

GRAINGER W W INC
Form 10-Q
July 31, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 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 36-1150280
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

100 Grainger Parkway, Lake Forest, Illinois 60045-5201
(Address of principal executive offices) (Zip Code)
(847) 535-1000
(Registrant's telephone number including area code)

Not Applicable
(Former name, former address and former fiscal year; if changed since last report)

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 Web site, 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

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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 Exchange Act).
Yes No

There were 68,395,811 shares of the Company’s Common Stock outstanding as of June 30, 2014.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

W.W. Grainger, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

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

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-------------|------------------|-------------|
| | June 30, 2014 | 2013 | June 30, 2014 | 2013 |
| Net sales | \$2,506,104 | \$2,381,561 | \$4,891,731 | \$4,661,996 |
| Cost of merchandise sold | 1,425,418 | 1,334,577 | 2,735,074 | 2,583,276 |
| Gross profit | 1,080,686 | 1,046,984 | 2,156,657 | 2,078,720 |
| Warehousing, marketing and administrative expenses | 739,935 | 696,912 | 1,461,567 | 1,385,344 |
| Operating earnings | 340,751 | 350,072 | 695,090 | 693,376 |
| Other income and (expense): | | | | |
| Interest income | 413 | 796 | 1,053 | 1,694 |
| Interest expense | (2,757) | (3,201) | (5,620) | (6,367) |
| Other non-operating income | 177 | 164 | 345 | 2,146 |
| Other non-operating expense | (159) | (311) | (830) | (1,405) |
| Total other expense | (2,326) | (2,552) | (5,052) | (3,932) |
| Earnings before income taxes | 338,425 | 347,520 | 690,038 | 689,444 |
| Income taxes | 129,348 | 126,767 | 261,906 | 254,164 |
| Net earnings | 209,077 | 220,753 | 428,132 | 435,280 |
| Less: Net earnings attributable to noncontrolling interest | 3,162 | 3,093 | 5,564 | 5,782 |
| Net earnings attributable to W.W. Grainger, Inc. | \$205,915 | \$217,660 | \$422,568 | \$429,498 |
| Earnings per share: | | | | |
| Basic | \$2.97 | \$3.08 | \$6.08 | \$6.07 |
| Diluted | \$2.94 | \$3.03 | \$6.00 | \$5.97 |
| Weighted average number of shares outstanding: | | | | |
| Basic | 68,453,602 | 69,664,697 | 68,576,232 | 69,613,947 |
| Diluted | 69,341,885 | 70,801,050 | 69,509,125 | 70,788,203 |
| Cash dividends paid per share | \$1.08 | \$0.93 | \$2.01 | \$1.73 |

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

W.W. Grainger, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands of dollars)

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------|------------------|-----------|
| | June 30, 2014 | 2013 | June 30, 2014 | 2013 |
| Net earnings | \$209,077 | \$220,753 | \$428,132 | \$435,280 |
| Other comprehensive earnings (losses): | | | | |
| Foreign currency translation adjustments, net of tax benefit of \$2,103, \$1,988, \$75 and \$3,517, respectively | 23,295 | (38,689) | 8,175 | (69,800) |
| Derivative instruments, net of tax (expense) benefit of \$(1,987), \$(1,862), \$255 and \$(2,994), respectively | 3,176 | 3,657 | (386) | 6,035 |
| Other, net of tax (expense) benefit of \$(1,692), \$430, \$(1,051) and \$722, respectively | 6,045 | (775) | 5,013 | (527) |
| Comprehensive earnings, net of tax | 241,593 | 184,946 | 440,934 | 370,988 |
| Comprehensive earnings (losses) attributable to noncontrolling interest | 4,713 | (1,221) | 8,594 | (5,299) |
| Comprehensive earnings attributable to W.W. Grainger, Inc. | \$236,880 | \$186,167 | \$432,340 | \$376,287 |

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

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

| | (Unaudited) June 30, 2014 | Dec 31, 2013 |
|--|------------------------------|--------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$331,707 | \$430,644 |
| Accounts receivable (less allowances for doubtful accounts of \$21,254 and \$20,096, respectively) | 1,177,543 | 1,101,656 |
| Inventories – net | 1,317,467 | 1,305,520 |
| Prepaid expenses and other assets | 112,598 | 115,331 |
| Deferred income taxes | 66,468 | 75,819 |
| Prepaid income taxes | 24,770 | 15,315 |
| Total current assets | 3,030,553 | 3,044,285 |
| PROPERTY, BUILDINGS AND EQUIPMENT | 2,957,430 | 2,941,090 |
| Less: Accumulated depreciation and amortization | 1,708,342 | 1,732,528 |
| Property, buildings and equipment – net | 1,249,088 | 1,208,562 |
| DEFERRED INCOME TAXES | 16,382 | 16,209 |
| GOODWILL | 554,719 | 525,467 |
| OTHER ASSETS AND INTANGIBLES – NET | 460,570 | 471,805 |
| TOTAL ASSETS | \$5,311,312 | \$5,266,328 |

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

| | (Unaudited) | |
|--|--------------------|--------------------|
| | June 30, 2014 | Dec 31, 2013 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Short-term debt | \$101,617 | \$66,857 |
| Current maturities of long-term debt | 33,352 | 30,429 |
| Trade accounts payable | 513,829 | 510,634 |
| Accrued compensation and benefits | 160,712 | 185,905 |
| Accrued contributions to employees' profit sharing plans | 93,764 | 176,800 |
| Accrued expenses | 214,479 | 218,835 |
| Income taxes payable | 8,700 | 6,330 |
| Total current liabilities | 1,126,453 | 1,195,790 |
| LONG-TERM DEBT (less current maturities) | 432,485 | 445,513 |
| DEFERRED INCOME TAXES AND TAX UNCERTAINTIES | 112,319 | 113,585 |
| EMPLOYMENT-RELATED AND OTHER NON-CURRENT LIABILITIES | 192,031 | 184,604 |
| SHAREHOLDERS' EQUITY | | |
| Cumulative Preferred Stock – \$5 par value – 12,000,000 shares authorized; none issued nor outstanding | — | — |
| Common Stock – \$0.50 par value – 300,000,000 shares authorized; issued 109,659,219 shares | 54,830 | 54,830 |
| Additional contributed capital | 923,061 | 893,055 |
| Retained earnings | 6,105,729 | 5,822,612 |
| Accumulated other comprehensive earnings | 38,687 | 28,914 |
| Treasury stock, at cost – 41,263,408 and 40,805,281 shares, respectively | (3,758,016 |) (3,548,973 |
| Total W.W. Grainger, Inc. shareholders' equity | 3,364,291 | 3,250,438 |
| Noncontrolling interest | 83,733 | 76,398 |
| Total shareholders' equity | 3,448,024 | 3,326,836 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$5,311,312 | \$5,266,328 |

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

W.W. Grainger, Inc. and Subsidiaries
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (In thousands of dollars)
 (Unaudited)

| | Six Months Ended | |
|---|------------------|---------------|
| | June 30, | |
| | 2014 | 2013 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net earnings | \$428,132 | \$435,280 |
| Provision for losses on accounts receivable | 4,782 | 3,783 |
| Deferred income taxes and tax uncertainties | (9,605) | (1,074) |
| Depreciation and amortization | 93,796 | 80,813 |
| Losses (gains) from sales of assets and write-offs | 14,576 | (868) |
| Stock-based compensation | 28,988 | 31,372 |
| Change in operating assets and liabilities – net of business acquisitions and divestitures: | | |
| Accounts receivable | (98,574) | (155,887) |
| Inventories | (13,497) | 57,771 |
| Prepaid expenses and other assets | (4,610) | 31,369 |
| Trade accounts payable | 2,852 | 31,472 |
| Other current liabilities | (127,930) | (128,468) |
| Current income taxes payable | 1,601 | (2,648) |
| Employment-related and other non-current liabilities | 6,712 | 8,088 |
| Other – net | 1,243 | (4,180) |
| Net cash provided by operating activities | 328,466 | 386,823 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Additions to property, buildings and equipment | (156,210) | (83,175) |
| Proceeds from sales of property, buildings and equipment | 5,416 | 2,528 |
| Net cash received (paid) for business divestitures (acquisitions) | 19,199 | (8,234) |
| Other – net | — | 100 |
| Net cash used in investing activities | (131,595) | (88,781) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Borrowings under lines of credit | 44,686 | 105,412 |
| Payments against lines of credit | (64,634) | (114,436) |
| Net borrowings of commercial paper | 54,997 | — |
| Net decrease in long-term debt | (9,538) | (4,845) |
| Proceeds from stock options exercised | 31,816 | 48,142 |
| Excess tax benefits from stock-based compensation | 22,177 | 41,690 |
| Purchase of treasury stock | (235,847) | (202,400) |
| Cash dividends paid | (140,885) | (123,549) |
| Net cash used in financing activities | (297,228) | (249,986) |
| Exchange rate effect on cash and cash equivalents | 1,420 | (11,378) |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | (98,937) | 36,678 |
| Cash and cash equivalents at beginning of year | 430,644 | 452,063 |
| Cash and cash equivalents at end of period | \$331,707 | \$488,741 |

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

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BACKGROUND AND BASIS OF PRESENTATION

W.W. Grainger, Inc. is a broad-line distributor of maintenance, repair and operating supplies, and other related products and services used by businesses and institutions. W.W. Grainger, Inc.'s operations are primarily in the United States and Canada, with a presence in Europe, Asia and Latin America. In this report, the words "Company" or "Grainger" mean W.W. Grainger, Inc. and its subsidiaries.

The Condensed Consolidated Financial Statements of the Company and the related notes are unaudited and should be read in conjunction with the consolidated financial statements and related notes for the year ended December 31, 2013 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC).

The Condensed Consolidated Balance Sheet as of December 31, 2013 has been derived from the audited consolidated financial statements at that date, but does not include all of the disclosures required by accounting principles generally accepted in the United States of America for complete financial statements.

The unaudited financial information reflects all adjustments (primarily consisting of normal recurring adjustments) which, in the opinion of management, are necessary for a fair presentation of the statements contained herein.

2. NEW ACCOUNTING STANDARDS

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. The amendments in ASU 2014-08 raise the threshold for a disposal to qualify as discontinued operations and require new disclosures for individually material disposal transactions that do not meet the definition of a discontinued operation. Under the new standard, companies report discontinued operations when they have a disposal that represents a strategic shift that has or will have a major impact on operations or financial results. This ASU will be applied prospectively and is effective for interim and annual periods beginning after December 15, 2014. Early adoption is permitted provided the disposal was not previously disclosed. This ASU is not expected to have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which will supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of the ASU is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. This ASU will be effective for interim and annual periods beginning after December 15, 2016, and early adoption is not permitted. The ASU allows for either full retrospective or modified retrospective adoption. The Company is currently evaluating the transition method that will be elected and the potential effects of the adoption of this ASU on the Company's consolidated financial statements.

3. DIVIDEND

On July 30, 2014, the Company's Board of Directors declared a quarterly dividend of \$1.08 per share, payable September 1, 2014, to shareholders of record on August 11, 2014.

4. SHORT-TERM DEBT

At June 30, 2014, there was \$55 million of commercial paper outstanding, issued for general working capital needs. The commercial paper matured on July 7, 2014, and was paid off in full.

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W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

5. DERIVATIVE INSTRUMENTS

The Company uses derivative instruments to manage a portion of exposures to fluctuations in interest rates and foreign currency exchange rates. The Company does not enter into derivative financial instruments for trading or speculative purposes. The fair values of these instruments are determined by using quoted market forward rates (level 2 inputs) and reflect the present value of the amount that the Company would pay for contracts involving the same notional amounts and maturity dates. These instruments qualify for hedge accounting and the changes in fair value are reported as a component of other comprehensive earnings (losses) net of tax effects.

As of June 30, 2014 and December 31, 2013, the fair value of the Company's interest rate swap included on the balance sheet as a liability under Employment-related and other noncurrent liabilities was \$3 million for both periods. The purpose of the interest rate swap is to partially hedge the future interest expense of the euro-denominated term loan entered into to fund a portion of the Fabory acquisition in 2011. The swap matures in August 2016.

The Company had a fair value of \$1 million in forward contracts as of June 30, 2014 and December 31, 2013, included on the balance sheet as assets under Prepaid expenses and other assets. The forward contracts were entered into to hedge against adverse changes in the exchange rate on the Company's intercompany loan with the Canadian subsidiary. The contracts expire in September 2014.

6. EMPLOYEE BENEFITS - POSTRETIREMENT

The Company has a postretirement healthcare benefits plan that provides coverage for a majority of its United States employees hired prior to January 1, 2013, and their dependents should they elect to maintain such coverage upon retirement. Covered employees become eligible for participation when they qualify for retirement while working for the Company. Participation in the plan is voluntary and requires participants to make contributions toward the cost of the plan, as determined by the Company.

The net periodic benefit costs charged to operating expenses, which are valued at the measurement date of January 1 and recognized evenly throughout the year, consisted of the following components (in thousands of dollars):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------------------------------|-----------------------------|---------|---------------------------|---------|
| | 2014 | 2013 | 2014 | 2013 |
| Service cost | \$2,252 | \$2,567 | \$4,503 | \$5,294 |
| Interest cost | 2,637 | 2,119 | 5,274 | 4,469 |
| Expected return on assets | (2,060) | (1,769) | (4,119) | (3,538) |
| Amortization of transition asset | (35) | (36) | (71) | (71) |
| Amortization of unrecognized losses | 195 | 746 | 390 | 1,862 |
| Amortization of prior service credits | (1,814) | (1,852) | (3,627) | (3,705) |
| Net periodic benefit costs | \$1,175 | \$1,775 | \$2,350 | \$4,311 |

The Company has established a Group Benefit Trust to fund the plan and process benefit payments. The funding of the trust is an estimated amount which is intended to allow the maximum deductible contribution under the Internal Revenue Code of 1986 (IRC), as amended. There are no minimum funding requirements and the Company intends to follow its practice of funding the maximum deductible contribution under the IRC. As of June 30, 2014, the plan was in an overfunded position, and the Company currently does not anticipate significant contributions to the trust in 2014.

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

During the second quarter of 2014, the Company adopted changes to the retirement plan offered to employees in the Netherlands. The plan was transitioned from a defined benefit plan to a defined contribution plan, and all existing and future obligations under the defined benefit plan have been transferred to a third party. As of December 31, 2013, this pension plan was in an overfunded position with a net pension asset of \$5 million and \$9 million of unrecognized losses included in Accumulated other comprehensive earnings (AOCE). As a result of the plan amendment and settlement, the Company reclassified the unrecognized losses from AOCE to warehousing, marketing and administrative expenses on the Statement of Earnings in an amount of \$9 million, with a corresponding tax benefit to income taxes on the Statement of Earnings in an amount of \$2 million. In addition, the Company recognized a \$3 million write-off related to the plan's assets and liabilities, net of tax. Effective January 1, 2014, the affected employees have an option to participate in the defined contribution plan sponsored by the Company for which contributions are made by the Company and participating employees.

7. SEGMENT INFORMATION

The Company has two reportable segments: the United States and Canada. The United States operating segment reflects the results of the Company's U.S. business. The Canada operating segment reflects the results for Acklands – Grainger Inc., the Company's Canadian business. Other businesses include Zoro, the single channel online business in the United States, and operations in Europe, Asia and Latin America. These other businesses individually do not meet the definition of a reportable segment. Operating segments generate revenue almost exclusively through the distribution of maintenance, repair and operating supplies, as service revenues account for approximately 1% of total revenues for each operating segment. Following is a summary of segment results (in thousands of dollars):

| | Three Months Ended June 30, 2014 | | | |
|---------------------------------|----------------------------------|------------|---------------------|--------------|
| | United States | Canada | Other Businesses | Total |
| Total net sales | \$ 1,992,955 | \$ 264,046 | \$ 298,926 | \$ 2,555,927 |
| Intersegment net sales | (49,358 |) (42 |) (423 |) (49,823 |
| Net sales to external customers | \$ 1,943,597 | \$ 264,004 | \$ 298,503 | \$ 2,506,104 |
| Segment operating earnings | \$ 365,099 | \$ 19,212 | \$(456 |) \$ 383,855 |
| | Three Months Ended June 30, 2013 | | | |
| | United States | Canada | Other Businesses | Total |
| Total net sales | \$ 1,863,112 | \$ 288,645 | \$ 261,282 | \$ 2,413,039 |
| Intersegment net sales | (31,135 |) (112 |) (231 |) (31,478 |
| Net sales to external customers | \$ 1,831,977 | \$ 288,533 | \$ 261,051 | \$ 2,381,561 |
| Segment operating earnings | \$ 338,884 | \$ 37,299 | \$ 12,799 | \$ 388,982 |
| | Six Months Ended June 30, 2014 | | | |
| | United States | Canada | Other Businesses | Total |
| Total net sales | \$ 3,890,265 | \$ 518,342 | \$ 573,832 | \$ 4,982,439 |
| Intersegment net sales | (90,225 |) (88 |) (395 |) (90,708 |
| Net sales to external customers | \$ 3,800,040 | \$ 518,254 | \$ 573,437 | \$ 4,891,731 |
| Segment operating earnings | \$ 718,786 | \$ 40,508 | \$ 8,019 | \$ 767,313 |

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

| | Six Months Ended June 30, 2013 | | | |
|---------------------------------|--------------------------------|-----------|---------------------|-------------|
| | United States | Canada | Other Businesses | Total |
| Total net sales | \$3,637,650 | \$571,786 | \$509,156 | \$4,718,592 |
| Intersegment net sales | (56,025 |) (151 |) (420 |) (56,596 |
| Net sales to external customers | \$3,581,625 | \$571,635 | \$508,736 | \$4,661,996 |
| Segment operating earnings | \$669,772 | \$70,155 | \$21,050 | \$760,977 |
| | | | | |
| | United States | Canada | Other Businesses | Total |
| Segment assets: | | | | |
| June 30, 2014 | \$2,133,561 | \$366,829 | \$390,602 | \$2,890,992 |
| December 31, 2013 | \$2,045,564 | \$392,147 | \$359,007 | \$2,796,718 |

Following are reconciliations of segment information with the consolidated totals per the financial statements (in thousands of dollars):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|-----------|---------------------------|-----------|
| | 2014 | 2013 | 2014 | 2013 |
| Operating earnings: | | | | |
| Total operating earnings for operating segments | \$383,855 | \$388,982 | \$767,313 | \$760,977 |
| Unallocated expenses and eliminations | (43,104 |) (38,910 |) (72,223 |) (67,601 |
| Total consolidated operating earnings | \$340,751 | \$350,072 | \$695,090 | \$693,376 |

| | June 30, 2014 | Dec 31, 2013 |
|--------------------------------------|---------------|--------------|
| Assets: | | |
| Total assets for operating segments | \$2,890,992 | \$2,796,718 |
| Other current and non-current assets | 2,162,687 | 2,118,298 |
| Unallocated assets | 257,633 | 351,312 |
| Total consolidated assets | \$5,311,312 | \$5,266,328 |

Assets for operating segments include net accounts receivable and first-in, first-out inventory which are reported to the Company's Chief Operating Decision Maker. Other current and non-current assets include all other asset balances for the operating segments.

Unallocated expenses and unallocated assets primarily relate to the Company headquarter's support services, which are not part of any business segment, as well as intercompany eliminations. Unallocated expenses include payroll and benefits, depreciation and other costs associated with headquarters-related support services. Unallocated assets include non-operating cash and cash equivalents, certain prepaid expenses and property, buildings and equipment-net.

Unallocated assets decreased by \$94 million at June 30, 2014 compared to December 31, 2013, due to lower cash balances primarily driven by payments for the employee profit sharing plan, share repurchases and dividends.

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

8. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share under the two-class method (in thousands of dollars, except for share and per share amounts):

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------|------------------|------------|
| | June 30, 2014 | 2013 | June 30, 2014 | 2013 |
| Net earnings attributable to W.W. Grainger, Inc. as reported | \$205,915 | \$217,660 | \$422,568 | \$429,498 |
| Distributed earnings available to participating securities | (727) | (826) | (1,562) | (1,717) |
| Undistributed earnings available to participating securities | (1,666) | (2,265) | (3,765) | (5,006) |
| Numerator for basic earnings per share – Undistributed and distributed earnings available to common shareholders | 203,522 | 214,569 | 417,241 | 422,775 |
| Undistributed earnings allocated to participating securities | 1,666 | 2,265 | 3,765 | 5,006 |
| Undistributed earnings reallocated to participating securities | (1,645) | (2,230) | (3,716) | (4,925) |
| Numerator for diluted earnings per share – Undistributed and distributed earnings available to common shareholders | \$203,543 | \$214,604 | \$417,290 | \$422,856 |
| Denominator for basic earnings per share – weighted average shares | 68,453,602 | 69,664,697 | 68,576,232 | 69,613,947 |
| Effect of dilutive securities | 888,283 | 1,136,353 | 932,893 | 1,174,256 |
| Denominator for diluted earnings per share – weighted average shares adjusted for dilutive securities | 69,341,885 | 70,801,050 | 69,509,125 | 70,788,203 |
| Earnings per share two-class method | | | | |
| Basic | \$2.97 | \$3.08 | \$6.08 | \$6.07 |
| Diluted | \$2.94 | \$3.03 | \$6.00 | \$5.97 |

9. CONTINGENCIES AND LEGAL MATTERS

From time to time the Company is involved in various legal and administrative proceedings that are incidental to its business, including 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. As a government contractor selling to federal, state and local governmental entities, the Company is also subject to governmental or regulatory inquiries or audits or other proceedings, including those related to pricing compliance. It is not expected that the ultimate resolution of any of these matters will have, either individually or in the aggregate, a material adverse effect on the Company's consolidated financial position or results of operations.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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 a presence in Europe, Asia and Latin America. Grainger uses a multichannel business model to provide customers with a range of options for finding and purchasing products utilizing sales representatives, catalogs and direct marketing materials and eCommerce. Grainger serves more than 2 million customers worldwide through a network of highly integrated branches, distribution centers, multiple websites and export services.

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. The table below provides these estimated indicators for 2014:

| | 2014 Forecasted Growth | |
|-----------------------|------------------------|--------|
| | United States | Canada |
| GDP | 1.7% | 2.1% |
| Industrial Production | 3.8% | 3.5% |
| Exports | 2.5% | 2.7% |
| Business Investment | 5.8% | 3.2% |
| Business Inventory | 3.4% | — |

Source: Global Insight (July 2014)

In the United States, exports and business investment are two major indicators of MRO spend. According to the Bureau of Economic Analysis, export levels dropped in the beginning of 2014 after growing strongly in the fourth quarter of 2013. For the remainder of 2014, exports are projected to grow in the low single digits versus prior year. Business investment levels also began the year slowly, but recent trends point to a rebound as shipments and orders of nondefense capital goods increased according to a July report by IHS Economics.

The light and heavy manufacturing customer end markets, which represent approximately 30% of Grainger's sales, have historically correlated with manufacturing employment levels and manufacturing output. The United States Department of Labor reported an increase of 1.1% in manufacturing employment levels from June 2013 to June 2014. According to the Federal Reserve, manufacturing output increased 3.5% from June 2013 to June 2014. Grainger's heavy and light manufacturing customer end-markets outperformed these indicators as sales to these customer end-markets increased in the mid to high single digits for the six months of 2014.

While full year 2014 forecasted growth for Canada is positive, the Canadian economy experienced pressure in the first six months of 2014 as the Canadian dollar weakened to new four-year lows. The weak Canadian dollar, along with slow international trade and a 2% drop in the commodity price index for metals and minerals from June 2013 to June 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 for the six months of 2014.

Outlook

On July 17, 2014, Grainger revised the 2014 sales growth guidance from a range of 5 to 9 percent to a range of 5 to 7 percent and also revised the 2014 earnings per share guidance from a range of \$12.10 to \$12.85 to a range of \$12.20 to \$12.60. The revised earnings per share guidance excludes the charge in the second quarter related to the retirement

plan transition costs in Europe.

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W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Matters Affecting Comparability

There were 64 sales days in the second quarter of 2014 and 2013. Grainger completed the E&R Industrial and Safety Solutions acquisitions as well as the divestiture of the four direct marketing brands in the second half of 2013, all of which were immaterial individually and in the aggregate.

Results of Operations – Three Months Ended June 30, 2014

The following table is included as an aid to understanding the changes in Grainger's Condensed Consolidated Statements of Earnings:

| | Three Months Ended June 30, | | Percent | |
|--|-----------------------------|---------|---------------------|----|
| | As a Percent of Net Sales | | Increase/(Decrease) | |
| | 2014 | 2013 | | |
| Net sales | 100.0 | % 100.0 | % 5.2 | % |
| Cost of merchandise sold | 56.9 | 56.0 | 6.8 | |
| Gross profit | 43.1 | 44.0 | 3.2 | |
| Operating expenses | 29.5 | 29.3 | 6.2 | |
| Operating earnings | 13.6 | 14.7 | (2.7 |) |
| Other income (expense) | (0.1 |) (0.1 |) (8.9 |) |
| Income taxes | 5.2 | 5.3 | 2.0 | |
| Noncontrolling interest | 0.1 | 0.2 | 2.2 | |
| Net earnings attributable to W.W. Grainger, Inc. | 8.2 | % 9.1 | % (5.4 |)% |

Grainger's net sales of \$2,506 million for the second quarter of 2014 increased 5% compared with sales of \$2,382 million for the comparable 2013 quarter. The 5% increase for the quarter consisted of the following:

| | Percent |
|---|---------------------|
| | Increase/(Decrease) |
| Volume | 5 |
| Business acquisitions (net of dispositions) | 2 |
| Timing of Good Friday | (1) |
| Foreign exchange | (1) |
| Total | 5% |

Sales to all customer end markets, except contractors and natural resources, increased in the second quarter of 2014. The increase in net sales was led by growth in sales to heavy and light manufacturing, retail and commercial service customers. Refer to the Segment Analysis below for further details. Additionally, the timing of Good Friday impacted sales results for the quarter as it fell in April of 2014 versus March of 2013. Good Friday is typically a day of slower customer activity in the United States with operations closed in Canada and much of Europe and Latin America.

Gross profit of \$1,081 million for the second quarter of 2014 increased 3%. The gross profit margin during the second quarter of 2014 decreased 0.9 percentage point when compared to the same period in 2013, primarily driven by lower margins from the newly acquired businesses, lower margins from the international businesses and faster growth with lower margin customers.

Operating expenses of \$740 million for the second quarter of 2014 increased 6% from \$697 million for the comparable 2013 quarter. Operating expenses in 2014 included a \$14 million non-cash charge related to the transition of the employee retirement plan in Europe from a defined benefit plan to a defined contribution plan. Excluding the retirement plan transition charge, operating expenses increased 4% driven primarily by \$20 million in incremental growth and infrastructure spending, incremental expenses from the newly acquired businesses and a \$7 million

non-cash expense related to the write-off of capitalized software costs primarily in Canada and Mexico. During the second quarter of 2014, a decision was made to implement an integrated IT system across North America as opposed to the previous plan to run two separate instances.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Operating earnings for the second quarter of 2014 were \$341 million, a decrease of 3% compared to the second quarter of 2013. Excluding the retirement plan transition charge mentioned above, operating earnings increased 1% driven by higher sales and positive operating expense leverage, partially offset by lower gross margins.

Net earnings attributed to W.W. Grainger, Inc. for the second quarter of 2014 decreased by 5% to \$206 million from \$218 million in the second quarter of 2013. Diluted earnings per share of \$2.94 in the second quarter of 2014 were 3% lower than the \$3.03 for the second quarter of 2013, due to lower earnings partially offset by lower average shares outstanding.

Segment Analysis

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 Inc., Grainger's Canadian operating segment. Other businesses include Zoro and operations in Europe, Asia and Latin America.

The following comments at the segment and business unit level include external and intersegment net sales and operating earnings. See Note 7 to the Condensed Consolidated Financial Statements.

United States

Net sales were \$1,993 million for the second quarter of 2014, an increase of \$130 million, or 7%, when compared with net sales of \$1,863 million for the same period in 2013. The 7% increase for the quarter consisted of the following:

| | Percent Increase/(Decrease) |
|---|--------------------------------|
| Volume | 6 |
| Business acquisitions (net of dispositions) | 2 |
| Timing of Good Friday | (1) |
| Total | 7% |

The increase in net sales was led by mid-single digit growth to retail, commercial service, natural resource and heavy and light manufacturing customers. Government and reseller customers were up in the low single digits and net sales to contractors were down in the low single digits. As mentioned previously, the timing of Good Friday impacted sales results for the quarter as it fell in April of 2014 versus March of 2013.

The gross profit margin for the second quarter of 2014 decreased 0.8 percentage point compared to the same period in 2013, primarily driven by lower gross margins from the newly acquired businesses and faster growth with lower margin customers.

Operating expenses were up 3% in the second quarter of 2014 versus the second quarter of 2013, driven primarily by incremental expenses from the newly acquired businesses and \$19 million of incremental spending on growth initiatives such as new sales representatives, eCommerce and advertising.

Operating earnings of \$365 million for the second quarter of 2014 increased 8% from \$339 million for the second quarter of 2013, driven by higher sales and positive operating expense leverage, partially offset by lower gross margins.

Canada

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Net sales were \$264 million for the second quarter of 2014, a decrease of \$25 million, or 9%, when compared with \$289 million for the same period in 2013. In local currency, sales decreased 3%. The 9% decrease for the quarter consisted of the following:

| | Percent (Decrease) |
|-----------------------|--------------------|
| Foreign Exchange | (6) |
| Timing of Good Friday | (2) |
| Volume | (1) |
| Total | (9)% |

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Sales performance in Canada was driven by declines in the construction, mining, oil and gas, government, light manufacturing and reseller customer end markets, partially offset by growth to customers in the commercial, forestry, utilities, transportation, heavy manufacturing and retail end markets. As mentioned previously, the timing of Good Friday impacted sales results for the quarter as it fell in April of 2014 versus March of 2013.

The gross profit margin decreased 2.0 percentage points in the second quarter of 2014 versus the second quarter of 2013, due primarily to the unfavorable foreign exchange from products sourced from the United States, inventory markdowns and higher freight costs.

Operating expenses were up 4% in the second quarter of 2014 versus the second quarter of 2013. In local currency, operating expenses increased 11%, primarily due to higher information technology expenses and other employment-related costs. During the 2014 second quarter, Grainger made the decision to implement an integrated IT system across North America as opposed to the previous plan to run two separate instances. As a result, \$4 million of capitalized software costs related to the multiple instance approach was written off in a non-cash charge and an incremental \$1 million was spent on the single IT instance.

Operating earnings of \$19 million for the second quarter of 2014 were down \$18 million, or 48%, versus the second quarter of 2013. In local currency, operating earnings decreased by 45%, driven by lower sales, a lower gross margin and negative operating expense leverage.

Other Businesses

Net sales for other businesses, which include Zoro and operations in Europe, Asia and Latin America, were \$299 million for the second quarter of 2014, an increase of \$38 million, or 14%, when compared with net sales of \$261 million for the same period in 2013. The drivers of net sales for the quarter consisted of the following:

| | Percent Increase/(Decrease) |
|------------------|--------------------------------|
| Volume/Price | 16 |
| Foreign exchange | (2) |
| Total | 14% |

Operating earnings were breakeven in the second quarter of 2014 and were down \$13 million compared to the second quarter of 2013. The weaker earnings performance for the quarter versus prior year was primarily driven by the \$14 million non-cash charge related to the retirement plan transition in Europe as well as a \$2 million write-off of capitalized software development costs in Mexico.

Income Taxes

Grainger's effective income tax rates were 38.2% and 36.5% for the three months ended June 30, 2014 and 2013, respectively. The second quarter of 2014 reflects a higher tax rate due to the effect of the pension transition in Europe. Excluding the pension transition impact, the effective tax rate for the second quarter of 2014 was 37.7%. The second quarter of 2013 reflected a benefit from the resolution of foreign tax matters in that period. Excluding this benefit, the effective tax rate for the second quarter of 2013 was 37.3%.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Matters Affecting Comparability

There were 127 sales days in the six months of 2014 and 2013. Grainger completed the E&R Industrial and Safety Solutions acquisitions as well as the divestiture of the four direct marketing brands in the second half of 2013, all of which were immaterial individually and in the aggregate.

Results of Operations – Six Months Ended June 30, 2014

The following table is included as an aid to understanding the changes in Grainger's Condensed Consolidated Statements of Earnings:

| | Six Months Ended June 30, | | Percent | |
|--|---------------------------|---------|---------------------|----|
| | As a Percent of Net Sales | | Increase/(Decrease) | |
| | 2014 | 2013 | | |
| Net sales | 100.0 | % 100.0 | % 4.9 | % |
| Cost of merchandise sold | 55.9 | 55.4 | 5.9 | |
| Gross profit | 44.1 | 44.6 | 3.7 | |
| Operating expenses | 29.9 | 29.7 | 5.5 | |
| Operating earnings | 14.2 | 14.9 | 0.2 | |
| Other income (expense) | (0.1 |) (0.1 |) 28.4 | |
| Income taxes | 5.4 | 5.5 | 3.0 | |
| Noncontrolling interest | 0.1 | 0.1 | (3.8 |) |
| Net earnings attributable to W.W. Grainger, Inc. | 8.6 | % 9.2 | % (1.6 |)% |

Grainger's net sales of \$4,892 million for the six months of 2014 increased 5% compared with sales of \$4,662 million for the comparable 2013 period. The 5% increase for the period consisted of the following:

| | Percent |
|---|---------------------|
| | Increase/(Decrease) |
| Volume | 3 |
| Business acquisitions (net of dispositions) | 2 |
| Price | 1 |
| Foreign exchange | (1) |
| Total | 5% |

Sales to all customer end markets, except contractors, increased in the six months of 2014. The increase in net sales was led by growth in sales to heavy and light manufacturing, retail and commercial service customers. Refer to the Segment Analysis below for further details.

Gross profit of \$2,157 million for the six months of 2014 increased 4%. The gross profit margin during the six months of 2014 decreased 0.5 percentage point when compared to the same period in 2013, primarily driven by lower margins from the newly acquired businesses, lower margins from the international businesses and faster growth with lower margin customers, partially offset by price inflation exceeding cost inflation.

Operating expenses of \$1,462 million for the six months of 2014 increased 6% from \$1,385 million for the comparable 2013 period. Operating expenses in 2014 included a \$14 million non-cash charge related to the transition of the employee retirement plan in Europe from a defined benefit plan to a defined contribution plan. Excluding the retirement plan transition charge, operating expenses increased 5% driven primarily by \$51 million in incremental growth and infrastructure spending, incremental expenses from the newly acquired businesses and a \$7 million non-cash expense related to the write-off of capitalized software costs. As mentioned previously, a decision was made in the second quarter of 2014 to implement an integrated IT system across North America as opposed to the previous

plan to run two separate instances.

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W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Operating earnings for the six months of 2014 were \$695 million or essentially flat compared to the six months of 2013. Excluding the retirement plan transition charge mentioned above, operating earnings increased 2% driven by higher sales and positive operating expense leverage, partially offset by lower gross margins.

Net earnings attributed to W.W. Grainger, Inc. for the six months of 2014 decreased by 2% to \$423 million from \$429 million in the six months of 2013. Diluted earnings per share of \$6.00 in the six months of 2014 were 1% higher than the \$5.97 for the six months of 2013, due to lower average shares outstanding, partially offset by lower earnings.

Segment Analysis

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 Inc., Grainger's Canadian operating segment. Other businesses include Zoro and operations in Europe, Asia and Latin America.

The following comments at the segment and business unit level include external and intersegment net sales and operating earnings. See Note 7 to the Condensed Consolidated Financial Statements.

United States

Net sales were \$3,890 million for the six months of 2014, an increase of \$252 million, or 7%, when compared with net sales of \$3,638 million for the same period in 2013. The 7% increase for the period consisted of the following:

| | Percent Increase |
|---|------------------|
| Volume | 4 |
| Business acquisitions (net of dispositions) | 2 |
| Price | 1 |
| Total | 7% |

The increase in net sales was led by high single digit growth to heavy manufacturing and natural resource customers, followed by mid-single digit growth to light manufacturing, commercial service and retail customers. Government and reseller customers were up in the low single digits and net sales to contractors were down in the low single digits.

The gross profit margin for the six months of 2014 decreased 0.5 percentage point compared to the same period in 2013, primarily driven by lower gross margins from the newly acquired businesses and faster growth with lower margin customers, partially offset by price inflation exceeding cost inflation.

Operating expenses were up 5% in the six months of 2014 versus the six months of 2013, driven by \$45 million of incremental spending on growth initiatives such as new sales representatives, eCommerce and advertising as well as incremental expenses from the newly acquired businesses.

Operating earnings of \$719 million for the six months of 2014 increased 7% from \$670 million for the six months of 2013, driven by higher sales and positive operating expense leverage, partially offset by lower gross margins.

Canada

Net sales were \$518 million for the six months of 2014, a decrease of \$54 million, or 9%, when compared with \$572 million for the same period in 2013. In local currency, sales decreased 2%. The 9% decrease for the period consisted of the following:

| | Percent (Decrease) |
|------------------|--------------------|
| Foreign Exchange | (7) |
| Volume | (2) |

Total (9)%

Sales performance in Canada was driven by declines in the construction, oil and gas, mining, government and light manufacturing customer end markets, partially offset by growth from utilities, forestry and transportation customer end markets.

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W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

The gross profit margin decreased 1.1 percentage points in the six months of 2014 versus the six months of 2013, due to the effect of unfavorable foreign exchange from products sourced from the United States, inventory markdowns and higher freight costs.

Operating expenses were up 2% in the six months of 2014 versus the six months of 2013. In local currency, operating expenses increased 10%, primarily due to higher payroll, benefits and information technology expenses. During the second quarter of 2014, Grainger made the decision to implement an integrated IT system across North America as opposed to the previous plan to run two separate instances. As a result, \$4 million of capitalized software costs related to the multiple instance approach was written off in a non-cash charge and an incremental \$3 million was spent on both the single IT instance and other information technology costs.

Operating earnings of \$41 million for the six months of 2014 were down \$29 million, or 42%, versus the six months of 2013. In local currency, operating earnings decreased by 38%, driven by lower sales, higher operating expenses and lower gross margins.

Other Businesses

Net sales for other businesses, which include Zoro and operations in Europe, Asia and Latin America, were \$574 million for the six months of 2014, an increase of \$65 million, or 13%, when compared with net sales of \$509 million for the same period in 2013. The drivers of net sales for the period consisted of the following:

| | Percent Increase/(Decrease) |
|------------------|--------------------------------|
| Volume/Price | 17 |
| Foreign exchange | (4) |
| Total | 13% |

Operating earnings of \$8 million in the six months of 2014 were down \$13 million compared to the six months of 2013. The weaker earnings performance for the period versus prior year was primarily driven by the \$14 million non-cash charge related to the retirement plan transition in Europe as well as a \$2 million write-off of capitalized software development costs in Mexico.

Income Taxes

Grainger's effective income tax rates were 38.0% and 36.9% for the six months ended June 30, 2014 and 2013, respectively. The effective tax rate in 2014 reflects a higher rate due to the effect of the pension transition in Europe. Excluding the pension transition impact, the effective tax rate for the six months of 2014 was 37.7%. The effective tax rate in 2013 reflected a benefit from the resolution of foreign tax matters in that period. Excluding this benefit, the effective tax rate for the six months of 2013 was 37.3%.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Financial Condition

Cash Flow

Cash from operating activities continues to serve as Grainger's primary source of liquidity. Net cash provided by operating activities was \$328 million and \$387 million for the six months ended June 30, 2014 and 2013, respectively. The reduction in cash flows from operating activities was driven primarily by higher inventory purchases, partially offset by changes in other operating assets and liabilities.

Net cash used in investing activities was \$132 million and \$89 million for the six months ended June 30, 2014 and 2013, respectively. The higher use of cash was driven by cash expended for additions to property, buildings, equipment and capitalized software.

Net cash used in financing activities was \$297 million and \$250 million for the six months ended June 30, 2014 and 2013, respectively. The \$47 million increase in cash used in financing activities for the six months ended June 30, 2014 was due to an increase in the purchase of treasury stock and dividends paid, partially offset by proceeds from the issuance of commercial paper.

Working Capital

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 at June 30, 2014, was \$1,865 million, an increase of \$244 million when compared to \$1,621 million at December 31, 2013. The working capital assets to working capital liabilities ratio increased to 2.9 at June 30, 2014, from 2.5 at December 31, 2013. The increase primarily related to higher receivable balances driven by sales volume as well as lower profit sharing accruals due to the timing of annual payments.

Debt

Grainger maintains a debt ratio and liquidity position that provide 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. Total debt as a percent of total capitalization was 14.1% at June 30, 2014, and 14.0% at December 31, 2013.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

Critical Accounting Policies and 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. For a description of Grainger's critical accounting policies see Grainger's Annual Report on Form 10-K for the year ended December 31, 2013.

Forward-Looking Statements

This Form 10-Q 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. Grainger has generally identified such forward-looking statements by using words such as "anticipate, assumptions, believes, continues, could, does not, estimated, estimates, expected, expects, forecasted, future, guidance, historically correlated, if, intended, intends, maintain, maintains, may, not expected, projected, projecting, provide, range, reasonably likely, should, tend, tend to positively correlate, tend to shape, trends, will, will be applied, will be elected, would, would pay" or similar expressions.

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 which 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; facilities disruptions or shutdowns; higher fuel costs or disruptions in transportation services; natural and other catastrophes and unanticipated weather conditions.

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.

W.W. Grainger, Inc. and Subsidiaries

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about market risk, see “Item 7A: Quantitative and Qualitative Disclosures About Market Risk” in Grainger's Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

Item 4. 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.

Changes in Internal Control Over Financial Reporting

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

PART II – OTHER INFORMATION

Items 1A, 3, 4 and 5 not applicable.

Item 1. Legal Proceedings

Information on specific and significant legal proceedings is set forth in Note 9 to the Condensed Consolidated Financial Statements included under Item 1.

W.W. Grainger, Inc. and Subsidiaries

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities – Second 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 |
|------------------|--------------------------------------|----------------------------------|--|--|
| Apr. 1 – Apr. 30 | 57,296 | \$250.80 | 57,296 | 10,000,000 |
| May 1 – May 31 | 147,107 | \$252.48 | 147,107 | 9,852,893 |
| June 1 – June 30 | 129,212 | \$261.47 | 129,212 | 9,723,681 |
| Total | 333,615 | \$255.66 | 333,615 | |

(A) There were no shares withheld to satisfy tax withholding obligations in connection with the vesting of employee restricted stock awards.

(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 in April were made pursuant to a share repurchase program approved by Grainger's Board of Directors on July 28, 2010. On April 30, 2014, the Board of Directors restored the authority to repurchase up to 10 million shares. The program has no specified expiration date. Activity is reported on a trade date basis.

Item 6. Exhibits

- (a) Exhibits (numbered in accordance with Item 601 of Regulation S-K)
- (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
 - 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.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

W.W. Grainger, Inc.
(Registrant)

Date: July 31, 2014

By: /s/ R. L. Jadin
R. L. Jadin, Senior Vice President
and Chief Financial Officer

Date: July 31, 2014

By: /s/ G. S. Irving
G. S. Irving, Vice President
and Controller