NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007, 2006 and 2005

NOTE 1 – BACKGROUND AND BASIS OF PRESENTATION

INDUSTRY INFORMATION

W.W. Grainger, Inc. is the leading broad-line supplier of facilities maintenance and other related products in North America. In this report, the words "Company" or "Grainger" mean W.W. Grainger, Inc. and its subsidiaries.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions are eliminated from the consolidated financial statements.

INVESTMENTS IN UNCONSOLIDATED ENTITIES

For investments in which the Company owns or controls from 20% to 50% of the voting shares, the equity method of accounting is used. Changes in interest arising from the issuance of stock by an investee is accounted for as additional contributed capital. See Note 6 to the Consolidated Financial Statements.

MANAGEMENT ESTIMATES

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities, and revenues and expenses. Actual results could differ from those estimates.

FOREIGN CURRENCY TRANSLATION

The financial statements of the Company's foreign subsidiaries are measured using the local currency as the functional currency. Net exchange gains or losses resulting from the translation of financial statements of foreign operations and related long-term debt are recorded as a separate component of shareholders' equity. See Notes 2 and 14 to the Consolidated Financial Statements.

RECLASSIFICATIONS

Certain amounts in the 2006 and 2005 financial statements, as previously reported, have been reclassified to conform to the 2007 presentation.

Under Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R), any unearned or deferred compensation (contra-equity accounts) related to awards prior to adoption of SFAS No. 123R shall be eliminated against the appropriate equity accounts. On January 1, 2006, at the date of adoption of SFAS No. 123R, the Company should have recorded the balance in unearned restricted stock compensation and all future activity against additional contributed capital. As such, the activity previously reported in unearned restricted stock compensation for 2006 was netted against additional contributed capital. There was no effect on earnings, assets, liabilities or total shareholders' equity.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REVENUE RECOGNITION

Revenues recognized include product sales, billings for freight and handling charges and fees earned for services provided. The Company recognizes product sales and billings for freight and handling charges primarily on the date products are shipped to, or picked up by, the customer. The Company's standard shipping terms are FOB shipping point. On occasion, the Company will negotiate FOB destination terms. These sales are recognized upon delivery to the customer. Fee revenues, which account for less than 1% of total revenues, are recognized after services are completed.

COST OF MERCHANDISE SOLD

Cost of merchandise sold includes product and product-related costs, vendor consideration, freight-out costs and handling costs. The Company defines handling costs as those costs incurred to fulfill a shipped sales order.

VENDOR CONSIDERATION

The Company receives rebates from its vendors to promote their products. The Company provides numerous advertising programs to promote its vendors' products, including catalogs and other printed media, Internet and other marketing programs. Most of these programs relate to multiple vendors, which makes supporting the specific, identifiable and incremental criteria difficult, and would require numerous assumptions and judgments. Based on the inexact nature of trying to track reimbursements to the exact advertising expenditure for each vendor, the Company treats most vendor advertising allowances as a reduction of cost of merchandise sold rather than a reduction of operating (advertising) expenses. Rebates earned from vendors that are based on purchases are capitalized into inventory as part of product purchase price. These rebates are credited to cost of merchandise sold based on sales. Vendor rebates that are earned based on product sales are credited directly to cost of merchandise sold.

ADVERTISING
Advertising costs are expensed in the year the related advertisement is first presented. Advertising expense was $122.4 million, $115.4 million and $102.3 million for 2007, 2006 and 2005, respectively. The majority of vendor provided allowances are classified as an offset to cost of merchandise sold. Any reimbursements from vendors that are classified as an offset against operating (advertising) costs are recorded when the related advertising is expensed. For additional information see subsection VENDOR CONSIDERATION.

For interim reporting purposes, advertising expense is amortized equally over each period, based on estimated expenses for the full year. Advertising costs for media that have not been distributed by year-end are capitalized as Prepaid expenses. Amounts included in Prepaid expenses at December 31, 2007, 2006 and 2005 were $32.1 million, $30.2 million and $20.8 million, respectively.

WAREHOUSING, MARKETING AND ADMINISTRATIVE EXPENSES
Included in this category are purchasing, branch operations, information services, and marketing and selling expenses, as well as other types of general and administrative costs.

STOCK INCENTIVE PLANS
On January 1, 2006, the Company adopted SFAS No. 123R. SFAS No. 123R requires the Company to measure all share-based payments using a fair-value-based method and record compensation expense related to these payments in the consolidated financial statements. The Company values stock option compensation using a binomial lattice option-pricing model.

See Note 12 to the Consolidated Financial Statements for further information on the adoption of SFAS No. 123R and related disclosures, including pro forma information for prior periods as if the Company had recorded share-based compensation expense.

INCOME TAXES
Income taxes are recognized during the year in which transactions enter into the determination of financial statement income, with deferred taxes being provided for temporary differences between financial and tax reporting.

OTHER COMPREHENSIVE EARNINGS (LOSSES)
The Company's Other comprehensive earnings (losses) include foreign currency translation adjustments and unrecognized gains (losses) on postretirement and other employment-related benefit plans. See Note 14 to the Consolidated Financial Statements.

CASH AND MARKETABLE SECURITIES
The Company considers investments in highly liquid debt instruments, purchased with an original maturity of ninety days or less, to be cash equivalents. For cash equivalents, the carrying amount approximates fair value due to the short maturity of these instruments.

The Company's investments in marketable securities consist of commercial paper to be held to maturity. These investments have an original maturity date of more than 90 days. The investments are issued from high credit quality issuers. The marketable securities are recorded at cost, which approximates fair value.

CONCENTRATION OF CREDIT RISK
The Company places temporary cash investments with institutions of high credit quality and, by policy, limits the amount of credit exposure to any one institution.

The Company has a broad customer base representing many diverse industries doing business in all regions of the United States as well as other areas of North America. Consequently, no significant concentration of credit risk is considered to exist.

ALLOWANCE FOR DOUBTFUL ACCOUNTS
The Company establishes reserves for customer accounts that are potentially uncollectible. The method used to estimate the allowances is based on several factors including the age of the receivables and the historical ratio of actual write-offs to the age of the receivables. These analyses also take into consideration economic conditions that may have an impact on a specific industry, group of customers or a specific customer.

INVENTORIES
Inventories are valued at the lower of cost or market. Cost is determined primarily by the last-in, first-out (LIFO) method, which accounts for approximately 73% of total inventory. For the remaining inventory, cost is determined by the first-in, first-out (FIFO) method.

PROPERTY, BUILDINGS AND EQUIPMENT
Property, buildings and equipment are valued at cost. For financial statement purposes, depreciation and amortization are provided in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives, principally on the declining-balance and sum-of-the-years-digits methods. The principal estimated useful lives for determining depreciation are as follows:

Buildings, structures and improvements	10 to 45 years
Furniture, fixtures, machinery and equipment	3 to 10 years

Improvements to leased property are amortized over the initial terms of the respective leases or the estimated service lives of the improvements, whichever is shorter.

The Company capitalized interest costs of $1.4 million, $0.3 million and $0.3 million in 2007, 2006 and 2005, respectively.

LONG-LIVED ASSETS

The carrying value of long-lived assets is evaluated whenever events or changes in circumstances indicate that the carrying value of the asset may be impaired. An impairment loss is recognized when estimated undiscounted future cash flows resulting from use of the asset, including disposition, is less than the carrying value of the asset. Impairment is measured as the amount by which the carrying amount exceeds the fair value.

GOODWILL AND OTHER INTANGIBLES

Goodwill is recognized as the excess cost of an acquired entity over the net amount assigned to assets acquired and liabilities assumed. Goodwill is not amortized, but rather tested for impairment on an annual basis and more often if circumstances require. Impairment losses are recognized whenever the implied fair value of goodwill is less than its carrying value.

The Company recognizes an acquired intangible apart from goodwill whenever the intangible arises from contractual or other legal rights, or whenever it can be separated or divided from the acquired entity and sold, transferred, licensed, rented or exchanged, either individually or in combination with a related contract, asset or liability. Such intangibles are amortized over their estimated useful lives unless the estimated useful life is determined to be indefinite. Amortizable intangible assets are being amortized over useful lives of three to 17 years. Impairment losses are recognized if the carrying amount of an intangible, subject to amortization, is not recoverable from expected future cash flows and its carrying amount exceeds its fair value.

The Company also maintains intangible assets with indefinite lives, which are not amortized. These intangibles are tested for impairment on an annual basis and more often if circumstances require, similar to the treatment for goodwill. Impairment losses are recognized whenever the implied fair value of these assets is less than their carrying value.

INSURANCE RESERVES

The Company purchases insurance for catastrophic exposures and those risks required to be insured by law. It also retains a significant portion of the risk of losses related to workers' compensation, general liability and property. Reserves for these potential losses are based on an external analysis of the Company's historical claims results and other actuarial assumptions.

WARRANTY RESERVES

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

	As of December 31,		
	2007	2006	2005
Beginning balance	$ 4,651	$ 3,763	$ 3,428
Returns	(12,781)	(9,579)	(9,179)
Provisions	11,572	10,467	9,514
Ending balance	$ 3,442	$ 4,651	$ 3,763

NEW ACCOUNTING STANDARDS

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 a tax position 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. The Company 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 related to FIN 48.

In September 2006, the FASB issued Statement of Financial Accounting Standards 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. The Company 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. The Company does not expect adoption of SFAS No. 159 to have a material effect on its results of operations or financial position.

In June 2007, the Emerging Issues Task Force (EITF) reached a consensus with respect to EITF Issue No. 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards" (Issue 06-11). Under Issue 06-11, a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and paid to employees for equity classified nonvested equity shares, nonvested equity share units, and outstanding equity share options should be recognized as an increase to additional paid-in capital (APIC). The amount recognized in APIC should be included in the pool of excess tax benefits available to absorb tax deficiencies on share-based payment awards. A tax benefit recognized from a dividend on an award that is subsequently forfeited or is no longer expected to vest would be reclassified from APIC to the income statement, if sufficient excess tax benefits are available in the pool of excess tax benefits in APIC. Issue 06-11 is to be applied prospectively to the income tax benefits of dividends on equity-classified employee share-based payment awards that are declared in fiscal years beginning after December 15, 2007, with early application permitted. The Company does not expect adoption of Issue 06-11 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 the Company.

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 income 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. The Company is currently evaluating the impact that adoption of SFAS No. 160 may have on its results of operations or financial position.

NOTE 3 – BUSINESS ACQUISITIONS

On May 31, 2007, Lab Safety Supply, Inc. (Lab Safety), a wholly owned subsidiary of the Company, acquired substantially all of the assets and assumed certain liabilities of McFeely's Square Drive Screws (McFeely's). McFeely's is a direct marketer of specialty fasteners, hardware and tools for the professional woodworking industry. McFeely's had more than $9 million in sales in 2006. The purchase price and costs of acquisition were $4.7 million in cash and $0.3 million in assumed liabilities. The estimated goodwill recognized in the transaction amounted to $1.2 million and is expected to be fully deductible for tax purposes.

On November 17, 2006, Lab Safety acquired substantially all of the assets and assumed certain liabilities of Professional Inspection Equipment, Inc. and Construction Book Express, Inc. The companies are direct marketers of tools, instruments and reference materials to the building and home inspection markets. The companies had annual sales in 2005 of more than $18 million. The aggregate purchase price for the two companies was $20.9 million in cash and $1.7 million in assumed liabilities. The goodwill recognized in the transaction amounted to $18.7 million and is expected to be fully deductible for tax purposes.

On January 31, 2006, Lab Safety acquired substantially all of the assets and assumed certain liabilities of Rand Materials Handling Equipment Co. (Rand). Rand is a national catalog distributor of warehouse, storage and packaging supplies. Rand had more than $16 million in sales in 2005. The aggregate purchase price for Rand was $13.9 million in cash and $2.3 million in assumed liabilities. The goodwill recognized in the transaction amounted to $9.9 million and is expected to be fully deductible for tax purposes.

On January 14, 2005, Lab Safety acquired substantially all of the assets and assumed certain liabilities of AW Direct, Inc. (AW Direct). AW Direct, a targeted direct marketer of products to the service vehicle accessories market, had sales of more than $28 million in 2004. The aggregate purchase price was $24.8 million in cash and $2.0 million in assumed liabilities. Goodwill recognized in this transaction amounted to $14.0 million and is expected to be fully deductible for tax purposes.

The results of these acquisitions are included in the Company's consolidated results from the respective dates of acquisition. Due to the immaterial nature of these transactions, disclosures of amounts assigned to the acquired assets and assumed liabilities and pro forma results of operations were not considered necessary.

NOTE 4 – ALLOWANCE FOR DOUBTFUL ACCOUNTS

The following table shows the activity in the allowance for doubtful accounts (in thousands of dollars):

	For the Years Ended December 31,		
	2007	2006	2005
Balance at beginning of period	$ 18,801	$ 18,401	$ 23,375
Provision for uncollectible accounts	15,436	6,057	1,326
Write-off of uncollectible accounts, less recoveries	(8,755)	(5,660)	(6,380)
Foreign currency exchange impact	348	3	80
Balance at end of period	$ 25,830	$ 18,801	$ 18,401

NOTE 5 – INVENTORIES

Inventories primarily consist of merchandise purchased for resale.

Inventories would have been $287.7 million, $270.0 million and $246.3 million higher than reported at December 31, 2007, 2006 and 2005, respectively, if the FIFO method of inventory accounting had been used for all Company inventories. Net earnings would have increased by $10.8 million, $14.5 million and $4.9 million for the years ended December 31, 2007, 2006 and 2005, respectively, using the FIFO method of accounting. Inventory values using the FIFO method of accounting approximate replacement cost.

NOTE 6 – INVESTMENTS IN UNCONSOLIDATED ENTITIES

The table below summarizes the activity of these investments (in thousands of dollars):

	MonotaRO Co., Ltd.	MRO Korea Co., Ltd.	USI-AGI Prairies Inc.	Total
Balance at January 1, 2005	$ 2,291	$ —	$ 23,835	$ 26,126
Equity earnings	472	—	2,337	2,809
Loan repayment	—	—	(3,706)	(3,706)
Foreign currency (loss) gain	(329)	—	255	(74)
Balance at December 31, 2005	2,434	—	22,721	25,155
Cash investments	3,988	—	—	3,988
Equity earnings	1,826	—	1,134	2,960
Divestiture	—	—	(24,967)	(24,967)
Change in interest due to issuance of stock by joint venture	453	—	—	453
Foreign currency (loss) gain	(209)	—	1,112	903
Balance at December 31, 2006	8,492	—	—	8,492
Cash investments	—	2,138	—	2,138
Equity earnings	1,401	615	—	2,016
Reinstatement to equity method of accounting	—	1,372	—	1,372
Foreign currency gain	620	121	—	741
Balance at December 31, 2007	$10,513	$4,246	$ —	$ 14,759
Ownership interest at December 31, 2007	38%	49%	0%	

The Company has investments in two Asian companies accounted for under the equity method of accounting. At December 31, 2007, the ownership percentages of the two investments were 38% and 49%.

In 2003, the Company wrote off its investment in MRO Korea Co., Ltd. and subsequently suspended the equity method of accounting even though the business was marginally profitable and self-funding. At that time, the market value of the business was limited because the business had only one significant customer (the other party in the joint venture) and the prospects for growth were dependent upon securing sufficient capital funding. In 2007, the Company and the other business partner in the joint venture agreed to significantly change the business model and fund the expansion of this business. The Company contributed $2.1 million to MRO Korea Co., Ltd., maintaining its 49% ownership, and resumed the equity method of accounting. In conjunction with the reinstatement of the equity accounting method, a credit was recorded to retained earnings for $1.4 million, which represents the accumulated unrecognized equity earnings during the period the equity method was suspended and the write-down recognized in 2003.

In the first quarter of 2006, the Company contributed $4.0 million to MonotaRO Co., Ltd., its 38% owned company in Japan. In the fourth quarter of 2006, an initial public offering by this company resulted in a change of interest of $0.5 million, recorded as additional contributed capital. The market value of this investment, based on the closing stock price on February 19, 2008, was $25.8 million.

On February 23, 2006, Acklands – Grainger Inc. (Acklands – Grainger), the Company's Canadian subsidiary, received a Notice of Purchase advising Acklands – Grainger that Uni-Select Inc., a Canadian company, was exercising its contractual option to purchase all of Acklands – Grainger's shares in the USI-AGI Prairies Inc. joint venture. The transaction closed on May 31, 2006, for Canadian $30.9 million (US$27.8 million), resulting in a US$2.3 million pre-tax gain for the Company. The Company's 50% ownership investment in this joint venture was previously accounted for under the equity method of accounting. The carrying value of this investment included US$5.1 million of allocated goodwill. The joint venture was managed by Uni-Select.

NOTE 7 – CAPITALIZED SOFTWARE

Amortization of capitalized software is on a straight-line basis over three and five years. Amortization begins when the software is available for its intended use. Amortization expense was $21.0 million, $13.9 million and $7.6 million for the years ended December 31, 2007, 2006 and 2005, respectively. The Company reviews the amounts capitalized for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable.

NOTE 8 – SHORT-TERM DEBT

The following summarizes information concerning short-term debt:

	As of December 31,		
	2007	2006	2005
	(In thousands of dollars)		
Line of Credit			
Outstanding at December 31	$ 6,113	$ —	$ —
Maximum month-end balance during the year	$ 11,234	$ —	$ —
Average amount outstanding during the year	$ 7,756	$ —	$ —
Weighted average interest rate during the year	6.48%	—%	—%
Weighted average interest rate at December 31	6.57%	—%	—%
Commercial Paper			
Outstanding at December 31	$ 95,947	$ —	$ —
Maximum month-end balance during the year	$139,104	$ —	$ —
Average amount outstanding during the year	$ 28,030	$ —	$ —
Weighted average interest rate during the year	5.38%	—%	—%
Weighted average interest rate at December 31	4.30%	—%	—%

The Company had $31.1 million, $8.6 million and $8.6 million of uncommitted lines of credit denominated in foreign currencies at December 31, 2007, 2006 and 2005, respectively. At December 31, 2007, there was $6.1 million outstanding under these lines of credit relating to Grainger China LLC. Grainger China LLC utilizes a line of credit to meet its business expansion and operating needs.

The increase in commercial paper borrowing was primarily to fund an accelerated share repurchase program in August 2007. Refer to Note 13 for further discussion of the Company's share repurchase program.

The Company and its subsidiaries had committed lines of credit totaling $250.0 million at December 31, 2007, 2006 and 2005, for which the Company compensated a bank through a commitment fee of 0.04% in 2007 and 2006, and 0.07% in 2005. There were no borrowings under the committed lines of credit.

The Company had $15.8 million of letters of credit at December 31, 2007, 2006 and 2005, primarily related to the Company's casualty insurance program. The Company also had $3.2 million, $3.3 million and $1.4 million at December 31, 2007, 2006 and 2005, respectively, in letters of credit to facilitate the purchase of product from foreign sources.

NOTE 9 – EMPLOYEE BENEFITS

Retirement Plans

A majority of the Company's employees are covered by a noncontributory profit sharing plan. This plan provides for annual employer contributions generally based upon a formula related primarily to earnings before federal income taxes, limited to 25% of the total eligible compensation paid to all eligible employees. The Company also sponsors additional defined contribution plans, which cover most of the other employees. Provisions under all plans were $130.2 million, $114.3 million and $92.8 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Postretirement Benefits

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

The Company's accumulated postretirement benefit obligation (APBO) and net periodic benefit costs include the effect of the federal subsidy provided by the "Medicare Prescription Drug, Improvement and Modernization Act of 2003" (the Medicare Act). The Medicare Act provides a federal subsidy to retiree healthcare benefit plan sponsors that provide a prescription drug benefit that is at least actuarially equivalent to that provided by Medicare. As a result of the subsidy, the APBO has been reduced by $40.4 million, $33.4 million and $30.6 million as of December 31, 2007, 2006 and 2005, respectively. The net periodic benefits costs have been reduced by approximately $6.4 million, $5.6 million and $4.4 million for the years ended December 31, 2007, 2006 and 2005, respectively.

The net periodic benefits costs charged to operating expenses, which were valued with a measurement date of January 1 for each year, consisted of the following components:

	For the Years Ended December 31,		
	2007	2006	2005
	(In thousands of dollars)		
Service cost	$ 10,856	$ 9,737	$ 7,577
Interest cost	8,973	7,599	6,287
Expected return on assets	(4,049)	(2,790)	(2,502)
Amortization of prior service credit	(437)	(858)	(858)
Amortization of transition asset	(143)	(143)	(143)
Amortization of unrecognized losses	2,094	2,903	1,923
Net periodic benefits costs	$ 17,294	$ 16,448	$ 12,284

The Company has elected to amortize the amount of net unrecognized losses over a period equal to the average remaining service period for active plan participants expected to retire and receive benefits, or approximately 17.2 years for 2007.

Reconciliations of the beginning and ending balances of the APBO, which is calculated using a December 31 measurement date, the fair value of assets and the funded status of the benefit obligation follow:

	2007	2006	2005
	(In thousands of dollars)		
Benefit obligation at beginning of year	$155,353	$127,598	$103,381
Service cost	10,856	9,737	7,577
Interest cost	8,973	7,599	6,287
Plan participants' contributions	1,575	1,670	1,527
Amendments	(9,433)	5,559	—
Actuarial (gain) loss	(12,754)	7,359	(12,843)
Benefits paid	(3,929)	(4,277)	(4,017)
Medicare Part D Subsidy received	269	108	—
Benefit obligation at end of year	150,910	155,353	127,598
Fair value of plan assets at beginning of year	67,486	46,503	41,706
Actual returns on plan assets	2,915	6,192	1,515
Employer contributions	6,385	17,398	5,772
Plan participants' contributions	1,575	1,670	1,527
Benefits paid	(3,929)	(4,277)	(4,017)
Fair value of plan assets at end of year	74,432	67,486	46,503
Funded status	(76,478)	(87,867)	(81,095)
Unrecognized prior service credit	—	—	(8,014)
Unrecognized transition asset	—	—	(1,285)
Unrecognized net actuarial loss	—	—	38,065
Accrued postretirement benefits cost	$ (76,478)	$ (87,867)	$ (52,329)

The amounts recognized in Accumulated other comprehensive earnings consisted of the following components:

	As of December 31,	
	2007	2006
	(In thousands of dollars)	
Prior service credit	$(10,592)	$ (1,596)
Transition asset	(1,000)	(1,143)
Net loss	25,405	39,119
Total	$ 13,813	$36,380

The components of Accumulated other comprehensive earnings (AOCE) related to the postretirement benefit costs that will be amortized into net periodic postretirement benefit cost in 2008 are as follows (in thousands of dollars):

	2008
Amortization of prior service credit	$ (1,215)
Amortization of transition asset	(143)
Amortization of net loss	1,477
Estimated amount amortized from AOCE into net periodic postretirement benefit cost in 2008	$ 119

The benefit obligation was determined by applying the terms of the plan and actuarial models. These models include various actuarial assumptions, including discount rates, assumed rates of return on plan assets and healthcare cost trend rates. The actuarial assumptions also anticipate future cost-sharing changes to retiree contributions that will maintain the current cost-sharing ratio between the Company and the retirees. The Company evaluates its actuarial assumptions on an annual basis and considers changes in these long-term factors based upon market conditions and historical experience.

The plan amendment effective January 1, 2008 (reflected in the 2007 valuation above), changed the out-of-pocket maximums, co-payments and coinsurance amounts for retirees. The plan amendment effective January 1, 2007 (reflected in the 2006 valuation above), changed the retiree contribution percentages for certain age groups.

The following assumptions were used to determine net periodic benefit cost at January 1:

	For the Years Ended December 31,		
	2007	2006	2005
Discount rate	5.90%	5.50%	5.75%
Expected long-term rate of return on plan assets, net of tax at 40%	6.00%	6.00%	6.00%
Initial healthcare cost trend rate	10.00%	10.00%	10.00%
Ultimate healthcare cost trend rate	5.00%	5.00%	5.00%
Year ultimate healthcare cost trend rate reached	2017	2016	2016

The following assumptions were used to determine benefit obligations at December 31:

	2007	2006	2005
Discount rate	6.50%	5.90%	5.50%
Expected long-term rate of return on plan assets, net of tax at 40%	6.00%	6.00%	6.00%
Initial healthcare cost trend rate	10.00%	10.00%	10.00%
Ultimate healthcare cost trend rate	5.00%	5.00%	5.00%
Year ultimate healthcare cost trend rate reached	2018	2017	2016

The discount rate assumptions reflect the rates available on high-quality fixed income debt instruments. These rates have been selected due to their similarity to the projected cash flows of the postretirement healthcare benefit plan.

The Company reviews external data and its own historical trends for healthcare costs to determine the healthcare cost trend rates. Assumed healthcare cost trend rates have a significant effect on the amounts reported for the healthcare plans. 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)

The Company has established a Group Benefit Trust to fund the plan and process benefit payments. The assets of the trust are invested entirely in funds designed to track the Standard & Poor's 500 Index (S&P 500). This investment strategy reflects the long-term nature of the plan obligation and seeks to take advantage of the superior earnings potential of equity securities. The Company uses the long-term historical return on the plan assets and the historical performance of the S&P 500 to develop its expected return on plan assets. The required use of an expected long-term rate of return on plan assets may result in recognizing income that is greater or less than the actual return on plan assets in any given year. Over time, however, the expected long-term returns are designed to approximate the actual long-term returns and, therefore, result in a pattern of income recognition that more closely matches the pattern of the services provided by the employees.

The funding of the trust is an estimated amount which is intended to allow the maximum deductible contribution under the Internal Revenue Code of 1986 (IRC), as amended, and was $6.4 million, $17.4 million and $5.8 million for the years ended December 31, 2007, 2006 and 2005, respectively. There are no minimum funding requirements and the Company intends to follow its practice of funding the maximum deductible contribution under the IRC.

The Company forecasts the following benefit payments (which include a projection for expected future employee service) and subsidy receipts (in thousands of dollars):

	Estimated gross benefit payments	Estimated Medicare subsidy receipts
2008	$ 3,483	$ (410)
2009	3,986	(491)
2010	4,615	(586)
2011	5,416	(686)
2012	6,322	(803)
2013 – 2017	50,995	(6,572)

Executive Death Benefit Plan

The Executive Death Benefit Plan provides one of three potential benefits: a supplemental income benefit (SIB), an executive death benefit (EDB) or a postretirement payment. The SIB provides income continuation at 50% of total compensation, payable for ten years to the beneficiary of a participant if that participant dies while employed by the Company. Alternatively, the EDB provides an after-tax lump sum payment of one times final total compensation to the beneficiary of a participant who dies after retirement. In addition, a participant may elect to receive a reduced postretirement payment instead of the EDB. Plan participation is determined by a committee of management. There are no plan assets. Benefits are paid as they come due from the general assets of the Company.

The net periodic benefits costs charged to operating expenses, which were valued with a measurement date of January 1 for each year, consisted of the following components:

	For the Years Ended December 31,		
	2007	2006	2005
	(In thousands of dollars)		
Service cost	$ 298	$ 361	$ 277
Interest cost	883	850	791
Amortization of unrecognized losses	127	154	69
Net periodic benefits costs	$ 1,308	$ 1,365	$ 1,137

Reconciliations of the beginning and ending balances of the projected benefit obligation, which is calculated using a December 31 measurement date, the fair value of assets and the status of the benefit obligation follow:

	2007	2006	2005
	(In thousands of dollars)		
Benefit obligation at beginning of year	$ 14,906	$ 15,222	$ 13,921
Service cost	298	361	277
Interest cost	883	850	791
Actuarial (gains) losses	(1,972)	(1,095)	562
Benefits paid	—	(432)	(329)
Benefit obligation at end of year	14,115	14,906	15,222
Fair value of plan assets at beginning of year	—	—	—
Employer contributions	—	432	329
Benefits paid	—	(432)	(329)
Fair value of plan assets at end of year	—	—	—
Benefit obligation	(14,115)	(14,906)	(15,222)
Unrecognized net actuarial losses	—	—	1,485
Accrued executive death benefits cost	$(14,115)	$(14,906)	$(13,737)

The amounts recognized as the current and long-term portions of the benefit obligation follow:

	As of December 31,		
	2007	2006	2005
	(In thousands of dollars)		
Current liabilities	$ (739)	$ (454)	$ (340)
Noncurrent liabilities	(13,376)	(14,452)	(13,397)
Net amounts recognized	$(14,115)	$(14,906)	$(13,737)

Net gains and losses recognized in other comprehensive earnings were gains of $1.9 million in 2007 and losses of $0.2 million in 2006.

The net loss that will be amortized from Accumulated other comprehensive earnings into net periodic benefit cost in 2008 is $0.2 million.

The benefit obligation was determined by applying the terms of the plan and actuarial models. These models include various actuarial assumptions, including discount rates, mortality and salary progression. The Company evaluates its actuarial assumptions on an annual basis and considers changes in these long-term factors based upon market conditions and historical experience.

The following assumptions were used to determine benefit obligations at December 31:

	2007	2006	2005
Discount rate used to determine net periodic benefit cost (January 1 valuation)	5.90%	5.50%	5.75%
Discount rate used to determine benefit obligation (December 31 valuation)	6.40%	5.90%	5.50%
Compensation increase used to determine obligation and cost	4.00%	4.00%	4.00%

The discount rate assumptions reflect the rates available on high-quality fixed income debt instruments. These rates have been selected due to their similarity to the projected cash flows of the Executive Death Benefit Plan.

Projected future benefit payments (in thousands of dollars):

	Benefit Payments
2008	$ 739
2009	540
2010	589
2011	641
2012	698
2013 – 2017	4,657

Deferred Compensation Plans

The Executive Deferred Compensation Plans are money purchase defined benefit plans. This benefit is reduced for early retirement. Plan participation was limited to Company executives during the years 1984 to 1986; no new executives have been added since that time. Participants were allowed to defer a portion of their compensation for the years 1984 through 1990. In return, under the plan, each participant receives an individually specified benefit at age 65. There are no plan assets. Benefits are paid as they come due from the general assets of the Company.

The net periodic benefits costs charged to operating expenses, which were valued with a measurement date of January 1 for each year, consisted of the following components:

	For the Years Ended December 31,		
	2007	2006	2005
	(In thousands of dollars)		
Interest cost	$ 568	$ 573	$ 610
Amortization of unrecognized losses	59	184	108
Net periodic benefits costs	$ 627	$ 757	$ 718

Reconciliations of the beginning and ending balances of the projected benefit obligation, which is calculated using a December 31 measurement date, the fair value of assets and the status of the benefit obligation follow:

	2007	2006	2005
	(In thousands of dollars)		
Benefit obligation at beginning of year	$ 10,945	$ 11,419	$ 11,550
Interest cost	568	573	610
Actuarial (gains) losses	(104)	129	179
Benefits paid	(1,258)	(1,176)	(920)
Benefit obligation at end of year	10,151	10,945	11,419
Fair value of plan assets at beginning of year	—	—	—
Employer contributions	1,258	1,176	920
Benefits paid	(1,258)	(1,176)	(920)
Fair value of plan assets at end of year	—	—	—
Accrued deferred compensation costs	$ (10,151)	$ (10,945)	$ (11,419)

The amounts recognized as the current and long-term portions of the benefit obligation follow:

	As of December 31,		
	2007	2006	2005
	(In thousands of dollars)		
Current liabilities	$ (1,226)	$ (1,229)	$ (928)
Noncurrent liabilities	(8,925)	(9,716)	(10,491)
Net amounts recognized	$ (10,151)	$ (10,945)	$ (11,419)

Net losses recognized in other comprehensive earnings were $0.4 million and $0.5 million in 2007 and 2006, respectively.

The benefit obligation was determined by applying the terms of the plan and actuarial models. These models include various actuarial assumptions, including discount rates, mortality and retirement age. The Company evaluates its actuarial assumptions on an annual basis and considers changes in these long-term factors based upon market conditions and historical experience.

The following assumptions were used to determine benefit obligations at December 31:

	2007	2006	2005
Discount rate used to determine net periodic benefit cost (January 1 valuation)	5.50%	5.25%	5.50%
Discount rate used to determine benefit obligation (December 31 valuation)	5.70%	5.50%	5.25%

The discount rate assumptions reflect the rates available on high-quality fixed income debt instruments. These rates have been selected due to their similarity to the projected cash flows of the Executive Deferred Compensation Plans.

Projected future benefit payments (in thousands of dollars):

	Benefit Payments
2008	$1,226
2009	1,227
2010	1,197
2011	1,162
2012	1,154
2013 – 2017	5,116

Other Employment-Related Benefit Plans

Certain of the Company's non-U.S. subsidiaries provide limited non-pension benefits to retirees in addition to government-mandated programs. The cost of these programs is not significant to the Company. Most retirees outside the United States are covered by government-sponsored and administered programs.

NOTE 10 – LONG-TERM DEBT

Long-term debt consisted of the following:

	As of December 31,		
	2007	2006	2005
	(In thousands of dollars)		
Industrial development revenue and private activity bonds	$ 9,485	$ 9,485	$ 9,485
Less current maturities	4,590	4,590	4,590
	$ 4,895	$ 4,895	$ 4,895

The industrial development revenue and private activity bonds include various issues that bear interest at variable rates capped at 15%, and come due in various amounts from 2009 through 2021. At December 31, 2007, the weighted average interest rate was 3.59%. Interest rates on some of the issues are subject to change at certain dates in the future. The bondholders may require the Company to redeem certain bonds concurrent with a change in interest rates and certain other bonds annually. In addition, $4.6 million of these bonds had an unsecured liquidity facility available at December 31, 2007, for which the Company compensated a bank through a commitment fee of 0.07%. There were no borrowings related to this facility at December 31, 2007. The Company classified $4.6 million of bonds currently subject to redemption options in current maturities of long-term debt at December 31, 2007, 2006 and 2005.

The Company's debt instruments include only standard affirmative and negative covenants that are normal in debt instruments of similar amounts and structure. The Company's debt instruments do not contain financial or performance covenants restrictive to the business of the Company, reflecting its strong financial position. The Company is in compliance with all debt covenants for the year ended December 31, 2007.

NOTE 11 – LEASES

The Company leases certain land, buildings and equipment under noncancellable operating leases that expire at various dates through 2036. The Company capitalizes all significant leases that qualify for capitalization, of which there were none at December 31, 2007. Many of the building leases obligate the Company to pay real estate taxes, insurance and certain maintenance costs, and contain multiple renewal provisions, exercisable at the Company's option. Leases that contain predetermined fixed escalations of the minimum rentals are recognized in rental expense on a straight-line basis over the lease term. Cash or rent abatements received upon entering into certain operating leases are also recognized on a straight-line basis over the lease term.

At December 31, 2007, the approximate future minimum lease payments for all operating leases were as follows (in thousands of dollars):

	Future Minimum Lease Payments
2008	$ 38,578
2009	32,618
2010	25,677
2011	21,497
2012	18,725
Thereafter	63,305
Total minimum payments required	$200,400
Less amounts representing sublease income	(203)
	$200,197

Rent expense, including items under lease and items rented on a month-to-month basis, was $42.1 million, $33.4 million and $28.6 million for 2007, 2006 and 2005, respectively. These amounts are net of sublease income of $0.5 million, $0.5 million and $0.4 million for 2007, 2006 and 2005, respectively.

NOTE 12 – STOCK INCENTIVE PLANS

The Company maintains stock incentive plans under which the Company may grant a variety of incentive awards to employees and directors. Shares of common stock were authorized for issuance under the plans in connection with awards of non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units and other stock-based awards. As of December 31, 2007, restricted stock, restricted stock units, performance shares, stock units and non-qualified stock options have been granted.

In 2005, the shareholders of the Company approved the 2005 Incentive Plan ("Plan"), which replaced all prior active plans ("Prior Plans"). Awards previously granted under Prior Plans will remain outstanding in accordance with their terms but no new awards are allowed. The Plan authorizes the granting of options to purchase shares at a price of not less than 100% of the closing market price on the last trading day preceding the date of grant. All options expire no later than ten years after the date of grant. A total of 9.5 million shares of common stock have been reserved for issuance under the Plan. As of December 31, 2007, there were 4,418,226 shares available for grant under the Plan.

Effective January 1, 2006, the Company adopted the Financial Accounting Standards Board's Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R), using the modified prospective method. Under this transition method, compensation cost recognized in 2007 and 2006 includes: (a) compensation costs for all share-based payments granted prior to, but not fully vested as of January 1, 2006, based on the grant date fair value as calculated under the pro forma disclosure-only expense provisions of SFAS No. 123 and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with provisions of SFAS No. 123R. The results for prior periods have not been restated.

Pre-tax stock-based compensation expense was $35.7 million, $34.8 million, and $10.4 million in 2007, 2006 and 2005, respectively. Related income tax benefits recognized in earnings were $11.8 million, $11.8 million and $3.9 million in 2007, 2006 and 2005, respectively.

Options

In 2007, 2006 and 2005, the Company provided broad-based stock option grants covering 162,100, 187,900 and 231,500 shares, respectively, to those employees who reached major service milestones and were not participants in other stock option programs.

In 2007, 2006 and 2005, the Company issued stock option grants to employees as part of their incentive compensation. Stock option grants were 578,120, 1,234,400 and 1,183,650 for the years 2007, 2006 and 2005, respectively.

Option awards are granted with an exercise price equal to the closing market price of the Company's stock on the last trading day preceding the date of grant. The options generally vest over three years, although accelerated vesting is provided in certain circumstances. Awards generally expire ten years from the grant date.

Transactions involving stock options are summarized as follows:

	Shares Subject to Option	Weighted Average Price Per Share	Options Exercisable
Outstanding at January 1, 2005	9,205,794	$46.86	4,415,343
Granted	1,415,150	$54.20	
Exercised	(1,550,316)	$44.51	
Canceled or expired	(378,788)	$48.98	
Outstanding at December 31, 2005	8,691,840	$48.37	4,572,250
Granted	1,422,300	$75.87	
Exercised	(1,390,461)	$46.35	
Canceled or expired	(268,810)	$57.88	
Outstanding at December 31, 2006	8,454,869	$53.00	4,627,249
Granted	740,220	$82.21	
Exercised	(2,430,523)	$47.74	
Canceled or expired	(236,580)	$67.29	
Outstanding at December 31, 2007	6,527,986	$58.19	3,447,856

At December 31, 2007, there was $16.4 million of total unrecognized compensation expense related to nonvested option awards, which the Company expects to recognize over a weighted average period of 1.6 years.

The following table summarizes information about stock options exercised (in thousands of dollars):

	For the years ended December 31,		
	2007	2006	2005
Fair value of options exercised	$ 31,736	$ 18,152	$ 20,668
Total intrinsic value of options exercised	88,921	38,906	31,577
Fair value of options vested	15,996	15,295	25,574
Settlements of options exercised	113,752	64,437	65,997

Information about stock options outstanding and exercisable as of December 31, 2007, is as follows:

	Options Outstanding				Options Exercisable			
		Weighted Average				Weighted Average		
Range of Exercise Prices	Number	Remaining Contractual Life	Exercise Price	Intrinsic Value (000's)	Number	Remaining Contractual Life	Exercise Price	Intrinsic Value (000's)
$30.88 – $44.25	1,025,630	2.87 Years	$41.00	$ 47,711	1,025,630	2.87 Years	$41.00	$ 47,711
$45.50 – $54.85	3,321,461	5.56 Years	$51.42	119,905	2,395,576	4.88 Years	$51.08	87,285
$55.20 – $70.95	216,400	7.13 Years	$61.99	5,526	12,600	7.01 Years	$61.13	333
$71.21 – $93.05	1,964,495	8.65 Years	$78.18	18,356	14,050	8.32 Years	$75.13	174
	6,527,986	6.12 Years	$58.19	$191,498	3,447,856	4.31 Years	$48.22	$135,503

Effective January 1, 2006, the Company adopted a binomial lattice model for the valuation of stock options. The weighted average fair value of options granted in 2007 and 2006 was $22.92 and $18.91, respectively. The fair value of each option 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 weighted average fair value of the stock options granted during 2005 was $13.36, based on a Black-Scholes valuation model. The fair value of each option estimated on the date of grant used the following assumptions:

	Year Ended December 31, 2005
Risk-free interest rate	4.1%
Expected life	7 years
Expected volatility	20.1%
Expected dividend yield	1.8%

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 holder exercise and termination behavior. Expected volatility is based upon implied and historical volatility of the closing price of the Company's stock over a period equal to the expected life of each option grant. Historical company information is also the primary basis for selection of expected dividend yield assumptions.

Performance Shares

In 2007 and 2006, the Company awarded performance-based shares to certain executives. Receipt of Company stock is contingent upon the Company meeting sales growth and return on invested capital (ROIC) performance goals. Each participant was granted a base number of shares. At the end of the first year performance period, the number of shares granted will be increased, decreased or remain the same based upon actual Company-wide sales growth versus target sales growth. The shares, as determined at the end of the performance year, will be issued at the end of the third year if the Company's average target ROIC is achieved during the vesting period.

Performance share value is based upon closing market prices on the last trading day preceding the date of award and is charged to earnings on a straight-line basis over the three year period. Holders of performance shares are entitled to receive cash payments equivalent to cash dividends after the end of the first year performance period. If the performance shares vest, they will be settled by the issuance of Company common stock in exchange for the performance shares on a one-for-one basis.

The following table summarizes the transactions involving performance-based share awards:

	2007	2006
Beginning nonvested shares outstanding	37,812	—
Issuances	83,089	37,812
Cancellations	(4,105)	—
Ending nonvested shares outstanding	116,796	37,812
Weighted average per share value of issuances	$ 68.64	$ 71.23

At December 31, 2007, the unearned compensation related to performance-based share awards outstanding was $4.2 million, which the Company expects to recognize over a weighted average period of 1.7 years.

Restricted Stock

The plans authorize the granting of restricted stock, which is held by the Company pursuant to the terms and conditions related to the applicable grants. Except for the right of disposal, holders of restricted stock have full shareholders' rights during the period of restriction, including voting rights and the right to receive dividends. Restricted stock grants have original vesting periods of six to ten years.

Compensation expense related to restricted stock awards is based upon the closing market price on the last trading day preceding the date of grant and is charged to earnings on a straight-line basis over the vesting period. The following table summarizes the transactions involving restricted stock granted to employees:

	2007	2006	2005
Beginning nonvested shares outstanding	105,000	270,000	322,000
Cancellations	—	(10,000)	(5,000)
Vesting	(40,000)	(155,000)	(47,000)
Ending nonvested shares outstanding	65,000	105,000	270,000
Fair value of shares vested	$3.0 million	$11.1 million	$3.0 million

At December 31, 2007, there was $0.5 million of total unrecognized compensation expense related to nonvested restricted stock, which the Company expects to recognize over a weighted average period of 1.5 years.

Restricted Stock Units (RSUs)

Awards of RSUs are provided for under the stock compensation plans. RSUs granted vest over periods from three to seven years from issuance, although accelerated vesting is provided in certain instances. Holders of RSUs are entitled to receive cash payments equivalent to cash dividends and other distributions paid with respect to common stock. At various times after vesting, RSUs will be settled by the issuance of stock evidencing the conversion of the RSUs into shares of the Company common stock on a one-for-one basis. Compensation expense related to RSUs is based upon the closing market prices on the last trading day preceding the date of award and is charged to earnings on a straight-line basis over the vesting period.

The following table summarizes RSUs activity:

	2007		2006		2005	
	Shares	Weighted Average	Shares	Weighted Average	Shares	Weighted Average
Beginning nonvested units	740,200	$65.24	517,000	$49.74	369,800	$47.70
Issuances	421,003	$83.53	408,300	$75.54	239,675	$53.96
Cancellations	(74,030)	$71.99	(26,750)	$66.84	(22,375)	$52.25
Vestings	(104,605)	$75.85	(158,350)	$58.68	(70,100)	$52.54
Ending nonvested units	982,568	$72.91	740,200	$65.24	517,000	$49.74
Fair value of shares vested	$7.5 million		$8.4 million		$3.7 million	

At December 31, 2007, there was $38.7 million of total unrecognized compensation expense related to nonvested RSUs, which the Company expects to recognize over a weighted average period of 3.4 years.

Director Stock Awards

The Company provides members of the Board of Directors with deferred stock unit grants. A stock unit is the economic equivalent of a share of common stock. The number of units covered by each grant is equal to $60,000 divided by the fair market value of a share of common stock at the time of the grant, rounded up to the next ten-unit increment. The Company also awards stock units in connection with elective deferrals of director fees and dividend equivalents on existing stock units. Deferred fees and dividend equivalents on existing stock units are converted into stock units on the basis of the market value of the stock at the relevant times. Payment of the value of stock units is scheduled to be made after termination of service as a director. As of December 31, 2007, 2006 and 2005, there were eleven, eleven and ten nonemployee directors who held stock units.

The Company recognizes income (expense) for the change in value of equivalent stock units. The following table summarizes activity for stock units related to deferred director fees (dollars in thousands):

	2007		2006		2005	
	Units	Dollars	Units	Dollars	Units	Dollars
Beginning balance	61,242	$ 4,283	51,977	$ 3,696	39,398	$ 2,625
Dividends	1,099	95	902	64	722	45
Deferred fees	12,181	1,012	14,844	1,128	15,039	856
Retirement distributions	—	—	(6,481)	(461)	(3,182)	(198)
Unit appreciation (depreciation)	—	1,132	—	(144)	—	368
Ending balance	74,522	$ 6,522	61,242	$ 4,283	51,977	$ 3,696

APB No. 25 Pro Forma Disclosure

Prior to January 1, 2006, the Company applied Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees” (APB No. 25), and related interpretations in accounting for its stock-based compensation plans. Under APB No. 25, no compensation expense was recognized for non-qualified stock option awards as the exercise price of the awards on the date of grant was equal to the current market price of the Company’s stock. The Company also provided the disclosure-only pro forma expense provision of SFAS No. 123 in its footnotes.

For the year ended December 31, 2005, the following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation. For the purposes of this pro forma disclosure, the value of options was estimated using a Black-Scholes option-pricing model.

	For the Year Ended December 31, 2005
	(In thousands of dollars, except for per share amounts)
Net earnings, as reported	$346,324
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax	(16,733)
Add: Stock-based employee compensation cost, net of related tax, included in net earnings, as reported	6,644
Net earnings, pro forma	$336,235
Earnings per share:	
Basic – as reported	$ 3.87
Basic – pro forma	$ 3.75
Diluted – as reported	$ 3.78
Diluted – pro forma	$ 3.65

NOTE 13 – CAPITAL STOCK

The Company had no shares of preferred stock outstanding as of December 31, 2007, 2006 and 2005. The activity of outstanding common stock and common stock held in treasury was as follows:

	2007		2006		2005	
	Outstanding Common Stock	Treasury Stock	Outstanding Common Stock	Treasury Stock	Outstanding Common Stock	Treasury Stock
Balance at beginning of period	84,067,627	25,590,311	89,715,641	19,952,297	90,597,427	19,075,511
Exercise of stock options, net of 3,318, 0 and 47,057 shares swapped in stock-for-stock exchange	2,427,205	(2,427,205)	1,390,461	(1,390,461)	1,503,259	(1,503,259)
Cancellation of shares related to tax withholdings on restricted stock vesting	(14,867)	14,867	(59,297)	59,297	(15,493)	15,493
Settlement of restricted stock units, net of 16,739, 6,228 and 3,017 shares retained, respectively	31,057	(29,776)	13,822	(13,822)	7,748	(7,748)
Cancellation of restricted shares	—	—	(10,000)	—	(5,000)	—
Purchase of treasury shares	(7,051,607)	7,051,607	(6,983,000)	6,983,000	(2,372,300)	2,372,300
Balance at end of period	79,459,415	30,199,804	84,067,627	25,590,311	89,715,641	19,952,297

On August 17, 2007, the Company's Board of Directors authorized the restoration of the share repurchase program to 10 million shares. The program, which has no stated expiration date, replaced the existing 10 million share program that was authorized in October 2006. A total of 4,010,200 shares had been acquired under the prior program.

On August 20, 2007, the Company entered into an accelerated share repurchase agreement (ASR) with Goldman, Sachs & Co. (Goldman) to purchase $500 million of its outstanding common stock. The Company 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, the Company 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.

NOTE 14 – ACCUMULATED OTHER COMPREHENSIVE EARNINGS

The following table sets forth the components of Accumulated other comprehensive earnings (losses), (in thousands of dollars):

	As of December 31,		
	2007	2006	2005
Foreign currency translation adjustments	$94,683	$31,859	$33,188
Effect of adopting SFAS No. 158 related to postretirement benefit plans and other employment-related benefit plans	—	(36,783)	—
Postretirement benefit plan			
Prior service credit	10,592	—	—
Transition asset	1,000	—	—
Unrecognized (losses)	(25,405)	—	—
Unrecognized gains (losses) on other employment-related benefit plans	1,335	(524)	(579)
Deferred tax (liability) asset	(10,034)	8,879	(5,527)
Total accumulated other comprehensive earnings	$72,171	$ 3,431	$27,082

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132R" (SFAS No. 158). SFAS No. 158 requires an employer to recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status, measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year (with limited exceptions), and recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. SFAS No. 158 requires funded status changes of a defined benefit postretirement plan within accumulated other comprehensive earnings, net of tax, to the extent such changes are not recognized in earnings as components of net periodic benefit costs. The Company adopted SFAS No. 158 during the fourth quarter of 2006. 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.

Foreign currency translation adjustments result from the translation of assets and liabilities of foreign subsidiaries and are accumulated in this section of Shareholders' Equity. The increase in foreign currency translation adjustments in 2007 is primarily due to the weakening of the U.S. dollar versus the Canadian dollar.

NOTE 15 – INCOME TAXES

The Company 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.

Income tax expense consisted of (in thousands of dollars):

	For the Years Ended December 31,		
	2007	2006	2005
Current provision:			
Federal	$238,220	$172,961	$134,194
State	42,401	31,725	27,517
Foreign	15,329	5,080	976
Total current	295,950	209,766	162,687
Deferred tax provision (benefit):			
Federal	(28,520)	8,996	17,575
State	(5,013)	1,636	3,298
Foreign	(676)	(774)	2,790
Total deferred	(34,209)	9,858	23,663
Total provision	$261,741	$219,624	$186,350

Earnings before income taxes by geographical area consisted of the following (in thousands of dollars):

	For the Years Ended December 31,		
	2007	2006	2005
United States	$646,762	$588,322	$518,038
Canada	38,766	12,387	9,702
Other countries	(3,667)	2,314	4,934
	$681,861	$603,023	$532,674

The income tax effects of temporary differences that gave rise to the net deferred tax asset were (in thousands of dollars):

	As of December 31,		
	2007	2006	2005
Deferred tax assets:			
Inventory	$ 19,577	$ 13,809	$ 28,817
Accrued expenses	30,295	28,606	30,463
Accrued employment-related benefits	111,147	99,006	71,446
Foreign operating loss carryforwards	10,239	9,530	9,272
Property, buildings and equipment	3,189	—	—
Other	8,064	8,582	7,364
Deferred tax assets	182,511	159,533	147,362
Less valuation allowance	(13,551)	(13,461)	(10,872)
Deferred tax assets, net of valuation allowance	$168,960	$146,072	$136,490
Deferred tax liabilities:			
Purchased tax benefits	$ (6,779)	$ (7,715)	$ (8,965)
Property, buildings and equipment	—	(4,303)	(17,423)
Intangibles	(16,884)	(14,182)	(10,219)
Software	(9,710)	(10,627)	(7,177)
Prepaids	(16,625)	(14,111)	(1,950)
Foreign currency gain	(13,661)	(4,453)	(4,599)
Deferred tax liabilities	(63,659)	(55,391)	(50,333)
Net deferred tax asset	$105,301	$ 90,681	$ 86,157
The net deferred tax asset is classified as follows:			
Current assets	$ 56,663	$ 48,123	$ 76,474
Noncurrent assets	54,658	48,793	16,702
Noncurrent liabilities (foreign)	(6,020)	(6,235)	(7,019)
Net deferred tax asset	$105,301	$ 90,681	$ 86,157

At December 31, 2007, the Company had $32.3 million of foreign operating loss carryforwards related to foreign operations, some of which begin to expire in 2008. The valuation allowance represents a provision for uncertainty as to the realization of the tax benefits of these carryforwards. In addition, the Company recorded a valuation allowance to reflect the estimated amount of deferred tax assets that may not be realized.

The changes in the valuation allowance were as follows (in thousands of dollars):

	For the Years Ended December 31,		
	2007	2006	2005
Beginning balance	$ 13,461	$ 10,872	$ 10,265
Increase (decrease) related to foreign net operating loss carryforwards	1,329	(70)	607
(Decrease) increase related to capital losses and other	(1,239)	2,659	—
Ending balance	$ 13,551	$ 13,461	$ 10,872

A reconciliation of income tax expense with federal income taxes at the statutory rate follows (in thousands of dollars):

	For the Years Ended December 31,		
	2007	2006	2005
Federal income tax at the 35% statutory rate	$238,651	$211,058	$186,436
State income taxes, net of federal income tax benefit	24,302	22,795	20,030
Resolution of prior year tax contingencies	—	(12,200)	(9,700)
Other – net	(1,212)	(2,029)	(10,416)
Income tax expense	$261,741	$219,624	$186,350
Effective tax rate	38.4%	36.4%	35.0%

Undistributed earnings of foreign subsidiaries at December 31, 2007, amounted to $10.5 million. No provision for deferred U.S. income taxes has been made for these subsidiaries because the Company intends to permanently reinvest such earnings in those foreign operations. Additionally, if such earnings were repatriated, U.S. taxes payable would be substantially eliminated by available tax credits arising from taxes paid outside of the United States.

On January 1, 2007, the Company adopted the provisions of FIN 48. As a result, the Company recognized a decrease of approximately $0.9 million in the liability for tax uncertainties, which resulted in an increase to the January 1, 2007, balance of Retained earnings.

The changes in the liability for tax uncertainties, excluding interest and penalties, are as follows (in thousands of dollars):

	2007
Balance at beginning of year	$15,274
Additions based on tax positions related to the current year	3,060
Reductions for tax positions of prior years	(4,729)
Settlements (audit payments) refunds – net	(37)
Balance at end of year	$13,568

The Company classifies the liability for tax uncertainties in Deferred income taxes and tax uncertainties. Included in this amount is $3.3 million of tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Any changes in the timing of deductibility of these items would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

The Company regularly undergoes examination of its federal income tax returns by the Internal Revenue Service (IRS). The Company and the IRS have settled tax years through 2004. The Company is not currently under examination by the IRS nor under notice of pending examination. The Company is also subject to state and local income tax audits and foreign jurisdiction tax audits. The Company's tax years 2002 – 2007 remain subject to state, local and foreign audits. The Company does not not expect any material changes to the estimated amount of liability associated with its uncertain tax positions within the next twelve months.

The Company recognizes interest expense and penalties in the provision for income taxes. The current year provision includes $0.7 million for interest and penalties. The Company accrued $1.1 million for interest and penalties at December 31, 2007.

NOTE 16 – EARNINGS PER SHARE

Basic earnings per share is based on the weighted average number of shares outstanding during the year. Diluted earnings per share is based on the combination of weighted average number of shares outstanding and dilutive potential shares. The Company had additional outstanding stock options of 0.01 million, 1.36 million and 0.04 million for the years ended December 31, 2007, 2006 and 2005, respectively, that were excluded from the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common stock.

The following table sets forth the computation of basic and diluted earnings per share:

	For the Years Ended December 31,		
	2007	2006	2005
	(In thousands, except for per share amounts)		
Net earnings	$420,120	$383,399	$346,324
Denominator for basic earnings per share – weighted average shares	82,404	87,839	89,569
Effect of dilutive securities – stock-based compensation	2,641	2,685	2,019
Denominator for diluted earnings per share – weighted average shares adjusted for dilutive securities	85,045	90,524	91,588
Basic earnings per common share	$ 5.10	$ 4.36	$ 3.87
Diluted earnings per common share	$ 4.94	$ 4.24	$ 3.78

NOTE 17 – PREFERRED SHARE PURCHASE RIGHTS

The Company has a shareholder rights plan, under which there is outstanding one preferred share purchase right (Right) for each outstanding share of the Company's common stock. Each Right, under certain circumstances, may be exercised to purchase one one-hundredth of a share of Series A-1999 Junior Participating Preferred Stock (intended to be the economic equivalent of one share of the Company's common stock) at a price of $250.00, subject to adjustment. The Rights become exercisable only after a person or group, other than a person or group exempt under the plan, acquires or announces a tender offer for 15% or more of the Company's common stock. If a person or group, other than a person or group exempt under the plan, acquires 15% or more of the Company's common stock or if the Company is acquired in a merger or other business combination transaction, each Right generally entitles the holder, other than such person or group, to purchase, at the then-current exercise price, stock and/or other securities or assets of the Company or the acquiring company having a market value of twice the exercise price.

The Rights expire on May 15, 2009, unless earlier redeemed. They generally are redeemable at $.001 per Right until thirty days following announcement that a person or group, other than a person or group exempt under the plan, has acquired 15% or more of the Company's common stock. The Rights do not have voting or dividend rights and, until they become exercisable, have no dilutive effect on the earnings of the Company.

NOTE 18 – SEGMENT INFORMATION

The Company has three reportable segments: Grainger Branch-based, Acklands – Grainger Branch-based and Lab Safety. Grainger Branch-based is an aggregation of the following business units: Grainger 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.

The Company's branch-based segments offer similar services and products while the Lab Safety segment offers differing ranges of services and products and requires different resources and marketing strategies. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Intersegment transfer prices are established at external selling prices, less costs not incurred due to a related party sale.

The following is the segment information (in thousands of dollars):

	2007			
	Grainger Branch-based	Acklands – Grainger Branch-based	Lab Safety	Total
Total net sales	$5,352,520	$636,524	$434,663	$6,423,707
Intersegment net sales	(1,997)	—	(3,696)	(5,693)
Net sales to external customers	5,350,523	636,524	430,967	6,418,014
Segment operating earnings	669,441	44,218	54,287	767,946
Segment assets	2,107,408	502,414	212,627	2,822,449
Depreciation and amortization	100,082	10,786	9,126	119,994
Additions to long-lived assets	$ 155,936	$ 10,794	$ 7,844	$ 174,574

	2006			
	Grainger Branch-based	Acklands – Grainger Branch-based	Lab Safety	Total
Total net sales	$4,910,836	$565,098	$411,511	$5,887,445
Intersegment net sales	(1,214)	—	(2,577)	(3,791)
Net sales to external customers	4,909,622	565,098	408,934	5,883,654
Segment operating earnings	593,455	15,242	52,283	660,980
Segment assets	1,938,270	394,707	215,515	2,548,492
Depreciation and amortization	88,753	9,505	8,099	106,357
Additions to long-lived assets	$ 112,414	$ 8,238	$ 37,733	$ 158,385

	2005			
	Grainger Branch-based	Acklands – Grainger Branch-based	Lab Safety	Total
Total net sales	$4,649,200	$502,021	$380,091	$5,531,312
Intersegment net sales	(2,125)	—	(2,551)	(4,676)
Net sales to external customers	4,647,075	502,021	377,540	5,526,636
Segment operating earnings	522,635	14,003	52,712	589,350
Segment assets	1,821,897	389,855	175,201	2,386,953
Depreciation and amortization	80,994	7,638	7,756	96,388
Additions to long-lived assets	$ 129,326	$ 17,405	$ 27,107	$ 173,838

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

	2007	2006	2005
Operating earnings:			
Total operating earnings for reportable segments	$ 767,946	$ 660,980	$ 589,350
Unallocated expenses	(97,293)	(82,909)	(70,361)
Total consolidated operating earnings	$ 670,653	$ 578,071	$ 518,989
Assets:			
Total assets for reportable segments	$2,822,449	$2,548,492	$2,386,953
Unallocated assets	271,579	497,596	720,968
Total consolidated assets	$3,094,028	$3,046,088	$3,107,921

	2007		
	Segment Totals	Unallocated	Consolidated Total
Other significant items:			
Depreciation and amortization	$ 119,994	$ 12,005	$ 131,999
Additions to long-lived assets	$ 174,574	$ 25,558	$ 200,132

	Revenues	Long-Lived Assets
Geographic information:		
United States	$5,643,500	$ 961,624
Canada	640,121	206,133
Other foreign countries	134,393	20,135
	$6,418,014	$1,187,892

	2006		
	Segment Totals	Unallocated	Consolidated Total
Other significant items:			
Depreciation and amortization	$ 106,357	$ 12,211	$ 118,568
Additions to long-lived assets	$ 158,385	$ 14,268	$ 172,653

	Revenues	Long-Lived Assets
Geographic information:		
United States	$5,197,240	$ 909,188
Canada	567,626	176,097
Other foreign countries	118,788	8,784
	$5,883,654	$1,094,069

	2005		
	Segment Totals	Unallocated	Consolidated Total
Other significant items:			
Depreciation and amortization	$ 96,388	$ 12,394	$ 108,782
Additions to long-lived assets	$ 173,838	$ 5,528	$ 179,366

	Revenues	Long-Lived Assets
Geographic information:		
United States	$4,897,309	$ 864,154
Canada	504,373	178,609
Other foreign countries	124,954	4,610
	$5,526,636	$1,047,373

Long-lived assets consist of property, buildings, equipment, capitalized software, goodwill and other intangibles.

Revenues are attributed to countries based on the ship-to location of the customer.

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

Unallocated expenses increased $14.4 million in the year ended December 31, 2007, when compared with the prior year primarily driven by payroll and benefits due to increased incentive-related expenses as a result of the Company's performance. Unallocated assets decreased $226.0 million in the year ended December 31, 2007, when compared with the prior year primarily driven by the decrease in non-operating cash and cash equivalents related to the Company's ongoing share repurchase program.

The change in the carrying amount of goodwill by segment from January 1, 2005 to December 31, 2007, is as follows:

Goodwill, net by Segment	Acklands – Grainger Branch-based	Lab Safety	Total
Balance at January 1, 2005	$117,083	$ 47,928	$165,011
Acquisition	—	14,019	14,019
Translation	3,696	—	3,696
Balance at December 31, 2005	120,779	61,947	182,726
Acquisitions	—	28,276	28,276
Translation	(331)	—	(331)
Balance at December 31, 2006	120,448	90,223	210,671
Acquisition	—	1,473	1,473
Translation	20,884	—	20,884
Balance at December 31, 2007	$141,332	$ 91,696	$233,028

NOTE 19 – SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

A summary of selected quarterly information for 2007 and 2006 is as follows:

	2007 Quarter Ended (In thousands of dollars, except for per share amounts)				
	March 31	June 30	September 30	December 31	Total
Net sales	$1,546,658	$1,601,011	$1,658,592	$1,611,753	$6,418,014
Cost of merchandise sold	914,570	960,546	999,003	940,272	3,814,391
Gross profit	632,088	640,465	659,589	671,481	2,603,623
Warehousing, marketing and administrative expenses	469,503	473,890	485,257	504,320	1,932,970
Operating earnings	162,585	166,575	174,332	167,161	670,653
Net earnings	101,787	104,791	109,150	104,392	420,120
Earnings per share – basic	1.21	1.25	1.33	1.32	5.10
Earnings per share – diluted	$ 1.17	$ 1.21	$ 1.29	$ 1.28	$ 4.94

	2006 Quarter Ended (In thousands of dollars, except for per share amounts)				
	March 31	June 30	September 30	December 31	Total
Net sales	$1,419,117	$1,482,880	$1,519,499	$1,462,158	$5,883,654
Cost of merchandise sold	848,790	899,575	920,412	860,727	3,529,504
Gross profit	570,327	583,305	599,087	601,431	2,354,150
Warehousing, marketing and administrative expenses	435,910	438,761	447,774	453,634	1,776,079
Operating earnings	134,417	144,544	151,313	147,797	578,071
Net earnings	86,233	93,739	104,494	98,933	383,399
Earnings per share – basic	0.96	1.05	1.20	1.15	4.36
Earnings per share – diluted	$ 0.93	$ 1.02	$ 1.16	$ 1.13	$ 4.24

The 2006 fourth quarter included a $0.06 per share benefit from a reduction of deferred tax liabilities related to property, buildings and equipment. The 2006 third quarter included a $0.09 per share benefit from the resolution of uncertainties related to the audit of the 2004 tax year.

NOTE 20 – UNCLASSIFIED – NET

The components of Unclassified – net were as follows (in thousands of dollars):

	For the Years Ended December 31,		
	2007	2006	2005
Income items	$ 404	$ 359	$ 25
Expense items	(363)	(228)	(168)
Unclassified – net	$ 41	$ 131	$ (143)

NOTE 21 – CONTINGENCIES AND LEGAL MATTERS

The Company has an outstanding guarantee relating to an industrial revenue bond assumed by the buyer of one of the Company's formerly owned facilities. The maximum exposure under this guarantee is $8.5 million and it expires on December 15, 2008. The Company has not recorded any liability relating to this guarantee and believes it is unlikely that material payments will be required.

The Company 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 the Company. As of January 14, 2008, the Company 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.

The Company 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 the Company, typically based on the lack of product identification. If a specific product distributed by the Company is identified in any of these lawsuits, the Company would attempt to exercise indemnification remedies against the product manufacturer. In addition, the Company believes that a substantial number of these claims are covered by insurance. The Company is engaged in active discussions with its insurance carriers regarding the scope and amount of coverage. While the Company 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 the Company's consolidated financial position or results of operations.

The Company 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 the Company has previously responded to subpoenas issued by the OIG in connection with its audit. In December of 2007, the Company received a letter from the Justice Department's Commercial Litigation Branch of the Civil Division suggesting that the Company 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 the Company in the U.S. District Court for the Eastern District of Wisconsin relating to the GSA contract. The complaint alleges that the Company failed to comply with pricing provisions of the GSA contract and that sales made by the Company 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 the Company 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 the Company 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 the Company 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 the Company's consolidated financial position or results of operations.

NOTE 22 – SUBSEQUENT EVENTS

On January 4, 2008, pursuant to the Company's accelerated share repurchase agreement (ASR), Goldman, Sachs & Co. (Goldman) informed the Company that it had completed its obligations under the agreement. As described in Note 13, final settlement of the agreement would be based on the volume weighted average price of the Company's shares during the purchase period and the initial number of shares delivered. Accordingly, the Company received 415,274 shares of its common stock from Goldman as final settlement of the ASR. A total of 5,731,281 shares were repurchased under the ASR.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements (Form S-8 No.'s 33-43902, 333-24215, 333-61980, 333-105185, 333-124356 and Form S-4 No. 33-32091) of W.W. Grainger, Inc. and in the related prospectuses of our reports dated February 25, 2008, with respect to the consolidated financial statements of W.W. Grainger, Inc. and the effectiveness of internal control over financial reporting of W.W. Grainger, Inc., included in this Annual Report (Form 10-K) for the year ended December 31, 2007.

ERNST & YOUNG LLP

Chicago, Illinois

February 25, 2008

CERTIFICATION

I, R. L. Keyser, certify that:

1. I have reviewed this Annual Report on Form 10-K of W.W. Grainger, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 27, 2008

By: R. L. Keyser

Name: R. L. Keyser

Title: Chairman and Chief Executive Officer

CERTIFICATION

I, P. O. Loux, certify that:

1. I have reviewed this Annual Report on Form 10-K of W.W. Grainger, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 27, 2008

By: P. O. Loux

Name: P. O. Loux

Title: Senior Vice President, Finance
and Chief Financial Officer

EXHIBIT 32(a)

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, R. L. Keyser, Chairman and Chief Executive Officer of W.W. Grainger, Inc. (“Grainger”), certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Annual Report on Form 10-K of Grainger for the annual period ended December 31, 2007, (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Grainger.

R. L. Keyser

R. L. Keyser
Chairman and Chief Executive Officer

February 27, 2008

EXHIBIT 32(b)

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, P. O. Loux, Senior Vice President, Finance and Chief Financial Officer of W.W. Grainger, Inc. (“Grainger”), certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Annual Report on Form 10-K of Grainger for the annual period ended December 31, 2007, (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Grainger.

P. O. Loux

P. O. Loux

Senior Vice President, Finance
and Chief Financial Officer

February 27, 2008