UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

[X] **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2007

OR

[ ] **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number 1-5684

W.W. Grainger, Inc.

(Exact name of registrant as specified in its charter)

Illinois (State or other jurisdiction of incorporation or organization)	**36-1150280** (I.R.S. Employer Identification No.)
100 Grainger Parkway, Lake Forest, Illinois (Address of principal executive offices)	**60045-5201** (Zip Code)

(847) 535-1000
(Registrant's telephone number including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock $0.50 par value, and accompanying Preferred Share Purchase Rights	New York Stock Exchange Chicago Stock Exchange

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

Yes __X__ No _____

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

Yes _____ No __X__

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 __X__ No _____

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

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

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

Yes _____ No __X__

The aggregate market value of the voting common equity held by nonaffiliates of the registrant was $6,823,136,530 as of the close of trading as reported on the New York Stock Exchange on June 30, 2007. The Company does not have nonvoting common equity.

The registrant had 78,963,866 shares of common stock outstanding as of January 31, 2008.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement relating to the annual meeting of shareholders of the registrant to be held on April 30, 2008, are incorporated by reference into Part III hereof.

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PART I

Item 1: Business

The Company

W.W. Grainger, Inc., incorporated in the State of Illinois in 1928, is in the service business. It distributes products used by businesses and institutions primarily across North America to keep their facilities and equipment running. In this report, the words “Grainger” or “Company” mean W.W. Grainger, Inc. and its subsidiaries.

Grainger uses a multichannel business model to serve approximately 1.8 million customers of all sizes with multiple ways to find and purchase facilities maintenance and other products through a network of branches, sales representatives, call centers, catalogs and other direct marketing media and the Internet. Orders can be placed via telephone, fax, Internet or in person. Products are available for immediate pick-up or for shipment.

Operations are managed and reported in three segments. The three reportable segments are Grainger Branch-based, Acklands – Grainger Branch-based (Acklands – Grainger) and Lab Safety Supply, Inc. (Lab Safety). Grainger Branch-based is an aggregation of the following business units: Grainger Industrial Supply (Industrial Supply), Grainger, S.A. de C.V. (Mexico), Grainger Caribe Inc. (Puerto Rico) and Grainger China LLC (China). Acklands – Grainger is the Company’s Canadian branch-based distribution business. Lab Safety is a direct marketer of safety and other industrial products.

Grainger has internal business support functions which provide coordination and guidance in the areas of accounting, administrative services, business development, communications, compensation and benefits, employee development, enterprise systems, environmental, finance, health and safety, human resources, insurance and risk management, internal audit, investor relations, legal, real estate and construction services, security, taxes and treasury services. These services are provided in varying degrees to all business units.

Grainger does not engage in basic or substantive product research and development activities. Items are regularly added to and deleted from Grainger’s product lines on the basis of market research, customer demand, recommendations of suppliers, sales volumes and other factors.

Grainger Branch-based

The Grainger Branch-based businesses provide customers with product solutions for facility maintenance and other product needs through logistics networks which are configured for rapid product availability. Grainger offers a broad selection of facility maintenance and other products through local branches, catalogs and the Internet. The more significant businesses in this segment are described below.

Industrial Supply

Industrial Supply offers U.S. businesses and institutions a combination of product breadth, local availability, speed of delivery, detailed product information, simplicity of ordering and competitively priced products. Industrial Supply distributes material handling equipment, safety and security supplies, lighting and electrical products, power and hand tools, pumps and plumbing supplies, cleaning and maintenance supplies and many other items. Its customers range from small and medium-sized businesses to large corporations, governmental entities at local, state and federal levels, and other institutions. During 2007, Industrial Supply completed an average of 92,000 sales transactions daily.

Industrial Supply operates 434 branches located in all 50 states. These branches are located within 20 minutes of the majority of U.S. businesses and serve the immediate needs of their local markets by allowing customers to pick up items directly from the branches.

Branches range in size from small, will-call branches to large master branches. The Grainger Express® will-call locations average 2,200 square feet, do not stock inventory and provide convenient pick-up locations. Branches primarily fulfill counter and will-call needs and provide customer service. Master branches handle counter and will-call customers, and ship to customers for other branches and themselves. In total, branches average 21,000 square feet in size, have 13 employees and handle about 125 transactions per day. In 2007, Industrial Supply opened eight full-size and four will-call branches, relocated 19 branches and expanded or remodeled 29 branches. In 2007, four branches were closed.

Industrial Supply’s distribution network is comprised of nine distribution centers (DCs). Using automated equipment and processes, the DCs handle most of the customer shipping and also replenish branch inventories.

Industrial Supply sells principally to customers in industrial and commercial maintenance departments, service shops, manufacturers, hotels, government, retail organizations, transportation businesses, contractors, and healthcare and educational facilities. Sales transactions during 2007 were made to approximately 1.4 million customers.
Approximately 23% of 2007 sales consisted of private label items bearing Grainger’s registered trademarks, including DAYTON® (principally electric motors, heating and ventilation equipment, and liquid pumps), SPEEDAIRE® (air compressors), AIR HANDLER® (air filtration equipment), DEM-KOTE® (spray paints), WESTWARD® (principally hand and power tools), CONDOR™ (safety products) and LUMAPRO® (task and outdoor lighting). Grainger has taken steps to protect these trademarks against infringement and believes that they will remain available for future use in its business. Sales of remaining items generally consisted of products carrying the names of other well-recognized brands.

The Industrial Supply catalog, most recently issued in February 2008, offers almost 183,000 facility maintenance and other products. Approximately 1.8 million copies of the catalog were produced.

Customers can also purchase products through grainger.com. This Web site serves as a prominent service channel for the Industrial Supply division. Customers have access to more than 400,000 products through grainger.com. It is available 24/7, providing real-time product availability, customer-specific pricing, multiple product search capabilities, customer personalization, and links to customer support and the fulfillment system. For large customers interested in connecting to grainger.com through sophisticated purchasing platforms, grainger.com has a universal connection. This technology translates the different data formats used by electronic marketplaces, exchanges, and e-procurement systems and allows these systems to communicate directly with Industrial Supply's operating platform.

Industrial Supply purchases products for sale from approximately 1,400 suppliers, most of which are manufacturers. No single supplier comprised more than 5% of Industrial Supply's purchases and no significant difficulty has been encountered with respect to sources of supply.

Through a global sourcing operation, Industrial Supply procures competitively priced, high-quality products produced outside the United States from approximately 230 suppliers. Grainger businesses sell these items primarily under private labels. Products obtained through the global sourcing operation include DAYTON® motors, WESTWARD® tools, LUMAPRO® lighting products and CONDOR™ safety products, as well as products bearing other trademarks.

Mexico

Grainger's operations in Mexico provide local businesses with facility maintenance and other products from both Mexico and the United States. In 2007, Mexico opened five branches and two master branches bringing their total number of locations to 15. The business ships products to customers as well as fulfills counter and will-call needs. The largest facility, an 85,000 square foot DC, is located outside of Monterrey, Mexico. During 2007, approximately 950 transactions were completed daily. Customers have access to approximately 35,000 products through a Spanish-language catalog or through grainger.com.mx.

China

Grainger operates in China from a 126,000 square foot DC with a showroom located in Shanghai and five surrounding will-call locations. Customers have access to approximately 30,000 products through a Chinese-language catalog or through grainger.com.cn.

Acklands – Grainger Branch-based

Acklands – Grainger is Canada's leading broad-line distributor of industrial and safety supplies. It serves customers through 153 branches and five DCs across Canada. Acklands – Grainger distributes tools, fasteners, safety supplies, instruments, welding and shop equipment, and many other items. During 2007, approximately 14,000 sales transactions were completed daily. A comprehensive catalog, printed in both English and French, showcases the product line to facilitate customer selection. This catalog, with more than 56,000 products, supports the efforts of account managers and branch personnel throughout Canada. In addition, customers can purchase products through acklandsgrainger.com, a fully bilingual Web site.

Lab Safety

Lab Safety is a direct marketer of safety and other industrial products to U.S. and Canadian businesses. Headquartered in Janesville, Wisconsin, Lab Safety primarily reaches its customers through the distribution of multiple branded catalogs and other marketing materials distributed throughout the year to targeted markets. Brands include LSS, Ben Meadows (forestry), Gempler's (agriculture), AW Direct (service vehicle accessories), Rand Materials (material handling), Professional Inspection Equipment and Construction Book Express (building and home inspection) and McFeely's Square Drive Screws (woodworking). Customers can purchase products by telephone, fax or through lss.com and other branded Web sites.

Lab Safety offers extensive product depth, technical support and high service levels. During 2007, Lab Safety issued 13 unique catalogs covering safety supplies, material handling and facility maintenance products, lab supplies, security and other products targeted to specific customer groups. Lab Safety provides access to approximately 163,000 products through its targeted catalogs and distributes products from two DCs.

Industry Segments

Operations are managed and reported in the following three segments: Grainger Branch-based, Acklands – Grainger and Lab Safety. Grainger Branch-based is an aggregation of the following business units: Grainger Industrial Supply, Grainger, S.A. de C.V., Grainger Caribe Inc. and Grainger China LLC. Acklands – Grainger is the Company's Canadian branch-based distribution business. Lab Safety is a direct marketer of safety and other industrial products. For segment and geographical information and consolidated net sales and operating earnings see **"Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations"** and Note 18 to the Consolidated Financial Statements.

Competition

Grainger faces competition in all markets it serves, from manufacturers (including some of its own suppliers) that sell directly to certain segments of the market, wholesale distributors, catalog houses and retail enterprises.

Grainger provides local product availability, sales representatives, competitive pricing, catalogs (which include product descriptions and, in certain cases, extensive technical and application data), electronic and Internet commerce technology and other services to assist customers in lowering their total facility maintenance costs. Grainger believes that it can effectively compete with manufacturers on small orders, but manufacturers may have an advantage in filling large orders.

Grainger serves a number of diverse markets. Based on available data, Grainger estimates the North American market for facilities maintenance and related products to be more than $145 billion, of which Grainger's share is approximately 4 percent. There are several large competitors, although most of the market is served by small local and regional competitors.

Employees

As of December 31, 2007, Grainger had 18,036 employees, of whom 15,732 were full-time and 2,304 were part-time or temporary. Grainger has never had a major work stoppage and considers employee relations to be good.

Web Site Access to Company Reports

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

Item 1A: Risk Factors

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

A slowdown in economic activity could negatively impact Grainger's sales growth. Economic and industry trends affect Grainger's business environments. Grainger's sales growth has tended to correlate with commercial activity, manufacturing output and non-farm employment levels. Thus, a slowdown in economic activity could negatively impact Grainger's sales growth.

The facilities maintenance industry is a highly fragmented industry, and competition could result in a decreased demand for Grainger's products and services. There are several large competitors in the industry, although most of the market is served by small local and regional competitors. Grainger faces competition in all markets it serves, from manufacturers (including some of its own suppliers) that sell directly to certain segments of the market, wholesale distributors, catalog houses and retail enterprises. Competitive pressures could adversely affect Grainger's sales and profitability.

Unexpected product shortages could negatively impact customer relationships, resulting in an adverse impact on results of operations. Grainger's competitive strengths include product selection and availability. Products are purchased from approximately 3,000 key suppliers, no one of which accounts for more than 5% of purchases. Historically, no significant difficulty has been encountered with respect to sources of supply. If Grainger were to experience difficulty in obtaining products, there could be a short-term adverse effect on results of operations and a longer-term adverse effect on customer relationships and Grainger's reputation. In addition, Grainger has strategic relationships with key vendors. In the event Grainger was unable to maintain those relations, there might be a loss of competitive pricing advantages which could in turn adversely affect results of operations.

A delay in the completion or lower than projected results from Grainger's multiyear market expansion program could negatively affect anticipated future sales growth. In 2004, Grainger launched a six phase market expansion program in the United States to strengthen its presence in top metropolitan markets and better position itself to serve the local customer. The program is being implemented in these markets in a phased approach. The success of the market expansion program is expected to be a driver of growth in 2008 and beyond. The first phase of the market expansion program was completed in 2005. The second, third and fourth phases of the market expansion program were completed in 2007. Phases five and six were more than 50% complete at December 31, 2007, and are expected to be completed during 2008. A delay in the completion of the program or lower than projected results from the program could negatively impact anticipated future sales growth.

The addition of new product lines could impact future sales growth. Grainger, from time to time, expands the breadth of its offerings by increasing the number of products it distributes. In 2006, Grainger launched a multiyear product line expansion program. The success of the expansion program is expected to be a driver of growth in 2008 and beyond. The success of these expansions will depend on Grainger's ability to accurately forecast market demand, obtain products from suppliers and effectively integrate these products into the supply chain.

Interruptions in the proper functioning of information systems could disrupt operations and cause unanticipated increases in costs or decreases in revenues, or both. The proper functioning of Grainger's information systems is critical to the successful operation of its business. Although Grainger's information systems are protected through physical and software safeguards and remote processing capabilities exist, information systems are still vulnerable to natural disasters, power losses, unauthorized access, telecommunication failures and other problems. If critical information systems fail or are otherwise unavailable, Grainger's ability to process orders, identify business opportunities, maintain proper levels of inventories, collect accounts receivable, pay expenses and maintain the security of Company and customer data could be adversely affected.

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

Changes in accounting standards, subjective assumptions and estimates used by management related to complex accounting matters could have an adverse effect on results of operations. Generally accepted accounting principles in the United States and related accounting pronouncements, implementation guidance and interpretations with regard to a wide range of matters, such as stock-based compensation, insurance and inventory reserves, income taxes and postretirement healthcare benefits are highly complex and involve many subjective assumptions, estimates and judgments by management. Changes in these rules or their interpretations or changes in underlying assumptions, estimates or judgments by management could significantly change reported results.

Item 1B: Unresolved Staff Comments

None.

Item 2: Properties

As of December 31, 2007, Grainger's owned and leased facilities totaled 19,731,000 square feet, an increase of approximately 3% from December 31, 2006. This increase primarily related to the market expansion program. Industrial Supply and Acklands – Grainger accounted for the majority of the total square footage. Industrial Supply facilities are located throughout the United States and Acklands – Grainger facilities are located throughout Canada.

Industrial Supply branches range in size from 1,200 to 109,000 square feet and average approximately 21,000 square feet. Most are located in or near major metropolitan areas with many located in industrial parks. Typically, a branch is on one floor, consists primarily of warehouse space, sales areas and offices and has off-the-street parking for customers and employees. Grainger believes that its properties are generally in good condition and well maintained.

A brief description of significant facilities follows:

Location	Facility and Use (6)	Size in Square Feet (in 000's)
United States (1)	434 Industrial Supply branch locations	9,686
United States (2)	Nine Distribution Centers	5,100
United States (3)	Four Lab Safety facilities	826
International (4)	Other facilities	628
Canada (5)	164 Acklands – Grainger facilities	2,164
Chicago Area	Headquarters and General Offices	1,327
	Total Square Feet	19,731

(1) Industrial Supply branches consist of 285 owned and 149 leased properties and other properties under construction. Most leases expire between 2008 and 2017.
(2) These facilities are all owned.
(3) Lab Safety facilities consist of general offices and a distribution center which are owned, one leased office facility, one leased storage facility and one leased distribution center.
(4) Other facilities include owned and leased locations for Puerto Rico, Mexico and China.
(5) Acklands – Grainger facilities consist of general offices, distribution centers and branches, of which 55 are owned and 109 leased.
(6) Owned facilities are not subject to any mortgages.

Item 3: Legal Proceedings

Grainger has been named, along with numerous other nonaffiliated companies, as a defendant in litigation in various states involving asbestos and/or silica. These lawsuits typically assert claims of personal injury arising from alleged exposure to asbestos and/or silica as a consequence of products purportedly distributed by Grainger. As of January 14, 2008, Grainger is named in cases filed on behalf of approximately 2,800 plaintiffs in which there is an allegation of exposure to asbestos and/or silica.

Grainger has denied, or intends to deny, the allegations in all of the above-described lawsuits. In 2007, lawsuits relating to asbestos and/or silica and involving approximately 250 plaintiffs were dismissed with respect to Grainger, typically based on the lack of product identification. If a specific product distributed by Grainger is identified in any of these lawsuits, Grainger would attempt to exercise indemnification remedies against the product manufacturer. In addition, Grainger believes that a substantial number of these claims are covered by insurance. Grainger is engaged in active discussions with its insurance carriers regarding the scope and amount of coverage. While Grainger is unable to predict the outcome of these lawsuits, it believes that the ultimate resolution will not have, either individually or in the aggregate, a material adverse effect on Grainger's consolidated financial position or results of operations.

Grainger is a party to a contract with the United States General Services Administration (the "GSA") first entered into in 1999 and subsequently extended in 2004. The GSA contract has been the subject of an ongoing audit performed by the GSA's Office of the Inspector General (the "OIG") and Grainger has previously responded to subpoenas issued by the OIG in connection with its audit. In December of 2007, Grainger received a letter from the Justice Department's Commercial Litigation Branch of the Civil Division suggesting that Grainger had not complied with the GSA contract's disclosure obligations and pricing provisions, and had potentially overcharged government customers under the contract. On January 29, 2008, the Justice Department intervened in a civil "qui tam" action previously filed under seal by a former employee of Grainger in the U.S. District Court for the Eastern District of Wisconsin relating to the GSA contract. The complaint alleges that Grainger failed to comply with pricing provisions of the GSA contract and that sales made by Grainger pursuant to the contract violated the Buy American Act and Trade Agreement Act. The complaint seeks various remedies including treble damages, statutory penalties and disgorgement of profits. Although Grainger believes that it has complied with the GSA contract in all material respects, it is unable, at this time, to predict the outcome of this matter.

In addition to the foregoing, from time to time Grainger is involved in various other legal and administrative proceedings that are incidental to its business, including claims relating to product liability, general negligence, environmental issues, employment, intellectual property and other matters. As a government contractor, from time to time Grainger is also subject to governmental or regulatory inquiries or audits or other proceedings, including those related to pricing compliance and Trade Agreement Act 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 Grainger's consolidated financial position or results of operations.

Item 4: Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of 2007.

Executive Officers

Following is information about the Executive Officers of Grainger including age as of February 27, 2008. Executive Officers of Grainger generally serve until the next annual election of officers, or until earlier resignation or removal.

Name and Age	Positions and Offices Held and Principal Occupations and Employment During the Past Five Years
Court D. Carruthers (35)	Senior Vice President, a position assumed in 2007, and President of Acklands – Grainger Inc., a position assumed in 2006. Prior to assuming the last-mentioned position, Mr. Carruthers served as Vice President, National Accounts and Sales of Acklands – Grainger Inc.
Y. C. Chen (60)	President, Grainger Industrial Supply, a position assumed in 2007. Mr. Chen had previously been the Company's Group President, a position assumed in 2006 after serving as Senior Vice President, Supply Chain Management, a position assumed in 2003.
Nancy A. Hobor (61)	Senior Vice President, Communications and Investor Relations, a position assumed in 1999.
John L. Howard (50)	Senior Vice President and General Counsel, a position assumed in 2000.
Ronald L. Jadin (47)	Vice President and Controller, a position assumed in 2006 after serving as Vice President, Finance - Grainger Industrial Supply, a position assumed in 2000.
Richard L. Keyser (65)	Chairman of the Board, a position assumed in 1997, and Chief Executive Officer, a position assumed in 1995.
Larry J. Loizzo (53)	Senior Vice President of the Company, a position assumed in 2003, and President of Lab Safety Supply, Inc., a position assumed in 1996.
P. Ogden Loux (65)	Senior Vice President, Finance and Chief Financial Officer, positions assumed in 1997.
James T. Ryan (49)	President and Chief Operating Officer, a position assumed in 2007. Mr. Ryan had previously been the Company's President, a position assumed in 2006 after serving as Group President. Before assuming that position in 2004, Mr. Ryan had been Executive Vice President, Marketing, Sales and Service since 2001.

PART II

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

Market Information and Dividends

Grainger's common stock is listed on the New York Stock Exchange and the Chicago Stock Exchange, with the ticker symbol GWW. The high and low sales prices for the common stock and the dividends declared and paid for each calendar quarter during 2007 and 2006 are shown below.

		Prices		
	Quarters	High	Low	Dividends
2007	First	$80.37	$68.77	$0.29
	Second	94.75	76.00	0.35
	Third	98.60	79.38	0.35
	Fourth	96.00	84.40	0.35
	Year	$98.60	$68.77	$1.34
2006	First	$76.59	$69.30	$0.24
	Second	79.95	68.22	0.29
	Third	76.21	60.60	0.29
	Fourth	75.90	65.86	0.29
	Year	$79.95	$60.60	$1.11

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

Holders

The approximate number of shareholders of record of Grainger's common stock as of January 31, 2008, was 1,100 with approximately 39,500 additional shareholders holding stock through nominees.

Issuer Purchases of Equity Securities – Fourth Quarter

Period	Total Number of Shares Purchased (A)	Average Price Paid per Share (B)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (C)	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
Oct. 1 – Oct. 31	—	—	—	4,683,993 shares
Nov. 1 – Nov. 30	—	—	—	4,683,993 shares
Dec. 1 – Dec. 31	—	—	—	4,683,993 shares
Total	—	—	—	

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

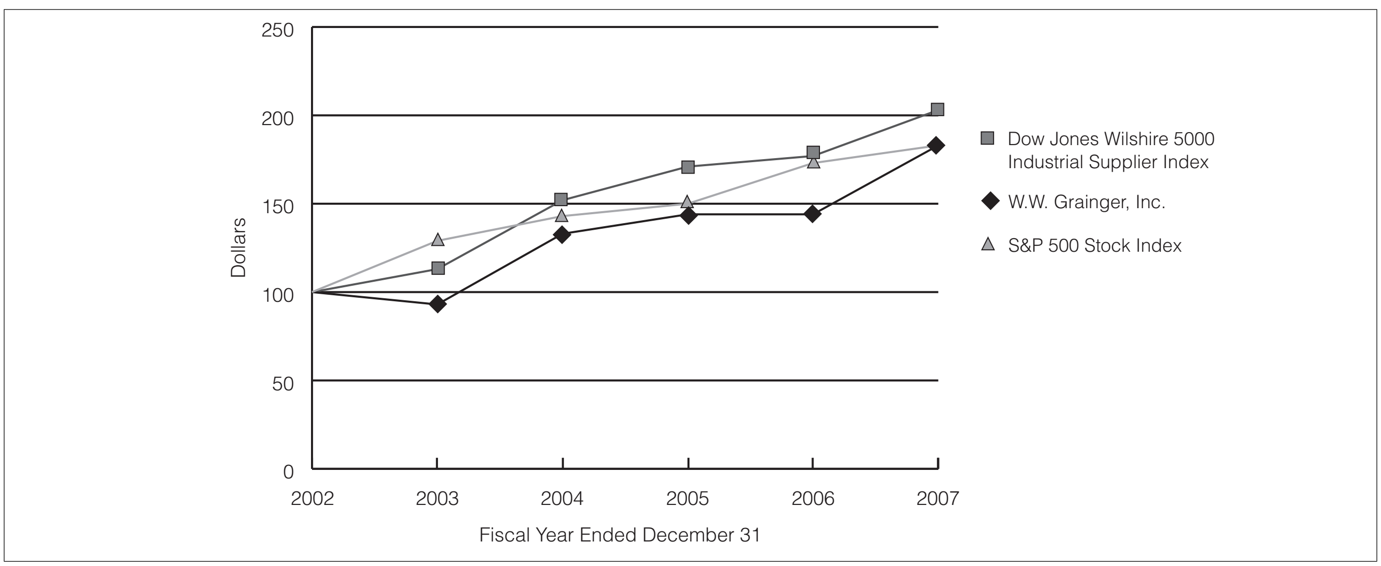
(B) Average price paid per share includes any commissions paid and includes only those amounts related to purchases as part of publicly announced plans or programs. Activity is reported on a trade date basis.

(C) During the first six months of 2007, purchases were made pursuant to a share repurchase program approved by Grainger's Board of Directors on October 16, 2006. A total of 4,010,200 shares were acquired under this authorization. Effective August 17, 2007, the Board of Directors granted authority to restore the repurchase program to 10 million shares.

On August 20, 2007, Grainger entered into an accelerated share repurchase agreement (ASR) with Goldman, Sachs & Co. (Goldman) to purchase $500 million of its outstanding common stock. Grainger paid Goldman $500 million on August 23, 2007, in exchange for an initial delivery of 5,316,007 shares. The ASR was treated as an equity transaction. At settlement, Grainger was to receive or pay additional shares of its common stock or cash (at Grainger's option), based upon the volume weighted average price during the term of the agreement. The ASR was completed on January 4, 2008. See Note 22 to the Consolidated Financial Statements for further discussion related to the ASR.

Company Performance

The following stock price performance graph compares the cumulative total return on an investment in Grainger common stock with the cumulative total return of an investment in each of the S&P 500 Stock Index and the Dow Jones Wilshire 5000 Industrial Supplier Index. It covers the period commencing December 31, 2002, and ending December 31, 2007. The graph assumes that the value for the investment in Grainger common stock and in each index was $100 on December 31, 2002, and that all dividends were reinvested.



	December 31, 2002	2003	2004	2005	2006	2007
W.W. Grainger, Inc.	$100	$ 93	$133	$144	$144	$183
S&P 500 Stock Index	100	129	143	150	173	183
Dow Jones Wilshire 5000 Industrial Supplier Index	100	113	152	171	177	203

Other

On May 1, 2007, Grainger timely submitted to the New York Stock Exchange (NYSE) an Annual CEO Certification, in which Grainger's Chief Executive Officer certified that he was not aware of any violation by Grainger of the NYSE's corporate governance listing standards as of the date of the certification.

Item 6: Selected Financial Data

	2007	2006	2005	2004	2003
	(In thousands of dollars, except for per share amounts)				
Net sales	$6,418,014	$5,883,654	$5,526,636	$5,049,785	$4,667,014
Net earnings	420,120	383,399	346,324	286,923	226,971
Net earnings per basic share	5.10	4.36	3.87	3.18	2.50
Net earnings per diluted share	4.94	4.24	3.78	3.13	2.46
Total assets	3,094,028	3,046,088	3,107,921	2,809,573	2,624,678
Long-term debt (less current maturities)	4,895	4,895	4,895	—	4,895
Cash dividends paid per share	$ 1.340	$ 1.110	$ 0.920	$ 0.785	$ 0.735

Effective January 1, 2006, Grainger adopted Statement of Financial Accounting Standards (SFAS) No. 123R, "Share-Based Payment," for the accounting of employee stock-based compensation using the modified prospective method. The effect of the adoption was an approximately $0.14 earnings per share reduction for 2006. See Note 12 to the Consolidated Financial Statements for further discussion of information related to SFAS No. 123R.

The results for 2006 included an effective tax rate, excluding the equity in net income of unconsolidated entities, of 36.7%, compared to 38.5% in 2007. The 2006 rate included tax benefits from the resolution of uncertainties related to the audit of the 2004 tax year and a tax benefit from a reduction of deferred tax liabilities related to property, buildings and equipment. These benefits increased diluted earnings per share by $0.15.

The results for 2005 included an effective tax rate, excluding the equity in net income of unconsolidated entities, of 35.2%. The 2005 rate included tax benefits related to a favorable revision to the estimate of income taxes for various state taxing jurisdictions and the resolution of certain federal and state tax contingencies. These benefits increased diluted earnings per share by $0.10.

The results for 2004 included an effective tax rate, excluding the equity in net income of unconsolidated entities, of 35.6%, which was down from 40.0% in the prior year. The lower tax rate resulted in an increase of $0.21 per diluted share. The tax rate reduction was primarily due to a lower tax rate in Canada, the realization of tax benefits related to operations in Mexico and to capital losses, the recognition of tax benefits from the "Medicare Prescription Drug, Improvement and Modernization Act of 2003" and the resolution of certain federal and state tax contingencies.

For further information see **"Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations."**

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

Overview

General. Grainger is the leading broad-line supplier of facilities maintenance and other related products in North America. Grainger reports its operating results in three segments: Grainger Branch-based, Acklands – Grainger Branch-based (Acklands – Grainger) and Lab Safety Supply, Inc. (Lab Safety). Grainger distributes a wide range of products used by businesses and institutions to keep their facilities and equipment up and running. Grainger uses a multichannel business model to provide customers with a range of options for finding and purchasing products through a network of branches, sales representatives, direct marketing including catalogs, and a variety of electronic and Internet channels. Grainger serves customers through a network of 610 branches, 18 distribution centers and multiple Web sites.

Business Environment. Several economic factors and industry trends shape Grainger's business environment. The current overall economy and leading economic indicators provide insight into anticipated economic factors for the near term and help in forming the development of projections for the upcoming year. Consensus Forecast-USA projected 2008 GDP growth of 1.6% and Industrial Production growth of 1.1% for the United States, a decrease from 2007 estimates of 2.2% and 1.9%, respectively. For Canada, Consensus Forecast-USA projected 2008 GDP growth of 1.8%, below the 2007 estimate of 2.6%.

In 2007, Grainger benefited from the economic growth in the United States. Grainger's sales correlate positively with industrial production growth. With the improvement in Industrial Production and general growth in the economy, Grainger realized an increase in sales across all customer sectors. Grainger's sales also tend to increase when non-farm payrolls grow, especially during economic recoveries. Non-farm payrolls increased approximately 1% on average in 2007 over 2006. For 2007, Grainger benefited from the combination of increased Industrial Production and non-farm payroll growth.

The light and heavy manufacturing customer sectors, which comprised more than 25% of Grainger's total 2007 sales, have historically correlated with manufacturing employment levels and manufacturing production. Manufacturing employment levels in the United States declined approximately 1% on average in 2007 from 2006, however, manufacturing output increased approximately 2%. This contributed to mid single-digit sales growth in the heavy manufacturing and light manufacturing customer sectors for Grainger in 2007.

In 2004, Grainger launched a multiyear initiative in the United States to strengthen its presence in top metropolitan markets and better position itself to serve the local customer. The market expansion program contributed to the sales growth in 2007 and is expected to be a driver of growth in 2008 and beyond. The first phase of the market expansion program was completed in 2005. The second, third and fourth phases of the market expansion program were completed in 2007. Phases five and six were more than 50% complete at December 31, 2007, and are expected to be completed during 2008.

In 2006, Grainger launched a multiyear product line expansion program in the United States. Over the past two years, Grainger has added approximately 90,000 new products to supplement Industrial Supply's plumbing, fastener, material handling and security product lines. The product line expansion program contributed to the sales growth in 2007 and is expected to be a driver of growth in 2008 and beyond. In 2008, Grainger plans to add an additional 50,000 products to further supplement Industrial Supply's product lines.

Customer buying behavior is also important in Grainger's business environment. Grainger believes that customers will continue to focus on reducing their cost to procure facilities maintenance products. Consequently, during 2006, Grainger increased information available to employees for improved service to customers by installing an upgraded SAP branch operating system as part of an overall conversion to an integrated SAP system in the U.S. branch-based business.

Grainger's financial strength enables it to fund major initiatives and acquisitions and to improve effectiveness. Capital spending in 2007 for the U.S. market expansion program was approximately $88 million, with total capital expenditures of $196 million.

For 2008, Grainger anticipates total capital expenditures of $175 million to $200 million. Grainger intends to continue its investment in the market expansion program and information technology enhancements, with spending planned for the following major projects:

- $50 million to $60 million for U.S. market expansion;
- $25 million to $30 million for supply chain infrastructure;
- $20 million to $30 million for information technology;
- $15 million to $25 million for international expansion.

Lease or purchase decisions, based on availability of facilities, may affect the timing and amount of capital expenditures associated with the market expansion program.

Matters Affecting Comparability. There were 255 sales days in 2007, compared to 254 sales days in 2006 and 255 sales days in 2005.

Grainger's operating results for 2007 include the operating results of McFeely's Square Drive Screws (McFeely's) from the acquisition date of May 31, 2007. The results of the acquisition are included in the Lab Safety segment.

Effective January 1, 2006, Grainger adopted SFAS No. 123R, "Share-Based Payment," for the accounting of employee stock-based compensation using the modified prospective method. The effect of the adoption was an approximately $0.14 earnings per share reduction for 2006. See Note 12 to the Consolidated Financial Statements for further discussion of information related to SFAS No. 123R.

During the fourth quarter of 2006, Grainger adopted SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132R." As a result of the adoption, Grainger recorded an additional liability of $36.8 million to Accrued employment-related benefit costs offset by $14.3 million of deferred income taxes and a reduction of Accumulated other comprehensive earnings of $22.5 million. See Note 14 to the Consolidated Financial Statements for further discussion of information related to SFAS No. 158.

Grainger's operating results for 2006 include the operating results of Rand Materials Handling Equipment Co. (Rand) from the acquisition date of January 31, 2006. Grainger's operating results for 2006 also include the operating results of Professional Inspection Equipment, Inc. (Professional Equipment) and Construction Book Express, Inc. (Construction Book) from the acquisition date of November 17, 2006. The results of these acquisitions are included in the Lab Safety segment.

Grainger's operating results for 2005 include the operating results of AW Direct from the acquisition date of January 14, 2005. AW Direct's results are included in the Lab Safety segment.

Results of Operations

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

	For the Years Ended December 31,				
	Items in Consolidated Statements of Earnings				
	As a Percent of Net Sales			Percent Increase/(Decrease) from Prior Year	
	2007	2006	2005	2007	2006
Net sales	100.0%	100.0%	100.0%	9.1%	6.5%
Cost of merchandise sold	59.4	60.0	60.9	8.1	4.9
Gross profit	40.6	40.0	39.1	10.6	8.9
Operating expenses	30.1	30.2	29.7	8.8	8.1
Operating earnings	10.5	9.8	9.4	16.0	11.4
Other income (expense)	0.2	0.4	0.3	(55.1)	82.3
Income taxes	4.1	3.7	3.4	19.2	17.9
Net earnings	6.6%	6.5%	6.3%	9.6%	10.7%

2007 Compared to 2006

Grainger's net sales of $6,418.0 million for 2007 increased 9.1% when compared with net sales of $5,883.7 million for 2006. There was one more selling day in 2007 versus 2006. Daily sales were up 8.7%. The increase in net sales was led by sales growth in the upper teens in the government sector, high single-digit sales growth in the commercial sector and mid single-digit sales growth in the manufacturing sector. Approximately 3 percentage points of the sales growth came from Grainger's ongoing strategic initiatives, market expansion and product line expansion, with another 1 percentage point from foreign exchange. Partially offsetting these sales improvements was a negative 1 percentage point effect from the continued wind-down of low margin integrated supply contracts. Refer to the ***Segment Analysis*** below for further detail of Grainger's ongoing strategic initiatives.

The gross profit margin for 2007 improved 0.6 percentage point to 40.6% from 40.0% in 2006. The improvement in the gross profit margin was primarily driven by positive inflation recovery, partially offset by unfavorable selling price category mix.

Operating earnings for 2007 totaled $670.7 million, an increase of 16.0% over 2006. This earnings improvement exceeded the sales growth rate due to an improved gross profit margin and operating expenses which grew at a slightly slower rate than sales.

Net earnings for 2007 increased by 9.6% to $420.1 million from $383.4 million in 2006. The growth in net earnings for 2007 primarily resulted from the improvement in operating earnings, partially offset by lower interest income, no counterpart to a gain on the sale of Acklands – Grainger's interest in the USI-AGI Prairies joint venture in 2006, and a higher effective tax rate in 2007. The results for 2006 included tax benefits from the resolution of uncertainties related to the audit of the 2004 tax year and a tax benefit from a reduction of deferred tax liabilities related to property, buildings and equipment. These benefits increased diluted earnings per share by $0.15 in 2006. Diluted earnings per share of $4.94 in 2007 were 16.5% higher than the $4.24 for 2006. This improvement was higher than the percentage increase for net earnings due to the effect of Grainger's share repurchase program.

Segment Analysis

The following comments at the segment level include external and intersegment net sales and operating earnings. Comments at the business unit level include external and inter- and intrasegment net sales and operating earnings. See Note 18 to the Consolidated Financial Statements.

Grainger Branch-based

Net sales were $5,352.5 million for 2007, an increase of $441.7 million, or 9.0%, when compared with net sales of $4,910.8 million for 2006. Daily sales were up 8.6%. Daily sales in the United States were up 8.5%, with growth in all customer end markets, led by sales growth in the upper teens in the government sector and high single-digit sales growth in the commercial sector. Approximately 4 percentage points of the sales growth came from Grainger's ongoing strategic initiatives, market expansion and product line expansion. The wind-down of Grainger's low margin integrated supply contracts reduced sales growth by approximately 1 percentage point.

In 2004, Grainger launched a multiyear market expansion program to strengthen its presence in top metropolitan markets and better position itself to serve local customers.

Market expansion contributed approximately 2 percentage points to the sales growth for the segment. Results for the market expansion program were as follows:

	Daily Sales Increase 2007 vs. 2006	Estimated Percent Complete
Phase 1 (Atlanta, Denver, Seattle)	15%	100%
Phase 2 (Four markets in Southern California)	6%	100%
Phase 3 (Houston, St. Louis, Tampa)	13%	100%
Phase 4 (Baltimore, Cincinnati, Kansas City, Miami, Philadelphia, Washington, D.C.)	10%	100%
Phase 5 (Dallas, Detroit, New York, Phoenix)	9%	75%
Phase 6 (Chicago, Minneapolis, Pittsburgh, San Francisco)	9%	65%

Product line expansion contributed approximately 2 percentage points to the growth in the segment. Over the past two years, Grainger has added approximately 90,000 new products in the plumbing, fastener, material handling and security product lines as part of its ongoing product line expansion initiative.

Daily sales in Mexico increased 22.7% in 2007 versus 2006. In local currency, daily sales were up 22.8%, driven primarily by the ongoing branch expansion program and an improved economy.

The segment gross profit margin increased 0.4 percentage point in 2007 over 2006, driven primarily by positive inflation recovery, partially offset by unfavorable selling price category mix.

Operating expenses in this segment were up 9.0% in 2007. Expenses grew at the same rate as sales with payroll and benefits growing at a slower rate than sales offset by other operating expenses growing faster than sales, primarily due to increased bad debt expense and provisions and higher facility costs related to market expansion.

For the segment, operating earnings of $669.4 million for 2007 increased 12.8% over the $593.5 million for 2006. This earnings improvement exceeded the sales growth rate due to an improved gross profit margin.

Acklands – Grainger Branch-based

Net sales at Acklands – Grainger were $636.5 million for 2007, an increase of $71.4 million, or 12.6%, when compared with $565.1 million for 2006. Daily sales were up 12.2%. In local currency, daily sales increased 5.8% due to a stronger economy. This increase was led by the mining sector with sales growth in the low twenties, high single-digit sales growth in the oil sector and mid single-digit sales growth in the government sector. These increases were partially offset by a mid-teens sales decline in the forestry sector.

The gross profit margin increased 2.6 percentage points in 2007 over 2006. The improvement in the gross profit margin was primarily due to positive inflation recovery.

Operating expenses were up 6.7% in 2007. Expenses grew at a slower rate than sales due to operating expense leverage, the result of improved cost management and lower severance costs.

Operating earnings of $44.2 million for 2007 were up $29.0 million, or 190%. This earnings improvement exceeded the sales growth rate due to an improved gross profit margin and operating expenses that grew at a slower rate than sales.

Lab Safety

Net sales at Lab Safety were $434.7 million for 2007, an increase of $23.2 million, or 5.6%, when compared with $411.5 million for 2006. Daily sales were up 5.2%. Sales from the acquisitions made during 2007 and late 2006 contributed 6.1 percentage points to the growth.

The gross profit margin decreased 0.5 percentage point in 2007 over 2006. Gross profit margin was down as a result of increased freight costs and unfavorable selling price category mix and product mix, partially offset by positive inflation recovery.

Operating expenses were 4.6% higher in 2007 and grew at a slower rate than sales due to cost management efforts.

Operating earnings of $54.3 million for 2007 were up 3.8% over 2006. This earnings improvement was less than the sales growth rate primarily due to a lower gross profit margin.

Other Income and Expense

Other income and expense was $11.2 million of income in 2007, a decrease of $13.8 million as compared with $25.0 million of income in 2006. The following table summarizes the components of other income and expense:

	For the Years Ended December 31,	
	2007	2006
	(In thousands of dollars)	
Other income and (expense):		
Interest income (expense) – net	$ 9,151	$19,570
Equity in net income of unconsolidated entities	2,016	2,960
Gain on sale of unconsolidated entity	—	2,291
Unclassified – net	41	131
	$11,208	$24,952

The decrease in interest income was primarily attributable to lower average cash balances due to working capital needs and share repurchases. There was a decrease in equity in net income of unconsolidated entities in 2007 versus 2006 primarily driven by the absence of earnings related to the joint venture that was sold.

Income Taxes

Income taxes of $261.7 million in 2007 increased 19.2% as compared with $219.6 million in 2006.

Grainger's effective tax rates were 38.4% and 36.4% in 2007 and 2006, respectively. Excluding the equity in net income of unconsolidated entities, the effective income tax rates were 38.5% for 2007 and 36.7% for 2006.

The 2006 tax rate benefited from resolution of uncertainties related to the audit of the 2004 tax year and from a reduction of deferred tax liabilities related to property, buildings and equipment.

Excluding the equity in net income of unconsolidated entities and the tax benefits noted above, the effective income tax rate for 2006 was 38.9%.

For 2008, Grainger is projecting its estimated effective tax rate to be approximately 39%, excluding the equity in net income of unconsolidated entities.

2006 Compared to 2005

Grainger's net sales for 2006 of $5,883.7 million were up 6.5% versus 2005. There was one less selling day in 2006 versus 2005. Daily sales were up 6.9%. The increase in net sales was led by low double-digit sales growth in the government sector, high single-digit sales growth in the manufacturing sector and mid single-digit sales growth in the commercial sector. Also contributing to the improvement was growth from the U.S. market expansion and product line expansion programs. Partially offsetting these sales improvements was the negative effect of the continued wind-down of low margin contracts with integrated supply and automotive customers.

The gross profit margin of 40.0% in 2006 improved 0.9 percentage point over the gross profit margin of 39.1% in 2005, principally due to selling price category mix and the positive effect of product mix, including the global sourcing of products. The major driver of the improvement in the selling price category mix was reduced sales to integrated supply and automotive customers, which carry lower than average gross profit margins.

Grainger's operating earnings of $578.1 million in 2006 increased $59.1 million, or 11.4%, over the prior year. The operating margin of 9.8% in 2006 improved 0.4 percentage point over 2005, as the combined effect of increased sales and improvement in gross profit margin exceeded the increase in operating expenses. Operating expenses were up 8.1% in 2006 principally due to higher payroll and benefits driven by increased stock-based compensation expense due to the adoption of SFAS No. 123R, and increased healthcare and profit sharing costs, partially offset by lower systems implementation costs.

In 2006, net earnings of $383.4 million increased $37.1 million, or 10.7%, over the prior year. The growth in net earnings was due to the improvement in operating earnings and higher net interest income, partially offset by an increase in income tax expense. Diluted earnings per share for 2006 of $4.24 were 12.2% higher than the $3.78 for 2005, the result of higher net earnings and fewer shares outstanding.

Segment Analysis

The following comments at the segment level include external and intersegment net sales and operating earnings. Comments at the business unit level include external and inter- and intrasegment net sales and operating earnings. See Note 18 to the Consolidated Financial Statements.

Grainger Branch-based

Net sales of $4,910.8 million increased by 5.6% in 2006 compared to net sales of $4,649.2 million in 2005. Daily sales were up 6.0%. Daily sales in the United States were up 6.0%, with growth in all customer end markets, led by low double-digit sales growth in the government sector and high single-digit sales growth in the heavy manufacturing sector. The wind-down of Grainger's low margin integrated supply and automotive contracts reduced sales growth by approximately 2 percentage points.

In 2004, Grainger launched a multiyear market expansion program to strengthen its presence in top metropolitan markets and better position itself to serve local customers. Phases 1 through 4 include sixteen markets. Work on Phases 5 and 6 began during 2006.

Market expansion contributed approximately 2 percentage points to the sales growth for the segment. Results for the market expansion program were as follows:

	Daily Sales Increase 2006 vs. 2005	Estimated Percent Complete*
Phase 1 (Atlanta, Denver, Seattle)	10%	100%
Phase 2 (Four markets in Southern California)	12%	95%
Phase 3 (Houston, St. Louis, Tampa)	13%	90%
Phase 4 (Baltimore, Cincinnati, Kansas City, Miami, Philadelphia, Washington, D.C.)	8%	90%

* Phases are reported once they reach 50% completion. Completion occurs when a new branch opens or a branch expansion or remodeling is finished.

In 2006, Grainger launched a multiyear product line expansion program in the United States. The 43,000 products added in 2006 contributed approximately 2 percentage points to the growth in the segment.

Daily sales in Mexico increased 20.1% in 2006 versus 2005. In local currency, daily sales were up 21.0%, driven by an improving economy, an expanded telesales operation, new branches in Santa Catarina and Chihuahua and an expanded presence in Tijuana.

Segment gross profit margin increased 1.1 percentage points in 2006 over the comparable 2005 period, primarily driven by positive inflation recovery and a positive change in selling price category mix. A major driver in the improvement in selling price category mix was the reduction of sales related to low margin integrated supply and automotive contracts.

Operating expenses were up 6.4% for 2006. The operating expense growth was primarily driven by higher payroll and benefits costs due to higher stock-based compensation related to the adoption of SFAS No. 123R and higher profit sharing costs, partially offset by lower systems implementation costs.

Operating earnings of $593.5 million for 2006 increased 13.6% over the $522.6 million for 2005. The earnings improvement resulted from higher sales and improved gross profit margins, partially offset by operating expenses, which grew at a faster rate than sales.

Acklands – Grainger Branch-based

Net sales at Acklands – Grainger of $565.1 million increased by 12.6% in 2006 compared to 2005 net sales of $502.0 million, including the effect of a favorable exchange rate. Daily sales were up 13.0%. In local currency, daily sales increased 5.8% due to a stronger economy, improved branch presence, and higher sales to the oil and gas sectors, partially offset by weak sales in the forestry industry.

The gross profit margin increased 0.5 percentage point in 2006 over 2005 primarily driven by positive inflation recovery.

Operating expenses for Acklands – Grainger were up 14.9% in 2006, primarily driven by payroll and benefits due to increased headcount and higher severance, information technology, advertising and occupancy costs.

Operating earnings of $15.2 million in 2006 increased 8.8% from the $14.0 million in 2005 as a result of sales growth and an improved gross profit margin, partially offset by operating expenses, which grew at a faster rate than sales.

Lab Safety

Net sales at Lab Safety were $411.5 million for 2006, an increase of $31.4 million, or 8.3%, when compared with $380.1 million for 2005. Daily sales were up 8.7%. The sales growth included the benefit of incremental sales from Rand, acquired on January 31, 2006, and Professional Equipment and Construction Book, acquired on November 17, 2006, as well as sales growth in the manufacturing sector. Rand contributed 4.0 percentage points to the daily sales increase. Professional Equipment and Construction Book contributed 0.6 percentage point to the daily sales increase. Excluding Rand, Professional Equipment and Construction Book, daily sales increased 4.1%.

The gross profit margin decreased 0.3 percentage point in 2006 from 2005 primarily as a result of increased freight costs and lower margin Rand product sales, partially offset by positive inflation recovery.

Operating expenses of $121.8 million were $12.8 million, or 11.7%, higher in 2006, primarily due to incremental costs associated with the acquisitions, higher advertising costs and increased expenses from the upgrade of the business' enterprise resource planning system.

Operating earnings of $52.3 million for 2006 were down 0.8% compared to 2005, resulting from a lower gross profit margin and higher operating expenses, partially offset by increased sales.

Other Income and Expense

Other income and expense was $25.0 million of income in 2006, an improvement of $11.3 million as compared with $13.7 million of income in 2005. The following table summarizes the components of other income and expense:

	For the Years Ended December 31,	
	2006	2005
	(In thousands of dollars)	
Other income and (expense):		
Interest income (expense) – net	$19,570	$11,019
Equity in net income of unconsolidated entities	2,960	2,809
Gain on sale of unconsolidated entity	2,291	—
Unclassified – net	131	(143)
	$24,952	$13,685

The increase in interest income in 2006 was the result of higher interest rates and higher average cash balances.

Income Taxes

Income taxes of $219.6 million in 2006 increased 17.9% as compared with $186.4 million in 2005.

Grainger's effective tax rates were 36.4% and 35.0% in 2006 and 2005, respectively. Excluding the effect of equity in net income of unconsolidated entities, the effective income tax rates were 36.7% for 2006 and 35.2% for 2005.

The 2006 tax rate benefited from resolution of uncertainties related to the audit of the 2004 tax year and from a reduction of deferred tax liabilities related to property, buildings and equipment.

The 2005 tax rate included tax benefits related to a favorable revision to the estimate of income taxes for various state and local taxing jurisdictions and the resolution of certain federal and state tax contingencies.

Excluding the equity in net income of unconsolidated entities and the tax benefits noted above, the effective income tax rate was 38.9% for 2006 and 37.0% for 2005.

Financial Condition

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

Cash Flow

Net cash flows from operations of $468.9 million in 2007, $436.8 million in 2006 and $432.5 million in 2005 continued to improve Grainger's financial position and serve as the primary source of funding. Net cash provided by operations increased $32.1 million in 2007 over 2006, driven primarily by increased net earnings. The Change in operating assets and liabilities – net of business acquisitions used cash of $106.4 million in 2007. This use of cash was primarily driven by increases in inventory and trade accounts receivable as well as a decrease in trade accounts payable due to the timing of payments at year-end. The increases in inventory and trade accounts receivable were due to product line expansion and increased sales. These changes were partially offset by an increase in other current liabilities due to higher compensation, benefit and profit sharing accruals, the result of increased headcount and improved Company performance. The increase in net cash flows from operations from 2005 to 2006 was primarily attributable to increased net earnings. The Change in operating assets and liabilities – net of business acquisitions used cash of $97.2 million in 2006. This use of cash was primarily driven by increases in inventory and trade accounts receivable, which were up due to increased sales and an increase in days sales outstanding. These changes were partially offset by an increase in trade accounts payable due to the higher inventory purchases.

Net cash flows used in investing activities were $197.0 million, $139.7 million and $163.0 million for 2007, 2006 and 2005, respectively. Capital expenditures for property, buildings, equipment and capitalized software were $197.4 million, $136.8 million and $157.2 million in 2007, 2006 and 2005, respectively. Additional information regarding capital spending is detailed in the ***Capital Expenditures*** section below. In 2007, Grainger continued to fund the Company's market expansion initiative ($88 million), purchased McFeely's ($4.7 million) and purchased its distribution center in China ($6.7 million). In 2006, Grainger also invested $13.9 million to purchase Rand and $20.5 million to purchase

Professional Equipment and Construction Book, which are part of the Lab Safety segment. The results of operations for the acquisitions have been included in the consolidated financial statements since the respective acquisition dates.

Net cash flows used in financing activities for 2007, 2006 and 2005 were $513.9 million, $492.9 million and $154.1 million, respectively. Treasury stock purchases increased $174.5 million in 2007, as Grainger repurchased 7,051,607 shares, compared with 6,950,900 shares in 2006. Treasury stock purchases were 2,404,400 shares in 2005. As of December 31, 2007, approximately 4.7 million shares of common stock remained available under Grainger's repurchase authorization. Dividends paid to shareholders were $113.1 million in 2007, $97.9 million in 2006 and $82.7 million in 2005. Partially offsetting these cash outlays were proceeds and excess tax benefits realized from stock options exercised of $144.2 million, $77.8 million and $66.0 million for 2007, 2006 and 2005, respectively.

Working Capital

Internally generated funds have been the primary source of working capital and for funds used in business expansion, supplemented by debt as circumstances dictated. In addition, funds were expended for facilities optimization and enhancements to support growth initiatives, as well as for business and systems development and other infrastructure improvements.

Working capital was $974.4 million at December 31, 2007, compared with $1,155.8 million at December 31, 2006, and $1,290.2 million at December 31, 2005. At these dates, the ratio of current assets to current liabilities was 2.2, 2.6 and 2.9, respectively. The current ratio and working capital decrease in 2007 was due to the increase in short-term borrowings and a reduction in cash primarily to fund the accelerated share repurchase program. See Note 13 to the Consolidated Financial Statements.

Capital Expenditures

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

	For the Years Ended December 31,		
	2007	2006	2005
	(In thousands of dollars)		
Land, buildings, structures and improvements	$100,380	$ 67,554	$ 52,955
Furniture, fixtures, machinery and equipment	87,389	62,233	59,342
Subtotal	187,769	129,787	112,297
Capitalized software	8,556	8,950	44,950
Total	$196,325	$138,737	$157,247

In 2007 and 2006, Grainger's investments included the market expansion program, which is designed to realign branches in several metropolitan markets, Mexico and China expansion and the normal, recurring replacement of equipment.

In 2005, Grainger's investments included the market expansion program, ongoing SAP initiatives, expenditures related to Canadian branch and systems projects, as well as the normal, recurring replacement of equipment.

Capital expenditures are expected to range from $175 million to $200 million in 2008. These projected investments include the completion of the market expansion program in the United States, branch expansion in Mexico, ongoing information technology expenditures, support for the product line expansion program, as well as other general projects including the normal, recurring replacement of equipment. Grainger expects to fund 2008 capital investments from operating cash flows, which Grainger believes will remain strong.

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 commercial paper sales and bank borrowings under lines of credit. At December 31, 2007, Grainger's long-term debt rating by Standard & Poor's was AA+. Grainger's available lines of credit, as further discussed in Note 8 to the Consolidated Financial Statements, were $250.0 million at December 31, 2007, 2006 and 2005. Total debt as a percent of total capitalization was 5.0%, 0.4% and 0.4% as of the same dates. The increase in total debt as a percent of total capitalization was primarily the result of short-term borrowings used to fund an accelerated share repurchase program. See Note 13 to the Consolidated Financial Statements for further discussion of Grainger's accelerated share repurchase program.

Grainger believes any circumstances that would trigger early payment or acceleration with respect to any outstanding debt securities would not have a material impact on its results of operations or financial position. Certain holders of industrial revenue bonds have various rights to require Grainger to redeem these bonds, thus a portion is classified as Current maturities of long-term debt.

Commitments and Other Contractual Obligations

At December 31, 2007, Grainger's contractual obligations, including estimated payments due by period, are as follows:

		Payments Due by Period			
	Total Amounts Committed	Less than 1 Year	1 – 3 Years	4 – 5 Years	More than 5 Years
		(In thousands of dollars)			
Long-term debt obligations	$ 9,485	$ 4,590	$ 4,895	$ —	$ —
Interest on long-term debt	675	340	335	—	—
Operating lease obligations	200,400	38,578	58,295	40,222	63,305
Purchase obligations:					
Uncompleted additions to property, buildings and equipment	48,287	48,287	—	—	—
Commitments to purchase inventory	228,534	228,534	—	—	—
Other purchase obligations	103,463	92,819	9,789	855	—
Other liabilities	113,784	6,747	13,866	16,352	76,819
Total	$704,628	$419,895	$87,180	$57,429	$140,124

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

Payments for Other liabilities represent future benefit payments for postretirement benefit plans and postemployment disability medical benefits as determined by actuarial projections. Other employment-related benefits costs of $33.8 million have not been included in this table as the timing of benefit payments is not statistically predictable. See Note 9 to the Consolidated Financial Statements.

See also Notes 10 and 11 to the Consolidated Financial Statements for further detail related to long-term debt and operating lease obligations, respectively.

In addition, Grainger has recorded a noncurrent liability of $14.7 million for tax uncertainties at December 31, 2007. This amount is excluded from the table above, as Grainger cannot make reliable estimates of these cash flows by period. See Note 15 to the Consolidated Financial Statements.

Off-Balance Sheet Arrangements

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

Critical Accounting Estimates

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

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

Note 2 to the Consolidated Financial Statements describes the significant accounting policies used in the preparation of the Consolidated Financial Statements. The most significant areas involving management judgments and estimates follow. Actual results in these areas could differ materially from management's estimates under different assumptions or conditions.

Allowance for Doubtful Accounts. Grainger uses several factors to estimate the allowance for uncollectible accounts receivable including the age of the receivables and the historical ratio of actual write-offs to the age of the receivables. The analyses performed also take into consideration economic conditions that may have an impact on a specific industry, group of customers or a specific customer.

Write-offs could be materially different than the reserves provided if economic conditions change or actual results deviate from historical trends.

Inventory Reserves. Grainger establishes inventory reserves for shrinkage and excess and obsolete inventory. Provisions for inventory shrinkage are based on historical experience to account for unmeasured usage or loss. Actual inventory shrinkage could be materially different from these estimates, affecting Grainger's inventory values and cost of merchandise sold.

Grainger regularly reviews inventory to evaluate continued demand and identify any obsolete or excess quantities of inventory. Grainger records provisions for the difference between excess and obsolete inventory and its estimated realizable value. Estimated realizable value is based on anticipated future product demand, market conditions and liquidation values. Actual results differing from these projections could have a material effect on Grainger's results of operations.

Stock Incentive Plans. Grainger maintains stock incentive plans under which a variety of incentive grants may be awarded to employees and directors. Grainger uses a binomial lattice option pricing model to estimate the value of stock option grants. The model requires projections of the risk-free interest rate, expected life, volatility, expected dividend yield and forfeiture rate of the stock option grants. The fair value of options granted in 2007 and 2006 used the following assumptions:

	Year Ended December 31, 2007	Year Ended December 31, 2006
Risk-free interest rate	4.6%	4.9%
Expected life	6 years	6 years
Expected volatility	24.3%	23.9%
Expected dividend yield	1.7%	1.5%

The risk-free interest rate is selected based on yields from U.S. Treasury zero-coupon issues with a remaining term approximately equal to the expected term of the options being valued. The expected life selected for options granted during each year presented represents the period of time that the options are expected to be outstanding based on historical data of option holders exercise and termination behavior. Expected volatility is based upon implied and historical volatility of the closing price of Grainger's stock over a period equal to the expected life of each option grant. The dividend yield assumption is based on history and expectation of dividend payouts. Because stock option compensation expense is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures, using historical forfeiture experience.

The amount of stock option compensation expense is significantly affected by the valuation model and these assumptions. If a different valuation model or different assumptions were used, the stock option compensation expense could be significantly different from what is recorded in the current period.

Compensation expense for other stock-based awards is based upon the closing market price on the last trading date preceding the date of the grant.

For additional information concerning stock incentive plans, see Note 12 to the Consolidated Financial Statements.

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

The discount rate assumptions used by management reflect the rates available on high-quality fixed income debt instruments as of December 31, the measurement date, of each year. A lower discount rate increases the present value of benefit obligations and net periodic postretirement benefit costs. As of December 31, 2007, Grainger increased the discount rate used in the calculation of its postretirement plan obligation from 5.9% to 6.5% to reflect the increase in market interest rates. Grainger estimates that the increase in the expected discount rate will increase 2008 pretax earnings by approximately $2.4 million, although other changes in assumptions may increase, decrease or eliminate this effect.

Grainger considers the long-term historical actual return on plan assets and the historical performance of the Standard & Poor's 500 Index in developing its expected long-term return on plan assets. In 2007, Grainger maintained the expected long-term rate of return on plan assets of 6.0% (net of tax at 40%) based on the historical average of long-term rates of return.

A 1 percentage point change in assumed healthcare cost trend rates would have the following effects on December 31, 2007 results:

	1 Percentage Point	
	Increase	(Decrease)
	(In thousands of dollars)	
Effect on total of service and interest cost	$ 4,652	$ (3,597)
Effect on accumulated postretirement benefit obligation	29,094	(23,181)

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

Grainger has used its best judgment in making assumptions and estimates and believes such assumptions and estimates used are appropriate. Changes to the assumptions may be required in future years as a result of actual experience or new trends and, therefore, may affect Grainger's retirement plan obligations and future expense.

For additional information concerning postretirement healthcare benefits, see Note 9 to the Consolidated Financial Statements.

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

Grainger is responsible for establishing policies on insurance reserves. Although it relies on outside parties to project future claims costs, it retains control over actuarial assumptions, including loss development factors and claim payment patterns. Grainger performs ongoing reviews of its insured and uninsured risks, which it uses to establish the appropriate reserve levels.

The use of assumptions in the analysis leads to fluctuations in required reserves over time. Any change in the required reserve balance is reflected in the current period's results of operations.

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

Other. Other significant accounting policies, not involving the same level of measurement uncertainties as those discussed above, are nevertheless important to an understanding of the financial statements. Policies such as revenue recognition, depreciation, intangibles, long-lived assets and warranties require judgments on complex matters that are often subject to multiple external sources of authoritative guidance such as the Financial Accounting Standards Board and the Securities and Exchange Commission. Possible changes in estimates or assumptions associated with these policies are not expected to have a material effect on the financial condition or results of operations of Grainger. More information on these additional accounting policies can be found in Note 2 to the Consolidated Financial Statements.

New Accounting Standards

The following new accounting standards exclude those pronouncements that are unlikely to have an effect on Grainger upon adoption.

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Grainger adopted FIN 48 on January 1, 2007, and the adoption did not have a material effect on its results of operations or financial position. See Note 15 to the Consolidated Financial Statements for further discussion of FIN 48.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective for fiscal years beginning after November 15, 2007. Grainger does not expect adoption of SFAS No. 157 to have a material effect on its results of operations or financial position.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159). SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. It also establishes presentation and disclosure requirements to facilitate comparisons between companies using different measurement attributes for similar types of assets and liabilities. The statement is effective for fiscal years beginning after November 15, 2007. Grainger does not expect adoption of SFAS No. 159 to have a material effect on its results of operations or financial position.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" (SFAS No. 141R). SFAS No. 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS No. 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. The statement is effective for fiscal years beginning after December 15, 2008, and will be applied to acquisitions after adoption by Grainger.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin No. 51" (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net earnings attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS No.160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. The statement is effective for fiscal years beginning after December 15, 2008. Grainger is currently evaluating the impact that adoption of SFAS No. 160 may have on its results of operations or financial position.

See Note 2 to the Consolidated Financial Statements for further discussion of new accounting standards.

Inflation and Changing Prices

Inflation during the last three years has not had a significant effect on operations. The predominant use of the last-in, first-out (LIFO) method of accounting for inventories and accelerated depreciation methods for financial reporting and income tax purposes result in a substantial recognition of the effects of inflation in the financial statements.

The major impact of inflation is on buildings and improvements, where the gap between historic cost and replacement cost accumulates for these long-lived assets. The related depreciation expense associated with these assets would likely increase if adjustments were to be made for the cumulative effect of inflation.

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

Forward-Looking Statements

This Form 10-K contains statements that are not historical in nature but concern future results and business plans, strategies and objectives and other matters that may be deemed to be "forward-looking statements" under federal securities laws. Grainger has generally identified such forward-looking statements by using words such as "believe, expect, anticipate, continue, estimate, intend, planned, predict, projection, potential, scheduled, assumption, presumption, may, might, would, could 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; 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; changes in laws and regulations; disruption of information technology or data security systems; general industry or market conditions; general economic conditions; labor shortages; facilities disruptions or shutdowns; higher fuel costs or disruptions in transportaion services; natural and other catastrophes; unanticipated weather conditions; and the factors identified in Item 1A, Risk Factors.

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

Item 7A: Quantitative and Qualitative Disclosures About Market Risk

Grainger is exposed to foreign currency exchange risk related to its transactions, assets and liabilities denominated in foreign currencies. For 2007, a uniform 10% strengthening of the U.S. dollar relative to foreign currencies that affect Grainger and its joint ventures would have resulted in a $2.1 million decrease in net earnings. Comparatively, in 2006 a uniform 10% strengthening of the U.S. dollar relative to foreign currencies that affect Grainger and its joint ventures would have resulted in a $1.0 million decrease in net earnings. A uniform 10% weakening of the U.S. dollar would have resulted in a $2.6 million increase in net earnings for 2007, as compared with an increase in net earnings of $1.2 million for 2006. This sensitivity analysis of the effects of changes in foreign currency exchange rates does not factor in potential changes in sales levels or local currency prices or costs. Grainger does not hold derivatives for trading purposes.

Grainger is also exposed to interest rate risk in its debt portfolio. During 2007 and 2006, all of its long-term debt was variable rate debt. A 1 percentage point increase in interest rates paid by Grainger would have resulted in a decrease to net earnings of approximately $0.3 million for 2007 and $0.1 million for 2006. A 1 percentage point decrease in interest rates would have resulted in an increase to net earnings of approximately $0.3 million for 2007 and $0.1 million for 2006. This sensitivity analysis of the effects of changes in interest rates on long-term debt does not factor in potential changes in long-term debt levels.

Grainger has limited primary exposure to commodity price risk since it purchases its goods for resale and does not purchase commodities directly.

Item 8: Financial Statements and Supplementary Data

The financial statements and supplementary data are included on pages 27 to 64. See the Index to Financial Statements and Supplementary Data on page 26.

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

None.

Item 9A: Controls and Procedures

Disclosure Controls and Procedures

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

Internal Control Over Financial Reporting

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

Management's report on the Company's internal control over financial reporting is included on page 27 of this Report under the heading Management's Annual Report on Internal Control Over Financial Reporting.

(B) Attestation Report of the Registered Public Accounting Firm

The report from Ernst & Young LLP on its audit of the effectiveness of Grainger's internal control over financial reporting as of December 31, 2007, is included on page 28 of this Report under the heading Report of Independent Registered Public Accounting Firm.

(C) Changes in Internal Control Over Financial Reporting

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

Item 9B: Other Information

None.

PART III

Item 10: Directors, Executive Officers and Corporate Governance

The information required by this item is incorporated by reference to Grainger's proxy statement relating to the annual meeting of shareholders to be held April 30, 2008, under the captions "Election of Directors," "Board of Directors and Board Committees" and "Section 16(a) Beneficial Ownership Reporting Compliance." Information required by this item regarding executive officers of Grainger is set forth in Part I of this report under the caption "Executive Officers."

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

Item 11: Executive Compensation

The information required by this item is incorporated by reference to Grainger's proxy statement relating to the annual meeting of shareholders to be held April 30, 2008, under the captions "Board of Directors and Board Committees," "Director Compensation," "Report of the Compensation Committee of the Board" and "Compensation Discussion and Analysis."

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

The information required by this item is incorporated by reference to Grainger's proxy statement relating to the annual meeting of shareholders to be held April 30, 2008, under the captions "Ownership of Grainger Stock" and "Equity Compensation Plans."

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

The information required by this item is incorporated by reference to Grainger's proxy statement relating to the annual meeting of shareholders to be held April 30, 2008, under the captions "Election of Directors" and "Transactions with Related Persons."

Item 14: Principal Accounting Fees and Services

The information required by this item is incorporated by reference to Grainger's proxy statement relating to the annual meeting of shareholders to be held April 30, 2008, under the caption "Audit Fees and Audit Committee Pre-Approval Policies and Procedures."

PART IV

Item 15: Exhibits and Financial Statement Schedules

(a) 1. Financial Statements. See Index to Financial Statements and Supplementary Data.

2. Financial Statement Schedules. The schedules listed in Reg. 210.5-04 have been omitted because they are either not applicable or the required information is shown in the consolidated financial statements or notes thereto.

3. Exhibits

(3) (a) Restated Articles of Incorporation, incorporated by reference to Exhibit 3(i) to Grainger's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998.

(b) Bylaws, as amended February 21, 2007, incorporated by reference to Exhibit 3(b) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2006.

(4) Instruments Defining the Rights of Security Holders, Including Indentures

(a) Agreement dated as of April 28, 1999, between Grainger and Fleet National Bank (formerly Bank Boston, NA), as rights agent, incorporated by reference to Exhibit 4 to Grainger's Current Report on Form 8-K dated April 28, 1999, and related letter concerning the appointment of EquiServe Trust Company, N.A. (now Computershare Trust Company, N.A.), as successor rights agent, effective August 1, 2002, incorporated by reference to Exhibit 4 to Grainger's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.

(b) No instruments which define the rights of holders of Grainger's Industrial Development Revenue Bonds are filed herewith, pursuant to the exemption contained in Regulation S-K, Item 601(b)(4)(iii). Grainger hereby agrees to furnish to the Securities and Exchange Commission, upon request, a copy of any such instrument.

(10) Material Contracts

(a) Accelerated Share Repurchase Agreement, incorporated by reference to Exhibit 10 to Grainger's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007.

(b) Compensatory Plans or Arrangements

(i) Director Stock Plan, as amended, incorporated by reference to Exhibit 10(c) to Grainger's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006.

(ii) Office of the Chairman Incentive Plan, incorporated by reference to Appendix B of Grainger's Proxy Statement dated March 26, 1997.

(iii) 1990 Long-Term Stock Incentive Plan, as amended, incorporated by reference to Exhibit 10(a) to Grainger's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006.

(iv) 2001 Long-Term Stock Incentive Plan, as amended, incorporated by reference to Exhibit 10(b) to Grainger's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006.

(v) Executive Death Benefit Plan, as amended.

(vi) Executive Deferred Compensation Plan, incorporated by reference to Exhibit 10(e) to Grainger's Annual Report on Form 10-K for the year ended December 31, 1989.

(vii) 1985 Executive Deferred Compensation Plan, as amended, incorporated by reference to Exhibit 10(d)(vii) to Grainger's Annual Report on Form 10-K for the year ended December 31, 1998.

(viii) Supplemental Profit Sharing Plan, as amended, incorporated by reference to Exhibit 10(viii) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2003.

(ix) Supplemental Profit Sharing Plan II, as amended.

(x) Form of Change in Control Employment Agreement between Grainger and certain of its executive officers, as amended.

(xi) Voluntary Salary and Incentive Deferral Plan, as amended.

(xii) Summary Description of Directors Compensation Program effective January 1, 2005, incorporated by reference to Exhibit 10(xv) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2004.

(xiii) Summary Description of Directors Compensation Program effective April 30, 2008, incorporated by reference to Exhibit 10 to Grainger's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007.

(xiv) 2005 Incentive Plan, as amended, incorporated by reference to Exhibit 10(d) to Grainger's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006.

(xv) Form of Stock Option Award Agreement between Grainger and certain of its executive officers, incorporated by reference to Exhibit 10(xiv) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2005.

(xvi) Form of Stock Option and Restricted Stock Unit Agreement between Grainger and certain of its executive officers, incorporated by reference to Exhibit 10(xv) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2005.

(xvii) Form of Performance Share Award Agreement between Grainger and certain of its executive officers, incorporated by reference to Exhibit 10(xvi) to Grainger's Annual Report on Form 10-K for the year ended December 31, 2005.

(xviii) Summary Description of 2008 Management Incentive Program.

(21) Subsidiaries of Grainger.

(23) Consent of Independent Registered Public Accounting Firm.

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

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

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

(32) Section 1350 Certifications

(a) Chief Executive Officer certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Chief Financial Officer certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, Grainger has duly issued this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DATE: February 27, 2008

W.W. GRAINGER, INC.

By: Richard L. Keyser

Richard L. Keyser
Chairman of the Board
and Chief Executive Officer

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of Grainger on February 27, 2008, in the capacities indicated.

Richard L. Keyser

Richard L. Keyser
Chairman of the Board
and Chief Executive Officer
(Principal Executive Officer and Director)

P. Ogden Loux

P. Ogden Loux
Senior Vice President, Finance
and Chief Financial Officer
(Principal Financial Officer)

Ronald L. Jadin

Ronald L. Jadin
Vice President and Controller
(Principal Accounting Officer)

Brian P. Anderson

Brian P. Anderson
Director

Wilbur H. Gantz

Wilbur H. Gantz
Director

V. Ann Hailey

V. Ann Hailey
Director

William K. Hall

William K. Hall
Director

Stuart L. Levenick

Stuart L. Levenick
Director

John W. McCarter, Jr.

John W. McCarter, Jr.
Director

Neil S. Novich

Neil S. Novich
Director

Michael J. Roberts

Michael J. Roberts
Director

Gary L. Rogers

Gary L. Rogers
Director

James T. Ryan

James T. Ryan
Director

James D. Slavik

James D. Slavik
Director

Harold B. Smith

Harold B. Smith
Director