Grainger's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006.
- (iv) Form of Indemnification Agreement between Grainger and each of its directors and certain of its executive officers, incorporated by reference to Exhibit 10(b)(i) to Grainger's Quarterly Report on Form 10-Q for the quarter ended March 31, 2009.
- (v) Frozen Executive Death Benefit Plan, as amended, incorporated by reference to Exhibit 10(b)(v) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2007.
- (1) First amendment to the Frozen Executive Death Benefit Plan, incorporated by reference to Exhibit 10(b)(v)(1) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2008.
- (2) Second amendment to the Frozen Executive Death Benefit Plan, incorporated by reference to Exhibit 10(b)(iv)(2) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2009.
- (vi) Supplemental Profit Sharing Plan, as amended, incorporated by reference to Exhibit 10(viii) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2003.
- (vii) Supplemental Profit Sharing Plan II, as amended, incorporated by reference to Exhibit 10(b)(ix) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2007.
- (viii) Voluntary Salary and Incentive Deferral Plan, as amended, incorporated by reference to Exhibit 10(b)(xi) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2007.
- (ix) Summary Description of the 2014 Directors Compensation Program, incorporated by reference to Exhibit 10(b)(ix) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2013.
- (x) 2005 Incentive Plan, as amended, incorporated by reference to Exhibit 10(d) to Grainger's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006.
- (xi) 2010 Incentive Plan, incorporated by reference to Exhibit B of Grainger's Proxy Statement dated March 12, 2010.
- (xii) Form of Stock Option Award Agreement between Grainger and certain of its executive officers, incorporated by reference to Exhibit 10(xiv) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2005.

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- (xiii) Form of Stock Option Award and Restricted Stock Unit Agreement between Grainger and certain of its executive officers, incorporated by reference to Exhibit 10(xv) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2005.
 - (xiv) Form of Stock Option Award Agreement between Grainger and certain of its executive officers, incorporated by reference to Exhibit 10(b)(xvi) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2009.
 - (xv) Form of Stock Option and Restricted Stock Unit Agreement between Grainger and certain of its executive officers, incorporated by reference to Exhibit 10(b)(xvii) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2009.
 - (xvi) Form of Restricted Stock Unit Agreement between Grainger and certain of its executive officers, incorporated by reference to Exhibit 10(b)(xviii) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2010.
 - (xvii) Form of 2012 Performance Share Award Agreement between Grainger and certain of its executive officers, incorporated by reference to Exhibit 10(b)(xix) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2012.
 - (xviii) Letter of Agreement – Long-Term International Assignment to Mr. Court D. Carruthers dated December 22, 2011, incorporated by reference to Exhibit 10(b)(xxi) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2011.
 - (xix) Summary Description of the 2015 Management Incentive Program.
 - (xx) Incentive Program Recoupment Agreement, incorporated by reference to Exhibit 10(b)(xxv) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2009.
 - (xxi) Form of Change in Control Employment Agreement between Grainger and certain of its executive officers, incorporated by reference to Exhibit 10(b)(xxvii) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2010.
 - (xxii) Form of 2013 Performance Share Award Agreement between Grainger and certain of its executive officers, incorporated by reference to Exhibit 10(b)(xxiii) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2013.
 - (xxiii) Separation Agreement and General Release by and between Grainger and Michael A. Pulick dated October 4, 2013, incorporated by reference to Exhibit 10(b)(xxiv) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2013.
 - (xxiv) Form of 2014 Performance Share Award Agreement between Grainger and certain of its executive officers.

(21) Subsidiaries of Grainger.

(23) Consent of Independent Registered Public Accounting Firm.

(31) Rule 13a – 14(a)/15d – 14(a) Certifications

(a) Chief Executive Officer certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

(b) Chief Financial Officer certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

(32) Section 1350 Certifications

Chief Executive Officer and Chief Financial Officer certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.