

INDEX TO FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
December 31, 2016, 2015 and 2014

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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, 2016, 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, 2016.

Ernst & Young LLP, an independent registered public accounting firm, has audited Grainger's internal control over financial reporting as of December 31, 2016, as stated in their report, which is included herein.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited W.W. Grainger, Inc. and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2016, 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, 2016, 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, 2016 and 2015, 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, 2016 of W.W. Grainger, Inc. and subsidiaries and our report dated February 28, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois
February 28, 2017

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of W.W. Grainger, Inc. and subsidiaries as of December 31, 2016 and 2015, 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, 2016. 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, 2016 and 2015, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, 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, 2016, 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 28, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois
February 28, 2017

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,		
	2016	2015	2014
Net sales	\$ 10,137,204	\$ 9,973,384	\$ 9,964,953
Cost of merchandise sold	6,022,647	5,741,956	5,650,711
Gross profit	4,114,557	4,231,428	4,314,242
Warehousing, marketing and administrative expenses	2,995,060	2,931,108	2,967,125
Operating earnings	1,119,497	1,300,320	1,347,117
Other income and (expense):			
Interest income	717	1,166	2,068
Interest expense	(66,332)	(33,571)	(10,093)
Loss from equity method investment	(31,193)	(11,740)	—
Other non-operating income	1,300	1,102	483
Other non-operating expense	(4,931)	(6,572)	(5,189)
Total other expense	(100,439)	(49,615)	(12,731)
Earnings before income taxes	1,019,058	1,250,705	1,334,386
Income taxes	386,220	465,531	522,090
Net earnings	632,838	785,174	812,296
Less: Net earnings attributable to noncontrolling interest	26,910	16,178	10,567
Net earnings attributable to W.W. Grainger, Inc.	\$ 605,928	\$ 768,996	\$ 801,729
Earnings per share:			
Basic	\$ 9.94	\$ 11.69	\$ 11.59
Diluted	\$ 9.87	\$ 11.58	\$ 11.45
Weighted average number of shares outstanding:			
Basic	60,430,892	65,156,864	68,334,322
Diluted	60,839,930	65,765,121	69,205,744

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,		
	2016	2015	2014
Net earnings	\$ 632,838	\$ 785,174	\$ 812,296
Other comprehensive earnings (losses):			
Foreign currency translation adjustments:			
Foreign currency translation loss, net of tax benefit of \$0, \$0 and \$2,806, respectively	(38,729)	(154,096)	(127,847)
Reclassification of cumulative currency translation	—	—	9,042
Other, net of tax expense of \$0, \$0 and \$(2,360), respectively	—	—	3,782
Net foreign currency translation loss	(38,729)	(154,096)	(115,023)
Defined postretirement benefit plan:			
Defined postretirement benefit plan (loss) gain, net of tax benefit (expense) of \$3,749, \$(19,056) and \$14,140, respectively	(6,022)	30,451	(22,667)
Reclassification related to amortization, net of tax expense	(4,034)	(3,246)	(4,072)
Net defined postretirement benefit plans	(10,056)	27,205	(26,739)
Other employment-related benefit plans:			
(Loss) gain on other employment-related benefit plans, net of tax benefit of \$718, \$0 and \$440, respectively	(2,397)	641	(1,462)
Reclassification related to plan amendment and settlement, net of tax benefit	—	—	6,971
Net other employment-related benefit plans	(2,397)	641	5,509
Other	885	1,300	786
Total other comprehensive losses	(50,297)	(124,950)	(135,467)
Comprehensive earnings, net of tax	582,541	660,224	676,829
Less: Comprehensive earnings attributable to noncontrolling interest:			
Net earnings	26,910	16,178	10,567
Foreign currency translation adjustments	906	(532)	(9,880)
Comprehensive earnings attributable to W.W. Grainger, Inc.	<u>\$ 554,725</u>	<u>\$ 644,578</u>	<u>\$ 676,142</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)

<u>ASSETS</u>	As of December 31,	
	2016	2015
CURRENT ASSETS		
Cash and cash equivalents	\$ 274,146	\$ 290,136
Accounts receivable - net	1,223,096	1,209,641
Inventories – net	1,406,470	1,414,177
Prepaid expenses and other assets	81,766	85,670
Prepaid income taxes	34,751	49,018
Total current assets	3,020,229	3,048,642
PROPERTY, BUILDINGS AND EQUIPMENT		
Land	355,976	323,765
Buildings, structures and improvements	1,313,233	1,352,498
Furniture, fixtures, machinery and equipment	1,742,293	1,694,050
	3,411,502	3,370,313
Less: Accumulated depreciation and amortization	1,990,611	1,939,072
Property, buildings and equipment – net	1,420,891	1,431,241
DEFERRED INCOME TAXES	64,775	83,996
GOODWILL	527,150	582,336
INTANGIBLES – NET	586,126	648,010
OTHER ASSETS	75,136	63,530
TOTAL ASSETS	\$ 5,694,307	\$ 5,857,755

W.W. Grainger, Inc. and Subsidiaries
CONSOLIDATED BALANCE SHEETS - CONTINUED
(In thousands of dollars, except for share and per share amounts)

<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>	As of December 31,	
	2016	2015
CURRENT LIABILITIES		
Short-term debt	\$ 386,140	\$ 353,072
Current maturities of long-term debt	19,966	247,346
Trade accounts payable	650,092	583,474
Accrued compensation and benefits	212,525	196,667
Accrued contributions to employees' profit-sharing plans	54,948	124,587
Accrued expenses	290,207	266,702
Income taxes payable	15,059	16,686
Total current liabilities	1,628,937	1,788,534
LONG-TERM DEBT (less current maturities)	1,840,946	1,388,414
DEFERRED INCOME TAXES AND TAX UNCERTAINTIES	126,101	154,352
EMPLOYMENT-RELATED AND OTHER NONCURRENT LIABILITIES	192,555	173,741
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	1,030,256	1,000,476
Retained earnings	7,113,559	6,802,130
Accumulated other comprehensive losses	(272,294)	(221,091)
Treasury stock, at cost – 50,854,905 and 47,630,511 shares, respectively	(6,128,416)	(5,369,711)
Total W.W. Grainger, Inc. shareholders' equity	1,797,935	2,266,634
Noncontrolling interest	107,833	86,080
Total shareholders' equity	1,905,768	2,352,714
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 5,694,307	\$ 5,857,755

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,		
	2016	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net earnings	\$ 632,838	\$ 785,174	\$ 812,296
Provision for losses on accounts receivable	16,216	10,181	12,945
Deferred income taxes and tax uncertainties	(5,884)	4,076	(13,732)
Depreciation and amortization	248,857	227,967	208,326
Impairment of goodwill and other intangible assets	52,318	—	16,652
(Gains) losses from non-cash charges and sales of assets	(18,521)	2,765	41,037
Stock-based compensation	35,735	46,861	49,032
Losses from equity method investment	31,193	11,740	—
Change in assets and liabilities – net of acquisitions and divestitures:			
Accounts receivable	(45,600)	(3,085)	(122,580)
Inventories	(4,403)	(37,737)	(92,443)
Prepaid expenses and other assets	18,641	15,788	(24,550)
Trade accounts payable	72,882	23,130	32,019
Other current liabilities	(25,044)	(70,306)	8,693
Income taxes payable	(3,513)	6,943	(1,487)
Accrued employment-related benefits cost	7,542	(27,721)	35,027
Other – net	(10,281)	(5,872)	(1,421)
Net cash provided by operating activities	<u>1,002,976</u>	<u>989,904</u>	<u>959,814</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to property, buildings and equipment and intangibles	(284,249)	(373,868)	(387,390)
Proceeds from sales of assets	55,023	14,857	26,755
Equity method investment	(34,103)	(20,382)	—
Cash paid for business acquisitions	(159)	(464,431)	(30,713)
Other – net	1,224	466	7,290
Net cash used in investing activities	<u>(262,264)</u>	<u>(843,358)</u>	<u>(384,058)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase in commercial paper	39,748	325,000	5,000
Borrowings under lines of credit	36,055	54,770	108,721
Payments against lines of credit	(37,358)	(78,559)	(117,277)
Proceeds from issuance of long-term debt	515,985	1,307,183	150,504
Payments of long-term debt	(262,248)	(52,838)	(170,907)
Proceeds from stock options exercised	34,125	60,885	48,579
Excess tax benefits from stock-based compensation	11,905	27,553	33,772
Purchase of treasury stock	(789,773)	(1,400,071)	(525,120)
Cash dividends paid	(302,971)	(306,474)	(291,395)
Net cash used in financing activities	<u>(754,532)</u>	<u>(62,551)</u>	<u>(758,123)</u>
Exchange rate effect on cash and cash equivalents	(2,170)	(20,503)	(21,633)
NET CHANGE IN CASH AND CASH EQUIVALENTS:	<u>(15,990)</u>	<u>63,492</u>	<u>(204,000)</u>
Cash and cash equivalents at beginning of year	290,136	226,644	430,644
Cash and cash equivalents at end of year	<u>\$ 274,146</u>	<u>\$ 290,136</u>	<u>\$ 226,644</u>
Supplemental cash flow information:			
Cash payments for interest (net of amounts capitalized)	\$ 63,143	\$ 31,591	\$ 10,172
Cash payments for income taxes	\$ 359,506	\$ 442,486	\$ 509,378

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)

	Common Stock	Additional Contributed Capital	Retained Earnings	Accumulated Other Comprehensive Earnings (Losses)	Treasury Stock	Noncontrolling Interest
Balance at January 1, 2014	\$ 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 losses	—	—	—	(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
Exercise of stock options	—	1,454	—	—	58,713	460
Tax benefits on stock-based compensation awards	—	31,614	—	—	—	—
Stock option expense	—	14,311	—	—	—	163
Amortization of other stock-based compensation awards	—	28,332	—	—	—	—
Settlement and vesting of other stock-based compensation awards	—	(24,235)	—	—	4,122	—
Purchase of treasury stock	—	—	—	—	(1,399,931)	(140)
Net earnings	—	—	768,996	—	—	16,178
Other comprehensive losses	—	—	—	(124,418)	—	(532)
Cash dividends paid (\$4.59 per share)	—	660	(302,856)	—	—	(4,278)
Balance at December 31, 2015	\$ 54,830	\$ 1,000,476	\$6,802,130	\$ (221,091)	\$ (5,369,711)	\$ 86,080
Exercise of stock options	—	(2,216)	—	—	36,131	58
Tax benefits on stock-based compensation awards	—	12,284	—	—	—	—
Stock option expense	—	11,508	—	—	—	441
Amortization of other stock-based compensation awards	—	23,407	—	—	—	—

Settlement and vesting of other stock-based compensation awards	—	(15,921)	—	—	5,176	—
Purchase of treasury stock	—	—	—	—	(800,012)	(130)
Net earnings	—	—	605,928	—	—	26,910
Other comprehensive (losses) earnings	—	—	—	(51,203)	—	3,664
Cash dividends paid (\$4.83 per share)	—	718	(294,499)	—	—	(9,190)
Balance at December 31, 2016	<u>\$ 54,830</u>	<u>\$ 1,030,256</u>	<u>\$ 7,113,559</u>	<u>\$ (272,294)</u>	<u>\$ (6,128,416)</u>	<u>\$ 107,833</u>

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