
INDEX TO FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

December 31, 2014, 2013 and 2012

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MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

Grainger's management assessed the effectiveness of Grainger's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Based on its assessment under that framework and the criteria established therein, Grainger's management concluded that Grainger's internal control over financial reporting was effective as of December 31, 2014.

Ernst & Young LLP, an independent registered public accounting firm, has audited Grainger's internal control over financial reporting as of December 31, 2014, as stated in their report, which is included herein.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited W.W. Grainger, Inc. and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). W.W. Grainger, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, W.W. Grainger, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of W.W. Grainger, Inc. and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of earnings, comprehensive earnings, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2014 of W.W. Grainger, Inc. and subsidiaries and our report dated February 27, 2015 expressed an unqualified opinion thereon.

Ernst & Young LLP

Chicago, Illinois
February 27, 2015

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of W.W. Grainger, Inc. and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of earnings, comprehensive earnings, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of W.W. Grainger, Inc. and subsidiaries at December 31, 2014 and 2013, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), W.W. Grainger Inc. and subsidiaries' internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 27, 2015 expressed an unqualified opinion thereon.

Ernst & Young LLP

Chicago, Illinois
February 27, 2015

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF EARNINGS

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

	For the Years Ended December 31,		
	2014	2013	2012
Net sales	\$9,964,953	\$9,437,758	\$8,950,045
Cost of merchandise sold	5,650,711	5,301,275	5,033,885
Gross profit	4,314,242	4,136,483	3,916,160
Warehousing, marketing and administrative expenses	2,967,125	2,839,629	2,785,035
Operating earnings	1,347,117	1,296,854	1,131,125
Other income and (expense):			
Interest income	2,068	3,234	2,660
Interest expense	(10,093)	(13,225)	(16,078)
Other non-operating income	483	2,732	1,866
Other non-operating expense	(5,189)	(1,996)	(1,784)
Total other income and (expense)	(12,731)	(9,255)	(13,336)
Earnings before income taxes	1,334,386	1,287,599	1,117,789
Income taxes	522,090	479,850	418,940
Net earnings	812,296	807,749	698,849
Less: Net earnings attributable to noncontrolling interest	10,567	10,713	8,968
Net earnings attributable to W.W. Grainger, Inc.	<u>\$ 801,729</u>	<u>\$ 797,036</u>	<u>\$ 689,881</u>
Earnings per share:			
Basic	<u>\$ 11.59</u>	<u>\$ 11.31</u>	<u>\$ 9.71</u>
Diluted	<u>\$ 11.45</u>	<u>\$ 11.13</u>	<u>\$ 9.52</u>
Weighted average number of shares			
Basic	<u>68,334,322</u>	<u>69,455,507</u>	<u>69,811,881</u>
Diluted	<u>69,205,744</u>	<u>70,576,432</u>	<u>71,181,733</u>

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

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands of dollars)

	For the Years Ended December 31,		
	2014	2013	2012
Net earnings	\$812,296	\$807,749	\$698,849
Other comprehensive earnings (losses):			
Foreign currency translation adjustments:			
Foreign currency translation (loss) gain, net of tax benefit (expense) of \$2,806, \$4,078 and \$(1,653), respectively	(127,847)	(78,253)	7,344
Net investment hedge, gain (loss) net of tax (expense) benefit of \$(2,360), \$(3,393) and \$1,204, respectively	3,782	5,438	(1,930)
Reclassification of cumulative currency translation	9,042	—	—
Net foreign currency translation (loss) gain	(115,023)	(72,815)	5,414
Defined postretirement benefit plan:			
Defined postretirement benefit plan, net of tax benefit (expense) of \$14,140, \$(21,632) and \$(47,948), respectively	(22,667)	35,045	75,625
Reclassification adjustments related to amortization, net of tax expense of \$2,545, \$1,444, respectively	(4,072)	(2,387)	—
Net defined postretirement benefit plans	(26,739)	32,658	75,625
Other employment-related benefit plans:			
Loss on other employment-related benefit plans, net of tax benefit of \$440, \$313, and \$1,621, respectively ..	(1,462)	(1,319)	(5,044)
Reclassification adjustment related to plan amendment and settlement, net of tax benefit of \$(2,324)	6,971	—	—
Net other employment-related benefit plans	5,509	(1,319)	(5,044)
Derivative instrument change in fair value of cash flow hedge	786	1,190	(2,545)
Total other comprehensive earnings (losses)	(135,467)	(40,286)	73,450
Comprehensive earnings, net of tax	676,829	767,463	772,299
Less: Comprehensive earnings attributable to noncontrolling interest:			
Net earnings	10,567	10,713	8,968
Foreign currency translation adjustments	(9,880)	(15,622)	(8,866)
Comprehensive earnings attributable to W.W. Grainger, Inc.	<u>\$676,142</u>	<u>\$772,372</u>	<u>\$772,197</u>

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

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

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

ASSETS	As of December 31,	
	2014	2013
CURRENT ASSETS		
Cash and cash equivalents	\$ 226,644	\$ 430,644
Accounts receivable (less allowances for doubtful accounts of \$22,121 and \$20,096, respectively)	1,172,924	1,101,656
Inventories – net	1,356,396	1,305,520
Prepaid expenses and other assets	102,669	115,331
Deferred income taxes	61,387	75,819
Prepaid income taxes	47,529	15,315
Total current assets	2,967,549	3,044,285
PROPERTY, BUILDINGS AND EQUIPMENT		
Land	337,573	277,256
Buildings, structures and improvements	1,269,491	1,259,237
Furniture, fixtures, machinery and equipment	1,508,066	1,404,597
	3,115,130	2,941,090
Less: Accumulated depreciation and amortization	1,790,784	1,732,528
Property, buildings and equipment – net	1,324,346	1,208,562
DEFERRED INCOME TAXES	16,718	16,209
GOODWILL	506,905	525,467
OTHER ASSETS AND INTANGIBLES – NET	468,734	471,805
TOTAL ASSETS	<u>\$5,284,252</u>	<u>\$5,266,328</u>

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS – CONTINUED

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

	As of December 31,	
LIABILITIES AND SHAREHOLDERS' EQUITY	2014	2013
CURRENT LIABILITIES		
Short-term debt.....	\$ 56,896	\$ 66,857
Current maturities of long-term debt	23,404	30,429
Trade accounts payable	554,088	510,634
Accrued compensation and benefits	191,696	185,905
Accrued contributions to employees' profit sharing plans	178,076	176,800
Accrued expenses	245,300	218,835
Income taxes payable	12,256	6,330
Total current liabilities	1,261,716	1,195,790
 LONG-TERM DEBT (less current maturities).....	 404,536	 445,513
 DEFERRED INCOME TAXES AND TAX UNCERTAINTIES	 95,455	 113,585
 EMPLOYMENT-RELATED AND OTHER NONCURRENT LIABILITIES	 238,444	 184,604
 SHAREHOLDERS' EQUITY		
Cumulative Preferred Stock –		
\$5 par value – 12,000,000 shares authorized;		
none issued or outstanding	—	—
Common Stock – \$0.50 par value –		
300,000,000 shares authorized; issued 109,659,219 shares.....	54,830	54,830
Additional contributed capital	948,340	893,055
Retained earnings	6,335,990	5,822,612
Accumulated other comprehensive (losses) earnings.....	(96,673)	28,914
Treasury stock, at cost – 42,227,178 and 40,805,281 shares, respectively.....	(4,032,615)	(3,548,973)
Total W.W. Grainger, Inc. shareholders' equity	3,209,872	3,250,438
Noncontrolling interest.....	74,229	76,398
Total shareholders' equity.....	3,284,101	3,326,836
 TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	 \$5,284,252	 \$5,266,328

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

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of dollars)

	For the Years Ended December 31,		
	2014	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net earnings	\$ 812,296	\$ 807,749	\$ 698,849
Provision for losses on accounts receivable	12,945	8,855	9,504
Deferred income taxes and tax uncertainties.....	(13,732)	(9,319)	12,343
Depreciation and amortization.....	208,326	180,613	159,049
Impairment of goodwill and other intangible assets.....	16,652	26,284	4,945
Losses (gains) from non-cash charges and sales of assets.....	41,037	(22,155)	2,609
Stock-based compensation.....	49,032	55,590	55,500
Change in operating assets and liabilities – net of business acquisitions and divestitures:			
Accounts receivable	(122,580)	(126,465)	(45,953)
Inventories	(92,443)	(23,636)	(14,872)
Prepaid expenses and other assets	(24,550)	16,873	8,346
Trade accounts payable	32,019	71,118	(54,314)
Other current liabilities.....	8,693	(707)	(58,673)
Current income taxes payable.....	(1,487)	(4,813)	(9,349)
Accrued employment-related benefits costs.....	35,027	9,872	45,795
Other – net	(1,421)	(3,361)	2,416
Net cash provided by operating activities	959,814	986,498	816,195
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to property, buildings and equipment	(387,390)	(272,145)	(249,860)
Proceeds from sales of assets.....	26,755	26,701	8,530
Cash paid for business acquisitions.....	(30,713)	(153,915)	(64,808)
Other – net	7,290	(68)	482
Net cash used in investing activities	\$(384,058)	\$(399,427)	\$(305,656)

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

(In thousands of dollars)

	For the Years Ended December 31,		
	<u>2014</u>	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Borrowings under lines of credit	\$ 113,721	\$ 144,805	\$ 161,160
Payments against lines of credit	(117,277)	(154,450)	(205,006)
Proceeds from issuance of long-term debt	150,504	—	300,000
Payments of long-term debt and commercial paper	(170,907)	(16,681)	(219,950)
Proceeds from stock options exercised	48,579	69,412	72,084
Excess tax benefits from stock-based compensation	33,772	59,984	57,885
Purchase of treasury stock	(525,120)	(438,473)	(340,532)
Cash dividends paid	(291,395)	(255,466)	(220,077)
Net cash used in financing activities	<u>(758,123)</u>	<u>(590,869)</u>	<u>(394,436)</u>
Exchange rate effect on cash and cash equivalents	<u>(21,633)</u>	<u>(17,621)</u>	<u>469</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS:	<u>(204,000)</u>	<u>(21,419)</u>	<u>116,572</u>
Cash and cash equivalents at beginning of year	<u>430,644</u>	<u>452,063</u>	<u>335,491</u>
Cash and cash equivalents at end of year	<u>\$ 226,644</u>	<u>\$ 430,644</u>	<u>\$ 452,063</u>
Supplemental cash flow information:			
Cash payments for interest (net of amounts capitalized) ...	\$ 10,172	\$ 12,954	\$ 16,028
Cash payments for income taxes	\$ 509,378	\$ 414,363	\$ 383,698

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

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

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

	W.W. Grainger, Inc. Shareholders' Equity					
	Common Stock	Additional Contributed Capital	Retained Earnings	Accumulated Other Comprehensive Earnings (Losses)	Treasury Stock	Noncontrolling Interest
Balance at January 1, 2012.....	\$54,830	\$700,826	\$4,806,110	\$ (28,738)	\$(2,904,243)	\$95,494
Exercise of stock options	—	(927)	—	—	72,502	564
Tax benefits on stock-based compensation awards	—	60,122	—	—	—	—
Stock option expense.....	—	17,898	—	—	—	105
Amortization of other stock-based compensation awards	—	35,125	—	—	—	—
Settlement and vesting of other stock-based compensation awards ...	—	(31,175)	—	—	1,452	—
Director's stock compensation	—	30,867	—	—	—	—
Purchase of treasury stock.....	—	(163)	—	—	(345,357)	(148)
Net earnings	—	—	689,881	—	—	8,968
Other comprehensive earnings.....	—	—	—	82,316	—	(8,866)
Cash dividends paid (\$3.06 per share)	—	—	(217,414)	—	—	(2,663)
Balance at December 31, 2012	\$54,830	\$812,573	\$5,278,577	\$ 53,578	\$(3,175,646)	\$93,454
Exercise of stock options	—	4,035	—	—	64,140	583
Tax benefits on stock-based compensation awards	—	62,385	—	—	—	—
Stock option expense.....	—	17,373	—	—	—	72
Amortization of other stock-based compensation awards	—	34,049	—	—	—	—
Settlement and vesting of other stock-based compensation awards ...	—	(37,851)	—	—	(3,709)	—
Purchase of treasury stock.....	—	—	—	—	(433,758)	(183)
Purchase of noncontrolling interest – Colombia	—	(51)	—	—	—	(9,612)
Net earnings	—	—	797,036	—	—	10,713
Other comprehensive earnings.....	—	—	—	(24,664)	—	(15,622)
Cash dividends paid (\$3.59 per share)	—	542	(253,001)	—	—	(3,007)
Balance at December 31, 2013	\$54,830	\$893,055	\$5,822,612	\$ 28,914	\$(3,548,973)	\$76,398
Exercise of stock options	—	4,709	—	—	42,920	872
Tax benefits on stock-based compensation awards	—	36,618	—	—	—	—
Stock option expense.....	—	14,547	—	—	—	152
Amortization of other stock-based compensation awards	—	31,480	—	—	—	—
Settlement and vesting of other stock-based compensation awards ...	—	(32,711)	—	—	(1,636)	—
Purchase of treasury stock.....	—	—	—	—	(524,926)	(194)
Net earnings	—	—	801,729	—	—	10,567
Other comprehensive earnings.....	—	—	—	(125,587)	—	(9,880)
Cash dividends paid (\$4.17 per share)	—	642	(288,351)	—	—	(3,686)
Balance at December 31, 2014	\$54,830	\$948,340	\$6,335,990	\$ (96,673)	\$(4,032,615)	\$74,229

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