

GRAINGER W W INC
Form 10-Q
July 28, 2011

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, 2011
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 69,893,007 shares of the Company’s Common Stock outstanding as of June 30, 2011.

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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, | | June 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Net sales | \$2,003,022 | \$1,783,696 | \$3,886,634 | \$3,456,050 |
| Cost of merchandise sold | 1,140,628 | 1,036,610 | 2,194,626 | 2,003,222 |
| Gross profit | 862,394 | 747,086 | 1,692,008 | 1,452,828 |
| Warehousing, marketing and administrative expenses | 597,112 | 532,171 | 1,164,112 | 1,055,028 |
| Operating earnings | 265,282 | 214,915 | 527,896 | 397,800 |
| Other income and (expense): | | | | |
| Interest income | 527 | 280 | 1,007 | 521 |
| Interest expense | (1,980) |) (2,220) |) (3,858) |) (4,250) |
| Equity in net income (loss) of unconsolidated entity | 32 |) (171) |) 132 |) (251) |
| Other non-operating income | 383 | 539 | 530 | 966 |
| Other non-operating expense | (418) |) (547) |) (717) |) (1,000) |
| Total other income and (expense) | (1,456) |) (2,119) |) (2,906) |) (4,014) |
| Earnings before income taxes | 263,826 | 212,796 | 524,990 | 393,786 |
| Income taxes | 92,257 | 83,129 | 194,333 | 164,702 |
| Net earnings | 171,569 | 129,667 | 330,657 | 229,084 |
| Net earnings attributable to noncontrolling interest | 1,684 | 590 | 2,839 | 834 |
| Net earnings attributable to W.W. Grainger, Inc. | \$169,885 | \$129,077 | \$327,818 | \$228,250 |
| Earnings per share: | | | | |
| Basic | \$2.39 | \$1.76 | \$4.62 | \$3.10 |
| Diluted | \$2.34 | \$1.73 | \$4.52 | \$3.04 |
| Weighted average number of shares outstanding: | | | | |
| Basic | 69,608,563 | 71,691,961 | 69,507,657 | 72,128,117 |
| Diluted | 71,122,909 | 72,931,206 | 71,016,638 | 73,386,284 |
| Cash dividends paid per share | \$0.66 | \$0.54 | \$1.20 | \$1.00 |

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, | | June 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Net earnings | \$ 171,569 | \$ 129,667 | \$ 330,657 | \$ 229,084 |
| Other comprehensive earnings (losses): | | | | |
| Foreign currency translation adjustments, net of tax (expense) benefit of \$(412), \$2,813, \$(2,209) and \$519, respectively | 12,236 | (17,113) | 27,226 | 1,763 |
| Derivative instruments, net of tax benefit of \$492, \$0, \$1,895 and \$0, respectively | (776) | — | (2,989) | — |
| Comprehensive earnings, net of tax | 183,029 | 112,554 | 354,894 | 230,847 |
| Comprehensive earnings attributable to noncontrolling interest | 4,472 | 4,020 | 4,213 | 3,988 |
| Comprehensive earnings attributable to W.W. Grainger, Inc. | \$ 178,557 | \$ 108,534 | \$ 350,681 | \$ 226,859 |

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)

| | June 30, 2011 (Unaudited) | Dec 31, 2010 |
|--|------------------------------|--------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$465,705 | \$313,454 |
| Accounts receivable (less allowances for doubtful accounts of \$18,800 and \$24,552, respectively) | 870,436 | 762,895 |
| Inventories – net | 996,600 | 991,577 |
| Prepaid expenses and other assets | 89,976 | 87,125 |
| Deferred income taxes | 48,358 | 44,627 |
| Prepaid income taxes | 35,183 | 38,393 |
| Total current assets | 2,506,258 | 2,238,071 |
| PROPERTY, BUILDINGS AND EQUIPMENT | 2,445,521 | 2,377,760 |
| Less: Accumulated depreciation and amortization | 1,464,179 | 1,414,088 |
| Property, buildings and equipment – net | 981,342 | 963,672 |
| DEFERRED INCOME TAXES | 89,460 | 87,244 |
| GOODWILL | 394,291 | 387,232 |
| OTHER ASSETS AND INTANGIBLES – NET | 229,084 | 228,158 |
| TOTAL ASSETS | \$4,200,435 | \$3,904,377 |

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

| | June 30, 2011 (Unaudited) | Dec 31, 2010 |
|---|------------------------------|--------------------|
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Short-term debt | \$49,220 | \$42,769 |
| Current maturities of long-term debt | 236,538 | 31,059 |
| Trade accounts payable | 394,086 | 344,295 |
| Accrued compensation and benefits | 175,507 | 169,343 |
| Accrued contributions to employees' profit sharing plans | 82,309 | 145,119 |
| Accrued expenses | 128,093 | 130,836 |
| Income taxes payable | 13,020 | 5,882 |
| Total current liabilities | 1,078,773 | 869,303 |
| LONG-TERM DEBT (less current maturities) | 200,469 | 420,446 |
| DEFERRED INCOME TAXES, TAX UNCERTAINTIES AND DERIVATIVE INSTRUMENTS | 83,607 | 82,502 |
| ACCRUED EMPLOYMENT-RELATED BENEFITS COSTS | 262,785 | 244,456 |
| 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 | 652,913 | 637,686 |
| Retained earnings | 4,569,434 | 4,326,761 |
| Accumulated other comprehensive earnings | 65,814 | 42,951 |
| Treasury stock, at cost – 39,766,212 and 40,281,417 shares, respectively | (2,854,693) | (2,857,012) |
| Total W.W. Grainger, Inc. shareholders' equity | 2,488,298 | 2,205,216 |
| Noncontrolling interest | 86,503 | 82,454 |
| Total shareholders' equity | 2,574,801 | 2,287,670 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$4,200,435 | \$3,904,377 |

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, | |
| | 2011 | 2010 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net earnings | \$330,657 | \$229,084 |
| Provision for losses on accounts receivable | 3,030 | 3,437 |
| Deferred income taxes and tax uncertainties | (9,979) | (5,713) |
| Depreciation and amortization | 66,044 | 71,901 |
| Stock-based compensation | 29,413 | 25,964 |
| Change in operating assets and liabilities – net of business acquisitions: | | |
| Accounts receivable | (107,281) | (99,770) |
| Inventories | 2,493 | 28,396 |
| Prepaid expenses and other assets | 683 | 17,596 |
| Trade accounts payable | 49,476 | 47,332 |
| Other current liabilities | (79,208) | (40,252) |
| Current income taxes payable | 7,280 | (5,173) |
| Accrued employment-related benefits cost | 18,219 | 13,373 |
| Other – net | (1,358) | 109 |
| Net cash provided by operating activities | 309,469 | 286,284 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Additions to property, buildings and equipment – net of dispositions | (79,800) | (26,942) |
| Net cash paid for business acquisitions and other investments | (12) | (41,046) |
| Net cash used in investing activities | (79,812) | (67,988) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Borrowings under lines of credit | 140,505 | 12,067 |
| Payments against lines of credit | (134,786) | (7,835) |
| Payments of long-term debt | (14,499) | (20,606) |
| Proceeds from stock options exercised | 37,926 | 46,112 |
| Excess tax benefits from stock-based compensation | 21,954 | 14,317 |
| Purchase of treasury stock | (50,769) | (256,503) |
| Cash dividends paid | (85,783) | (74,628) |
| Net cash used in financing activities | (85,452) | (287,076) |
| Exchange rate effect on cash and cash equivalents | 8,046 | (3,034) |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 152,251 | (71,814) |
| Cash and cash equivalents at beginning of year | 313,454 | 459,871 |
| Cash and cash equivalents at end of period | \$465,705 | \$388,057 |

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 an expanding presence in 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, 2010 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, 2010 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. DIVIDEND

On July 27, 2011, the Company's Board of Directors declared a quarterly dividend of 66 cents per share, payable September 1, 2011, to shareholders of record on August 8, 2011.

3. WARRANTY RESERVES

The Company generally warrants the products it sells against defects for one year. For a significant portion of warranty claims, the manufacturer of the product is responsible for the expenses associated with this warranty program. For warranty expenses not covered by the manufacturer, the Company provides a reserve for future costs based on historical experience. The warranty reserve activity was as follows (in thousands of dollars):

| | Six Months Ended June 30, | |
|-------------------|---------------------------|----------|
| | 2011 | 2010 |
| Beginning balance | \$3,171 | \$3,238 |
| Returns | (4,743 |) (5,144 |
| Provision | 4,665 | 5,303 |
| Ending balance | \$3,093 | \$3,397 |

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

4. DERIVATIVE INSTRUMENTS

The Company uses foreign currency forward contracts to minimize the foreign exchange rate effect on its net investment in its Canadian subsidiary. These forward contracts are designated and qualify as a hedge of a net investment in a foreign subsidiary. The Company uses the forward method of assessing hedge effectiveness for derivatives designated as hedging instruments of a net investment in a foreign subsidiary. All changes in fair value of the derivatives are reported as a component of other comprehensive earnings (losses), net of tax effects, as long as specific hedge accounting criteria are met. The Company from time to time also enters into cash flow hedging instruments. The Company does not enter into derivative financial instruments for trading or speculative purposes.

During the fourth quarter of 2010, the Company entered into multiple foreign currency forward contracts with a total notional value of Canadian Dollar (CAD) \$160 million maturing in September 2014. At June 30, 2011 and December 31, 2010, the fair value of these contracts (Level 2 input) included in Deferred income taxes, tax uncertainties and derivative instruments was a liability of \$10.7 million and \$5.8 million, respectively.

5. EMPLOYEE BENEFITS

Postretirement Benefits

The Company has a postretirement healthcare benefits plan that provides coverage for a majority of its employees 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, | |
|---------------------------------------|-----------------------------|---------|---------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Service cost | \$3,940 | \$3,573 | \$7,881 | \$7,146 |
| Interest cost | 3,338 | 3,213 | 6,676 | 6,426 |
| Expected return on assets | (1,447) | (1,108) | (2,895) | (2,217) |
| Amortization of transition asset | (36) | (36) | (71) | (71) |
| Amortization of unrecognized losses | 818 | 912 | 1,635 | 1,824 |
| Amortization of prior service credits | (124) | (123) | (248) | (247) |
| Net periodic benefit costs | \$6,489 | \$6,431 | \$12,978 | \$12,861 |

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. During the three and six months ended June 30, 2011, the Company contributed \$1.2 million and \$2.2 million to the trust.

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

6. SEGMENT INFORMATION

The Company has two reportable segments: the United States and Canada. The United States operating segment reflects the results of Grainger's U.S. business. The Canada operating segment reflects the results for Acklands – Grainger Inc., the Company's Canadian business. Other Businesses include the following operating segments which are not material individually and in the aggregate: MonotaRO Co., Ltd. (Japan), Grainger, S.A. de C.V. (Mexico), Grainger Industrial Supply India Private Limited (India), Grainger Caribe Inc. (Puerto Rico), Grainger China LLC (China), Grainger Colombia SAS (Colombia) and Grainger Panama S.A. (Panama). Operating segments generate revenue almost exclusively through the distribution of maintenance, repair and operating supplies as service revenues account for less than 1% of total revenues for each operating segment. Following is a summary of segment results (in thousands of dollars):

| | Three Months Ended June 30, 2011 | | | |
|---------------------------------|----------------------------------|-----------|---------------------|-------------|
| | United States | Canada | Other Businesses | Total |
| Total net sales | \$1,625,776 | \$256,912 | \$135,648 | \$2,018,336 |
| Intersegment net sales | (15,110) | (26) | (178) | (15,314) |
| Net sales to external customers | \$1,610,666 | \$256,886 | \$135,470 | \$2,003,022 |
| Segment operating earnings | \$270,592 | \$29,240 | \$8,617 | \$308,449 |
| | Three Months Ended June 30, 2010 | | | |
| | United States | Canada | Other Businesses | Total |
| Total net sales | \$1,497,424 | \$207,852 | \$90,818 | \$1,796,094 |
| Intersegment net sales | (12,264) | (28) | (106) | (12,398) |
| Net sales to external customers | \$1,485,160 | \$207,824 | \$90,712 | \$1,783,696 |
| Segment operating earnings | \$231,027 | \$12,698 | \$1,934 | \$245,659 |
| | Six Months Ended June 30, 2011 | | | |
| | United States | Canada | Other Businesses | Total |
| Total net sales | \$3,163,462 | \$499,285 | \$252,517 | \$3,915,264 |
| Intersegment net sales | (28,243) | (81) | (306) | (28,630) |
| Net sales to external customers | \$3,135,219 | \$499,204 | \$252,211 | \$3,886,634 |
| Segment operating earnings | \$527,008 | \$53,178 | \$15,025 | \$595,211 |
| | Six Months Ended June 30, 2010 | | | |
| | United States | Canada | Other Businesses | Total |
| Total net sales | \$2,905,565 | \$401,991 | \$171,739 | \$3,479,295 |
| Intersegment net sales | (22,970) | (54) | (221) | (23,245) |
| Net sales to external customers | \$2,882,595 | \$401,937 | \$171,518 | \$3,456,050 |
| Segment operating earnings | \$432,642 | \$19,012 | \$1,852 | \$453,506 |

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

| | United States | Canada | Other Businesses | Total |
|-------------------|---------------|-----------|---------------------|-------------|
| Segment assets: | | | | |
| June 30, 2011 | \$2,427,994 | \$674,606 | \$478,473 | \$3,581,073 |
| December 31, 2010 | \$2,365,532 | \$605,023 | \$446,216 | \$3,416,771 |

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, | |
|--|-----------------------------|-----------|---------------------------|----------------------|
| | 2011 | 2010 | 2011 | 2010 |
| Operating earnings: | | | | |
| Total operating earnings for reportable segments | \$308,449 | \$245,659 | \$595,211 | \$453,506 |
| Unallocated expenses and eliminations | (43,167 |) (30,744 |) (67,315 |) (55,706 |
| Total consolidated operating earnings | \$265,282 | \$214,915 | \$527,896 | \$397,800 |
| | | | June 30, 2011 | December 31, 2010 |
| Assets: | | | | |
| Total assets for reportable segments | | | \$3,581,073 | \$3,416,771 |
| Unallocated assets | | | 619,362 | 487,606 |
| Total consolidated assets | | | \$4,200,435 | \$3,904,377 |

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

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

7. 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, 2011 | 2010 | June 30, 2011 | 2010 |
| Net earnings attributable to W.W. Grainger, Inc. as reported | \$ 169,885 | \$ 129,077 | \$ 327,818 | \$ 228,250 |
| Distributed earnings available to participating securities | (831) | (654) | (1,641) | (1,389) |
| Undistributed earnings available to participating securities | (2,447) | (2,076) | (5,118) | (3,536) |
| Numerator for basic earnings per share – Undistributed and distributed earnings available to common shareholders | 166,607 | 126,347 | 321,059 | 223,325 |
| Undistributed earnings allocated to participating securities | 2,447 | 2,076 | 5,118 | 3,536 |
| Undistributed earnings reallocated to participating securities | (2,397) | (2,042) | (5,012) | (3,477) |
| Numerator for diluted earnings per share – Undistributed and distributed earnings available to common shareholders | \$ 166,657 | \$ 126,381 | \$ 321,165 | \$ 223,384 |
| Denominator for basic earnings per share – weighted average shares | 69,608,563 | 71,691,961 | 69,507,657 | 72,128,117 |
| Effect of dilutive securities | 1,514,346 | 1,239,245 | 1,508,981 | 1,258,167 |
| Denominator for diluted earnings per share – weighted average shares adjusted for dilutive securities | 71,122,909 | 72,931,206 | 71,016,638 | 73,386,284 |
| Earnings per share two-class method | | | | |
| Basic | \$2.39 | \$1.76 | \$4.62 | \$3.10 |
| Diluted | \$2.34 | \$1.73 | \$4.52 | \$3.04 |

W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

8. CONTINGENCIES AND LEGAL MATTERS

As previously reported, in December 2007, the Company received a letter from the Commercial Litigation Branch of the Civil Division of the Department of Justice (the DOJ) regarding the Company's contract with the United States General Services Administration (the GSA). The letter suggested that the Company had not complied with its disclosure obligations and the contract's pricing provisions, and had potentially overcharged government customers under the contract.

Discussions with the DOJ relating to the Company's compliance with its disclosure obligations and the contract's pricing provisions are ongoing. The timing and outcome of these discussions are uncertain and could include settlement or civil litigation by the DOJ to recover, among other amounts, treble damages and penalties under the False Claims Act. Due to uncertainties surrounding this matter, an estimate of possible loss cannot be determined. While this matter is not expected to have a material adverse effect on the Company's financial position, an unfavorable resolution could result in significant payments by the Company. The Company continues to believe that it has complied with the GSA contract in all material respects.

As previously reported, the Company received a subpoena dated August 29, 2008 from the United States Postal Service (USPS) Office of Inspector General seeking information about the Company's pricing compliance under the Company's contract with the USPS covering the sale of certain Maintenance Repair and Operating Supplies (the MRO Contract).

As previously reported, the Company received a subpoena dated June 30, 2009 from the USPS Office of Inspector General seeking information about the Company's pricing practices and compliance under the Company's contract with the USPS covering the sale of certain janitorial and custodial items (the Custodial Contract).

Discussions with the USPS and DOJ relating to the Company's pricing practices and compliance with the pricing provisions of the MRO Contract and the Custodial Contract are ongoing. The timing and outcome of the USPS and DOJ investigations are uncertain and could include settlement or civil litigation by the USPS and DOJ to recover, among other amounts, treble damages and penalties under the False Claims Act. Due to uncertainties surrounding these matters, an estimate of possible loss cannot be determined. While these matters are not expected to have a material adverse effect on the Company's financial position, an unfavorable resolution could result in significant payments by the Company. The Company continues to believe that it has complied with each of the MRO Contract and the Custodial Contract in all material respects.

W.W. Grainger, Inc. and Subsidiaries

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

Item 2.

Overview

General

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 an expanding presence in 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, direct marketing materials and catalogs. Grainger serves approximately 2.0 million customers worldwide through a network of highly integrated branches, distribution centers, multiple websites and export services.

Grainger's two reportable segments are the United States and Canada. The United States segment reflects the results of Grainger's U.S. business. The Canada segment reflects the results for Acklands – Grainger Inc., Grainger's Canadian business. Other businesses include the following: MonotaRO Co., Ltd. (Japan), Grainger, S.A. de C.V. (Mexico), Grainger Industrial Supply India Private Limited (India), Grainger Caribe Inc. (Puerto Rico), Grainger China LLC (China), Grainger Colombia SAS (Colombia) and Grainger Panama S.A. (Panama).

Business Environment

Several economic factors and industry trends tend to shape Grainger's business environment. The overall economy and leading economic indicators provide insight into anticipated Company performance for the near term and help in forming the development of projections for the rest of the year. Historically, Grainger's sales trends have tended to correlate with industrial production and non-farm payrolls. According to the Federal Reserve, overall industrial production increased 3.4% from June 2010 to June 2011. The improvement in the economy has positively affected Grainger's sales growth for the six months of 2011.

In July 2011, Consensus Forecasts-USA projected 2011 Industrial Production and GDP growth for the United States of 4.2% and 2.5%, respectively. In July 2011, Consensus Forecasts-USA projected GDP growth of 2.8% for Canada.

The light and heavy manufacturing customer end-markets have historically correlated with manufacturing employment levels and manufacturing output. Manufacturing output increased 1.4% from June 2010 to June 2011 while manufacturing employment levels increased 0.8%. Grainger's heavy and light manufacturing customer end-markets outperformed these indicators as sales to these customer end-markets increased in the high teens and high single digits, respectively, for both the second quarter and six months ended of 2011.

Outlook

Despite more difficult sales comparisons to the second half of 2010 and heavier growth investments for the remainder of 2011, Grainger raised 2011 sales growth guidance on July 19, 2011 to a range of 9 to 10 percent and earnings per share guidance to a range of \$8.40 to \$8.70. The second quarter of 2011 included a \$0.12 per share benefit primarily from the settlement of tax examinations related to 2007 and 2008. This benefit is excluded from Company guidance. In April 2011, the Company issued 2011 guidance of 7 to 10 percent sales growth and earnings per share of \$8.10 to \$8.60.

Gross profit margins in the third and fourth quarters of 2011 are expected to be similar to the 2011 second quarter, with some slight price erosion during the second half of the year.

Operating expenses are anticipated to be higher for the remainder of the year driven by increased spending on growth initiatives such as additional sales representatives, eCommerce and advertising. In addition, there will be incremental operating expenses associated with the opening of the new distribution center in Northern California in the 2011 fourth quarter.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
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Matters Affecting Comparability

Grainger completed several acquisitions throughout 2010, all of which were immaterial individually and in the aggregate. Grainger's operating results have included the results of each business acquired since the respective acquisition dates.

Results of Operations – Three Months Ended June 30, 2011

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 Increase (Decrease) | |
|--|-----------------------------|---------|--------------------------------|---|
| | As a Percent of Net Sales | | | |
| | 2011 | 2010 | | |
| Net sales | 100.0 | % 100.0 | % 12.3 | % |
| Cost of merchandise sold | 56.9 | 58.1 | 10.0 | |
| Gross profit | 43.1 | 41.9 | 15.4 | |
| Operating expenses | 29.9 | 29.8 | 12.2 | |
| Operating earnings | 13.2 | 12.1 | 23.4 | |
| Other income (expense) | (0.1 |) (0.1 |) (31.3 |) |
| Income taxes | 4.6 | 4.7 | 11.0 | |
| Noncontrolling interest | 0.0 | 0.0 | — | |
| Net earnings attributable to W.W. Grainger, Inc. | 8.5 | % 7.3 | % 31.6 | % |

Grainger's net sales of \$2,003.0 million for the second quarter of 2011 increased 12% compared with sales of \$1,783.7 million for the comparable 2010 quarter. For the quarter, approximately 8 percentage points of the sales growth came from an increase in volume. Approximately 2 percentage points came from price and foreign exchange each and approximately 1 percentage point of the sales growth came from business acquisitions, partially offset by a 1 percentage point decrease related to 2010 sales of products used to assist with the oil spill clean up in the Gulf of Mexico. The overall increase in net sales was led by a high teens increase to heavy manufacturing and agriculture and mining customers, followed by a high single-digit increase to light manufacturing customers. Refer to the Segment Analysis below for further details.

Gross profit of \$862.4 million for the second quarter of 2011 increased 15%. The gross profit margins during the second quarter of 2011 increased 1.2 percentage points when compared to the same period in 2010, primarily driven by selling price increases exceeding product cost increases.

Operating expenses of \$597.1 million for the second quarter of 2011 increased 12%, primarily driven by higher payroll and benefits expenses due to increased headcount and higher profit sharing tied to Company performance. In addition, the 2010 second quarter benefitted by \$10.3 million from a paid time off policy change. Excluding this benefit, operating expenses increased 10% in the second quarter of 2011.

Operating earnings for the second quarter of 2011 were \$265.3 million, an increase of 23% compared to the second quarter of 2010. The increase in operating earnings was primarily due to higher gross profit margins.

Net earnings attributed to W.W. Grainger, Inc. for the second quarter of 2011 increased by 32% to \$169.9 million from \$129.1 million in the second quarter of 2010. The increase in net earnings for the quarter primarily resulted from an increase in operating earnings and a lower effective tax rate. Diluted earnings per share of \$2.34 in the second quarter of 2011 were 35% higher than the \$1.73 for the second quarter of 2010 due to increased net earnings and fewer shares outstanding. The second quarter of 2011 included a \$0.12 per share benefit primarily from the settlement

of tax examinations related to 2007 and 2008. The second quarter of 2010 included one unusual non-cash item, an \$0.08 per share benefit from a paid time off policy change. Excluding the impact of both items, earnings per share increased 35% in 2011 versus the 2010 second quarter.

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W.W. Grainger, Inc. and Subsidiaries

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

Segment Analysis

The following comments at the segment and business unit level include external and intersegment net sales and operating earnings. See Note 6 to the Condensed Consolidated Financial Statements.

United States

Net sales were \$1,625.8 million for the second quarter of 2011, an increase of \$128.4 million, or 9%, when compared with net sales of \$1,497.4 million for the same period in 2010. For the quarter, approximately 7 percentage points of the sales growth came from an increase in volume and approximately 3 percentage points due to price, partially offset by a 1 percentage point decrease related to 2010 sales of products used to assist with the oil spill clean up in the Gulf of Mexico. Sales to all except one customer end-markets increased for the second quarter of 2011. The overall increase in net sales was led by a mid teens increase to heavy manufacturing customers. The agriculture and mining customer end-market declined due to the difficult comparison from the oil spill in the prior year.

The gross profit margin increased 1.2 percentage points in the second quarter of 2011 over the comparable quarter of 2010 primarily driven by price increases exceeding product cost increases.

Operating expenses were up 9% in the second quarter of 2011 versus the second quarter of 2010, primarily driven by higher payroll and benefits expenses due to increased headcount and higher profit sharing tied to Company performance. In addition, the 2010 second quarter benefitted by \$9.3 million from a paid time off policy change. Excluding this benefit, operating expenses increased 6% in the second quarter of 2011.

Operating earnings of \$270.6 million for the second quarter of 2011 increased 17% from \$231.0 million for the second quarter of 2010. The increase in operating earnings for the quarter was primarily due to higher sales and an improved gross profit margin.

Canada

Net sales were \$256.9 million for the second quarter of 2011, an increase of \$49.0 million, or 24%, when compared with \$207.9 million for the same period in 2010. Daily sales were up 16% in local currency for the quarter driven by 12 percentage points from volume, 3 percentage points from acquisitions and 1 percentage point from price. The increase in net sales was led by growth in the oil and gas, heavy manufacturing, retail and agriculture and mining customer end-markets.

The gross profit margin increased 2.6 percentage points in the second quarter of 2011 versus the second quarter of 2010 driven by less price discounting and better customer mix. In addition, a modest selling price increase along with product cost deflation tied to the strength of the Canadian dollar contributed to this expansion.

Operating expenses were up 13% in the second quarter of 2011 versus the second quarter of 2010. In local currency, operating expenses increased 6% primarily due to higher bonus accruals and occupancy expenses, partly offset by lower commissions, severance and professional services.

Operating earnings of \$29.2 million for the second quarter of 2011 were up \$16.5 million, or 130% over the second quarter of 2010. In local currency, operating earnings increased 117% in the second quarter of 2011 over the same period in 2010. The increase in earnings was due higher sales, an improved gross profit margin and operating expenses which increased at a slower rate than sales.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
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Other Businesses

Net sales for other businesses, which include Japan, Mexico, India, Puerto Rico, China, Colombia and Panama, increased 49% for the second quarter of 2011 when compared to the same period in 2010. The sales increase was due to strong growth from Japan and Mexico, along with incremental sales from the business in Colombia, acquired in June 2010. Operating earnings were \$8.6 million for the second quarter of 2011, compared to \$1.9 million in the second quarter of 2010. The increase was primarily driven by strong earnings growth in Japan and Mexico along with lower operating losses in China and India and incremental earnings from Colombia.

Other Income and Expense

Other income and expense was expense of \$1.5 million in the second quarter of 2011, a decrease of \$0.6 million compared to \$2.1 million of expense in the second quarter of 2010.

Income Taxes

Grainger's effective income tax rates were 35.0% and 39.1% for the second quarter of 2011 and 2010, respectively. The 2011 effective rate benefited primarily from the settlement of tax examinations related to 2007 and 2008. Excluding this benefit, the effective tax rate is now expected to be 38.7% for the full year due to higher earnings forecasted in foreign jurisdictions with lower tax rates and a slightly lower overall effective state tax rate.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
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Matters Affecting Comparability

There were 128 and 127 sales days in the six months of 2011 and 2010, respectively. Grainger completed several acquisitions throughout 2010, all of which were immaterial individually and in the aggregate. Grainger's operating results have included the results of each business acquired since the respective acquisition dates.

Results of Operations – Six Months Ended June 30, 2011

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 Increase (Decrease) | |
|--|---------------------------|---------|--------------------------------|---|
| | As a Percent of Net Sales | | | |
| | 2011 | 2010 | | |
| Net sales | 100.0 | % 100.0 | % 12.5 | % |
| Cost of merchandise sold | 56.5 | 58.0 | 9.6 | |
| Gross profit | 43.5 | 42.0 | 16.5 | |
| Operating expenses | 29.9 | 30.5 | 10.3 | |
| Operating earnings | 13.6 | 11.5 | 32.7 | |
| Other income (expense) | (0.1 |) (0.1 |) (27.6 |) |
| Income taxes | 5.0 | 4.8 | 18.0 | |
| Noncontrolling interest | 0.1 | 0.0 | 240.6 | |
| Net earnings attributable to W.W. Grainger, Inc. | 8.4 | % 6.6 | % 43.6 | % |

Grainger's net sales of \$3,886.6 million for the six months of 2011 increased 12% compared with sales of \$3,456.1 million for the comparable 2010 period. Sales were also up 12% on a daily basis. For the six months, approximately 8 percentage points of the sales growth came from an increase in volume, approximately 2 percentage points from price and approximately 1 percentage point of the sales growth came from each of business acquisitions and foreign exchange. Sales to all customer end-markets increased for the six months of 2011. The overall increase in net sales was led by a high teens increase to heavy manufacturing and agriculture and mining customers, followed by a high single-digit increase to light manufacturing customers. Refer to the Segment Analysis below for further details.

Gross profit of \$1,692.0 million during the six months of 2011 increased 16%. The gross profit margins during the six months of 2011 increased 1.5 percentage points when compared to the same period in 2010, primarily driven by price increases exceeding product cost increases.

Operating expenses of \$1,164.1 million during the six months of 2011 increased 10%, primarily driven by higher payroll and benefits expenses due to increased headcount and higher profit sharing tied to Company performance. In addition, the first six months of 2010 benefitted by \$20.6 million from a paid time off policy change. Excluding this benefit, operating expenses increased 9% in the six months of 2011.

Operating earnings during the six months of 2011 were \$527.9 million, an increase of 33% compared to the same period in 2010. The increase in operating earnings was due to higher sales, improved gross profit margins and operating expenses which increased at a slower rate than sales.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
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Net earnings for the six months of 2011 increased by 44% to \$327.8 million from \$228.3 million in the six months of 2010. The increase in net earnings for the quarter primarily resulted from an increase in operating earnings and a lower effective tax rate. Diluted earnings per share of \$4.52 in the six months of 2011 were 49% higher than the \$3.04 in the six months of 2010 due to increased net earnings and fewer shares outstanding. The first six months of 2011 included a \$0.12 per share benefit primarily from the settlement of tax examinations related to 2007 and 2008. In 2010, there were two unusual non-cash items: a \$0.17 per share benefit from a paid time off policy change and a \$0.15 per share expense related to the tax treatment of retiree healthcare benefits following the passage of the Patient Protection and Affordable Care Act, which resulted in a net benefit of \$0.02 per share. Excluding unusual items in both years, earnings per share for the first half of 2011 increased 46% versus 2010.

Segment Analysis

The following comments at the segment and business unit level include external and intersegment net sales and operating earnings. See Note 6 to the Condensed Consolidated Financial Statements.

United States

Net sales were \$3,163.5 million for the six months of 2011, an increase of \$257.9 million, or 9%, when compared with net sales of \$2,905.6 million for the same period in 2010. Sales in the United States were up 8% on a daily basis. Approximately 6 percentage points of the daily sales growth came from an increase in volume and approximately 2 percentage points due to price. Sales to all customer end-markets increased during the six months of 2011. The overall increase in net sales was led by a high teens increase to heavy manufacturing customers.

The gross profit margin increased 1.5 percentage points in the six months of 2011 over the comparable period of 2010 primarily driven by price increases exceeding product cost increases.

Operating expenses were up 8% in the six months of 2011 versus the six months of 2010, primarily driven by higher payroll and benefits expenses due to increased headcount and higher profit sharing tied to Company performance. In addition, the first six months of 2010 benefitted by \$18.6 million from a paid time off policy change. Excluding this benefit, operating expenses increased 6% in the six months of 2011.

Operating earnings of \$527.0 million for the six months of 2011 increased 22% from \$432.6 million for the six months of 2010. The increase in operating earnings for the six months was due to higher sales, an improved gross profit margin and operating expenses which increased at a slower rate than sales.

Canada

Net sales were \$499.3 million for the six months of 2011, an increase of \$97.3 million, or 24%, when compared with \$402.0 million for the same period in 2010. Daily sales were up 23% or 16% in local currency for the six months driven by 11 percentage points from volume, 4 percentage points from acquisitions and 1 percentage point from price. The increase in net sales was led by growth in the oil and gas, heavy manufacturing, retail and agriculture and mining customer end-markets.

The gross profit margin increased 3.2 percentage points in the six months of 2011 versus the six months of 2010 driven by less price discounting and better customer mix. In addition, a modest selling price increase along with product cost deflation tied to the strength of the Canadian dollar contributed to this expansion.

Operating expenses were up 13% in the six months of 2011 versus the six months of 2010. In local currency, operating expenses increased 7% primarily due to higher payroll, bonus accruals and occupancy expenses, partially

offset by lower severance, advertising and bad debt expense.

Operating earnings of \$53.2 million for the six months of 2011 were up \$34.2 million, or 180% over the six months of 2010. In local currency, operating earnings increased 164% in the six months of 2011 over the same period in 2010. The increase in earnings was primarily due to an improved gross profit margin and operating expenses which increased at a slower rate than sales.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
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Other Businesses

Net sales for other businesses, which include Japan, Mexico, India, Puerto Rico, China, Colombia and Panama, increased 47% for the six months of 2011 when compared to the same period in 2010. The sales increase was due to strong growth from Japan and Mexico, along with incremental sales from the business in Colombia, acquired in June 2010. Operating earnings were \$15.0 million for the six months of 2011, compared to \$1.9 million from the six months of 2010. The increase was primarily driven by strong earnings growth in Japan and Mexico along with lower operating losses in China and India and incremental earnings from Colombia.

Other Income and Expense

Other income and expense was expense of \$2.9 million in the six months of 2011, a decrease of \$1.1 million compared to \$4.0 million of expense in the six months of 2010.

Income Taxes

Grainger's effective income tax rates were 37.0% and 41.8% for the six months of 2011 and 2010, respectively. The 2011 effective rate benefited primarily from the settlement of tax examinations related to 2007 and 2008. Excluding the effect of this one-time benefit, the effective tax rate is now expected to be 38.7% for the full year due to higher earnings forecasted in foreign jurisdictions with lower tax rates and a slightly lower overall effective state tax rate. The effective tax rate for the first six months of 2010, excluding the impact from the healthcare legislation in the first quarter of 2010, was 39.3%.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
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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 \$309.5 million and \$286.3 million for the six months ended June 30, 2011 and 2010, respectively. Contributing to cash flows from operations were net earnings in the six months ended June 30, 2011 of \$330.7 million compared to \$229.1 million in 2010. Offsetting these amounts were changes in operating assets and liabilities, which resulted in a net use of cash of \$108.3 million in the first six months of 2011 compared to \$38.5 million in the first six months of 2010. This increase was primarily driven by other current liabilities which declined in part due to annual cash payments for profit sharing and bonuses, which were higher in 2011 versus 2010.

Net cash used in investing activities was \$79.8 million and \$68.0 million for the six months ended June 30, 2011 and 2010, respectively. Net cash expended for additions to property, buildings, equipment and capitalized software was \$79.8 million in the six months ended June 30, 2011 versus \$26.9 million in the six months ended June 30, 2010. Capital expenditures in 2011 included funding of infrastructure improvement projects for distribution centers in the United States and Canada.

Net cash used in financing activities was \$85.5 million and \$287.1 million for the six months ended June 30, 2011 and 2010, respectively. The \$201.6 million reduction in cash used in financing activities for the six months ended June 30, 2011 was due primarily to lower treasury share repurchases. Cash paid for treasury stock purchases was \$50.8 million for the six months ended June 30, 2011 versus \$256.5 million for the six months ended June 30, 2010. Grainger also used cash to pay dividends to shareholders of \$85.8 million and \$74.6 million for the six months ended June 30, 2011 and 2010, respectively.

Working Capital

Working capital at June 30, 2011, was \$1,427.5 million, an increase of \$58.7 million when compared to \$1,368.8 million at December 31, 2010. The increase in working capital primarily relates to higher cash and accounts receivable balances on higher sales. The ratio of current assets to current liabilities decreased to 2.3 at June 30, 2011 from 2.6 at December 31, 2010. The decrease was primarily due to an increase in current maturities of long-term debt as the balance of the term loan is due within one year.

Debt

Grainger maintains a debt ratio and liquidity position that provides flexibility in funding working capital needs and long-term cash requirements. In addition to internally generated funds, Grainger has various sources of financing available, including bank borrowings under lines of credit. Total debt as a percent of total capitalization was 15.9% at June 30, 2011 and 17.8% at December 31, 2010.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
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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 the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

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 "anticipated, believes, continued, continues, continues to believe it complies, could, earnings per share guidance, estimate, estimated, expected, forecasted, growth initiatives, guidance, had potentially, intended, intends, historically correlated, may, not expected to have a material adverse effect, possible, projected, projections, range, reasonably likely, sales growth guidance, should, slight price erosion, tended, timing and outcome are uncertain, trends, unanticipated, uncertainties, and will" 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.

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 the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

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 and 5 not applicable.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
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Item 1. Legal Proceedings

As previously reported, in December 2007, the Company received a letter from the Commercial Litigation Branch of the Civil Division of the Department of Justice (the DOJ) regarding the Company's contract with the United States General Services Administration (the GSA). The letter suggested that the Company had not complied with its disclosure obligations and the contract's pricing provisions, and had potentially overcharged government customers under the contract.

Discussions with the DOJ relating to the Company's compliance with its disclosure obligations and the contract's pricing provisions are ongoing. The timing and outcome of these discussions are uncertain and could include settlement or civil litigation by the DOJ to recover, among other amounts, treble damages and penalties under the False Claims Act. Due to uncertainties surrounding this matter, an estimate of possible loss cannot be determined. While this matter is not expected to have a material adverse effect on the Company's financial position, an unfavorable resolution could result in significant payments by the Company. The Company continues to believe that it has complied with the GSA contract in all material respects.

As previously reported, the Company received a subpoena dated August 29, 2008 from the United States Postal Service (USPS) Office of Inspector General seeking information about the Company's pricing compliance under the Company's contract with the USPS covering the sale of certain Maintenance Repair and Operating Supplies (the MRO Contract).

As previously reported, the Company received a subpoena dated June 30, 2009 from the USPS Office of Inspector General seeking information about the Company's pricing practices and compliance under the Company's contract with the USPS covering the sale of certain janitorial and custodial items (the Custodial Contract).

Discussions with the USPS and DOJ relating to the Company's pricing practices and compliance with the pricing provisions of the MRO Contract and the Custodial Contract are ongoing. The timing and outcome of the USPS and DOJ investigations are uncertain and could include settlement or civil litigation by the USPS and DOJ to recover, among other amounts, treble damages and penalties under the False Claims Act. Due to uncertainties surrounding these matters, an estimate of possible loss cannot be determined. While these matters are not expected to have a material adverse effect on the Company's financial position, an unfavorable resolution could result in significant payments by the Company. The Company continues to believe that it has complied with each of the MRO Contract and the Custodial Contract in all material respects.

W.W. Grainger, Inc. and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
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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 | — | — | — | 7,705,641 shares |
| May 1 – May 31 | — | — | — | 7,705,641 shares |
| June 1 – June 30 | — | — | — | 7,705,641 shares |
| Total | — | — | — | |

(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 were made pursuant to a share repurchase program approved by Grainger's Board of Directors on July 28, 2010. The program has no specified expiration date. Activity is reported on a trade date basis.

W.W. Grainger, Inc. and Subsidiaries

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
 - (a) Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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 28, 2011

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

Date: July 28, 2011

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