PRIMEDIA INC
Form 8-K
May 17, 2011

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

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

Date of report (Date of earliest event reported) May 15, 2011

PRIMEDIA Inc.
(Exact Name of Registrant as Specified in Charter)

3585 Engineering Drive, Norcross, Georgia 30092
(Address of Principal Executive Offices)

Delaware	1-11106	13-3647573
(State or Other Jurisdiction of Incorporation)	(Commission File Number)	(IRS Employer Identification No.)

Registrant’s telephone number, including area code 678-421-3000

(Former Name or Former Address, if Changed Since Last Report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 1.01 Entry into a Material Definitive Agreement.

On May 15, 2011, PRIMEDIA Inc., a Delaware corporation (the "Company") entered into an Agreement and Plan of Merger (the "Merger Agreement") with Pittsburgh Holdings, LLC, a Delaware limited liability company ("Parent"), and Pittsburgh Acquisition, Inc., a Delaware corporation and a direct wholly-owned subsidiary of Parent ("Merger Sub"). Pursuant to the Merger Agreement and subject to the conditions set forth therein, Merger Sub will merge with and into the Company, with the Company as the surviving entity and continuing its separate existence under the laws of the State of Delaware as a wholly-owned subsidiary of Parent (the "Merger").

At the Effective Time (as defined in the Merger Agreement), each holder of the Company's common stock ("Company Common Stock") will be entitled to receive $7.10 per share in cash without interest (the "Merger Consideration"), excluding (i) treasury stock held by the Company, (ii) Company Common Stock owned by Parent, Merger Sub or any wholly-owned subsidiary of the Company immediately prior to the Effective Time and (iii) Common Stock with respect to which appraisal rights under Delaware law are properly exercised and not withdrawn.

Immediately prior to the Effective Time, each outstanding option to purchase Company Common Stock (a "Company Stock Option") granted under any of the Company's Stock Plans (as defined in the Merger Agreement) or otherwise, whether or not vested and exercisable, will become fully vested and exercisable and the holder will be entitled to generally receive, an amount in cash (less any tax withholding), equal to the product of (i) the excess, if any, of the Merger Consideration over the applicable exercise price per share of such Company Stock Option and (ii) the number of shares of Common Stock such holder could have purchased had such holder exercised the Company Stock Option immediately prior to the Effective Time. Immediately prior to the Effective Time, all outstanding shares of restricted Company Common Stock will be fully vested and converted into the right to receive the Merger Consideration. Immediately prior to the Effective Time, each option to purchase shares of Company Common Stock granted to KKR Capstone (a "Capstone Option"), whether or not vested and exercisable, will become fully vested and exercisable and the holder will be entitled to generally receive, an amount in cash (less any tax withholding), equal to the product of (i) the excess, if any, of the Merger Consideration over the applicable exercise price per share of such Capstone Option and (ii) the number of shares of Company Common Stock such holder could have purchase had such holder exercised the Capstone Option in full immediately prior to the Effective Time. Immediately prior to the Effective Time, each warrant to purchase shares of Company Common Stock (a "Warrant") will become fully vested and exercisable and the holder will be entitled to generally receive an amount in cash (less any tax withholding) equal to the product of (i) the excess, if any, of the Merger Consideration over the applicable exercise price per share of such Warrant and (ii) the number of shares of Company Common Stock such holder could have purchased had such holder exercised the Warrant in full immediately prior to the Effective Time.

Completion of the Merger is subject to various customary closing conditions, including expiration or termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended. The transaction is not subject to any financing condition. Further, as previously disclosed, holders of approximately 58% of the outstanding shares of Company Common Stock have executed a written consent adopting the Merger Agreement and approving the Merger. Therefore, no additional action by holders of Company Common Stock is required to complete the transaction.

The Merger Agreement contains representations, warranties and covenants of the parties customary for a transaction of this type. Until the closing of the Merger, the Merger Agreement permits the Company to continue making ordinary quarterly dividend payments in an amount not to exceed $0.07 per share with record dates consistent with the Company's record dates for such dividends during 2010.

The Company is not permitted to solicit inquiries or initiate discussions with third parties regarding other proposals to acquire the Company and has agreed to certain restrictions on its ability to respond to such proposals. The Merger Agreement contains certain termination rights for Parent and the Company. Parent will be required to pay the Company a termination fee equal to $30,000,000 (the "Reverse Termination Fee") under certain specified circumstances as set forth in the Merger Agreement. An affiliate of Parent and Merger Sub has provided the Company with a limited guarantee in favor of the Company guaranteeing the payment of certain monetary obligations that may be owed by Parent or Merger Sub pursuant to the Merger Agreement, including the Reverse Termination Fee.

A copy of the Merger Agreement has been provided solely to inform investors of its terms. The representations, warranties and covenants contained in the Merger Agreement were made only for the purposes of such agreement and as of specific dates, were made solely for the benefit of the parties to the Merger Agreement and may be intended not as statements of fact, but rather as a way of allocating risk to one of the parties if those statements prove to be inaccurate. In addition, such representations, warranties and covenants may have been qualified by certain disclosures not reflected in the text of the Merger Agreement and may apply standards of materiality in a way that is different from what may be viewed as material by stockholders of, or other investors in, the Company. The Company's stockholders and other investors are not third-party beneficiaries under the Merger Agreement and should not rely on the representations, warranties and covenants or any descriptions thereof as a characterization of the actual state of facts or conditions of the Company, Parent, Merger Sub or any of their respective subsidiaries or affiliates.

The foregoing description of the Merger Agreement does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, which is filed as Exhibit 2.1 hereto and is incorporated herein by this reference.

Additional Information and Where to Find It

In connection with the proposed transaction, the Company will prepare an information statement to be filed with the SEC. When completed, a definitive information statement will be mailed to the stockholders of the Company. THE COMPANY'S SECURITY HOLDERS ARE URGED TO READ THE INFORMATION STATEMENT REGARDING THE PROPOSED TRANSACTION BECAUSE IT WILL CONTAIN IMPORTANT INFORMATION. The Company's stockholders will be able to obtain, without charge, a copy of the information statement (when available) and other relevant documents filed with the SEC from the SEC's website at http://www.sec.gov. The Company's stockholders will also be able to obtain, without charge, a copy of the information statement and other relevant documents (when available) by directing a request by mail or telephone to PRIMEDIA Inc., Attn: Corporate Secretary, 3585 Engineering Drive, Norcross, Georgia 30092, telephone: (678) 421-3000, or from the company's website, http://www.primedia.com. The contents of the websites referenced above are not deemed to be incorporated by reference into the information statement.

Item 9.01 Financial Statements and Exhibits.

(d) Exhibits.

Exhibit Number	Description of Exhibit
2.1	Agreement and Plan of Merger, dated as of May 15, 2011, by and among, Pittsburgh Holdings, LLC, Pittsburgh Acquisition, Inc. and PRIMEDIA Inc.

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SIGNATURE

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

PRIMEDIA INC.

Dated: May 17, 2011

By:	/s/ KEITH L. BELKNAP
Name:	Keith L. Belknap
Title:	Senior Vice President, General Counsel and Secretary

EXHIBIT INDEX

Exhibit No.	Description
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2006

2005

2004

ASSETS

CURRENT ASSETS

Cash and cash equivalents

$ 348,471

$ 544,894

$ 429,246

Marketable securities at cost,

which approximates market value

12,827

Accounts receivable (less allowances for

doubtful accounts of $18,801, $18,401

and $23,375, respectively)

566,607

518,625

480,893

Inventories

827,254

791,212

700,559

Prepaid expenses and other assets

58,804

54,334

47,086

Deferred income taxes

48,123

76,474

86,632

Total current assets

1,862,086

1,985,539

1,744,416

PROPERTY, BUILDINGS AND EQUIPMENT

Land

167,218

162,123

154,673

Buildings, structures and improvements

890,380

841,031

804,317

Furniture, fixtures, machinery and equipment

769,506

716,497

679,141

1,827,104

1,719,651

1,638,131

Less accumulated depreciation and amortization

1,034,169

949,026

876,558

Property, buildings and equipment net

792,935

770,625

761,573

DEFERRED INCOME TAXES

48,793

16,702

29,168

INVESTMENTS IN UNCONSOLIDATED ENTITIES

8,492

25,155

26,126

GOODWILL

210,671

182,726

165,011

OTHER ASSETS AND INTANGIBLES NET

123,111

127,174

83,279

TOTAL ASSETS

$ 3,046,088

$ 3,107,921

$ 2,809,573

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W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS CONTINUED

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

	As of December 31, 2006	2005	2004
LIABILITIES AND SHAREHOLDERS EQUITY			
CURRENT LIABILITIES			
Current maturities of long-term debt	$ 4,590	$ 4,590	$ 9,485
Trade accounts payable	334,820	319,254	289,388
Accrued compensation and benefits	140,141	152,543	127,994
Accrued contributions to employees profit sharing plans	113,014	90,478	76,052
Accrued expenses	106,681	103,932	97,860
Income taxes	7,077	24,554	35,253
Total current liabilities	706,323	695,351	636,032
LONG-TERM DEBT (less current maturities)	4,895	4,895	
DEFERRED INCOME TAXES	6,235	7,019	4,482
ACCRUED EMPLOYMENT-RELATED BENEFITS COSTS	151,020	111,680	101,089
SHAREHOLDERS EQUITY			
Cumulative Preferred Stock $5 par value 12,000,000 shares authorized; none issued nor outstanding			
Common Stock $0.50 par value 300,000,000 shares authorized; issued, 109,657,938, 109,667,938 and 109,672,938 shares, respectively	54,829	54,834	54,836
Additional contributed capital	513,667	451,578	432,171
Retained earnings	3,007,606	2,722,103	2,458,442
Unearned restricted stock compensation	(35,213)	(17,280)	(14,463)
Accumulated other comprehensive earnings	3,431	27,082	18,052
Treasury stock, at cost 25,590,311, 19,952,297 and 19,075,511 shares, respectively	(1,366,705)	(949,341)	(881,068)
Total shareholders equity	2,177,615	2,288,976	2,067,970
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 3,046,088	$ 3,107,921	$ 2,809,573

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

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W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of dollars)

	For the Years Ended December 31,		
	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net earnings	$ 383,399	$ 346,324	$ 286,923
Provision for losses on accounts receivable	6,057	1,326	5,159
Deferred income taxes	9,858	23,663	(4,450)
Depreciation and amortization:			
Property, buildings and equipment	100,975	98,087	85,566
Capitalized software and other intangibles	17,593	10,695	12,690
Stock-based compensation	33,754	9,015	8,226
Tax benefit of stock incentive plans	1,563	11,962	12,068
Net gains on sales of property, buildings and equipment	(11,035)	(7,337)	(1,725)
(Income) from unconsolidated entities	(2,960)	(2,809)	(996)
(Gains) on sales of unconsolidated entities	(2,291)		(750)
Change in operating assets and liabilities net of business acquisitions and joint venture contributions:			
(Increase) decrease in accounts receivable	(53,056)	(36,378)	(49,935)
(Increase) decrease in inventories	(33,839)	(84,031)	(30,728)
(Increase) decrease in prepaid expenses	(3,918)	(6,251)	(9,087)
Increase (decrease) in trade accounts payable	10,888	27,121	29,302
Increase (decrease) in other current liabilities	(2,558)	43,056	64,372
Increase (decrease) in current income taxes payable	(17,395)	(10,632)	(4,268)
Increase (decrease) in accrued employment-related benefits costs	2,634	10,012	8,613
Other net	(2,916)	(1,280)	(4,493)
Net cash provided by operating activities	436,753	432,543	406,487
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to property, buildings and equipment	(127,814)	(112,297)	(128,276)
Proceeds from sales of property, buildings and equipment net	17,314	15,037	17,616
Additions to capitalized software	(8,950)	(44,950)	(32,482)
Purchase of marketable securities	(13,187)		
Proceeds from sale of unconsolidated entity	27,843		
Net cash paid for business acquisitions	(34,390)	(24,817)	
(Investments in) and loan repayment from unconsolidated entities	(3,988)	4,088	
Other net	3,426	(46)	750
Net cash used in investing activities	(139,746)	(162,985)	(142,392)

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W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS CONTINUED

(In thousands of dollars)

	For the Years Ended December 31,		
	2006	2005	2004
CASH FLOWS FROM FINANCING ACTIVITIES:			
Long-term debt payments	$	$	$ (140,800)
Stock options exercised	64,437	65,997	72,275
Excess tax benefits from stock-based compensation	13,373		
Purchase of treasury stock	(472,787)	(137,473)	(100,872)
Cash dividends paid	(97,896)	(82,663)	(71,243)
Net cash used in financing activities	(492,873)	(154,139)	(240,640)
Exchange rate effect on cash and cash equivalents	(557)	229	2,967
NET (DECREASE) INCREASE			
IN CASH AND CASH EQUIVALENTS	(196,423)	115,648	26,422
Cash and cash equivalents at beginning of year	544,894	429,246	402,824
Cash and cash equivalents at end of year	$ 348,471	$ 544,894	$ 429,246
Supplemental cash flow information:			
Cash payments for interest			
(net of amounts capitalized)	$ 1,413	$ 1,791	$ 3,408
Cash payments for income taxes	212,350	162,030	154,589
Noncash investing activities:			
Fair value of noncash assets			
acquired in business acquisitions	$ 38,430	$ 26,811	$
Liabilities assumed in business acquisitions	(4,040)	(1,994)	

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

W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

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

	Common Stock	Additional Contributed Capital	Retained Earnings	Unearned Restricted Stock Compensation	Accumulated Other Comprehensive Earnings (Losses)	Treasury Stock
Balance at January 1, 2004	$ 54,689	$ 394,409	$ 2,242,762	$ (11,471)	$ 2,594	$ (837,848)
Exercise of stock options	253	11,910				60,112
Tax benefits on stock options exercised		10,138				
Issuance of other stock-based compensation awards	5	12,647		(12,652)		
Tax benefits on other vested stock-based compensation awards		1,930				
Conversion of restricted stock to restricted stock units	(108)	108				
Remeasurement of stock options and other stock-based compensation awards		2,620		(809)		
Cancellation of other stock-based compensation awards	(3)	(1,479)		1,482		
Amortization of unearned compensation on other stock-based compensation awards				8,987		
Settlement of other stock-based compensation awards		(161)				(2,411)
Purchase of 2,001,000 shares of treasury stock; 5,510 shares issued		49				(100,921)
Other comprehensive earnings					15,458	
Net earnings			286,923			
Cash dividends paid ($0.785 per share)			(71,243)			
Balance at December 31, 2004	$ 54,836	$ 432,171	$ 2,458,442	$ (14,463)	$ 18,052	$ (881,068)
Exercise of stock options		(3,882)				69,879

Tax benefits on stock options exercised		11,546				
Issuance of other stock-based compensation awards		12,932		(12,932)		
Tax benefits on other vested stock-based compensation awards		416				
Remeasurement of stock options and other stock-based compensation awards		303		(208)		
Cancellation of other stock-based compensation awards	(2)	(1,401)		1,403		
Amortization of unearned compensation on other stock-based compensation awards				8,920		
Vesting of restricted stock						(994)
Settlement of other stock-based compensation awards		(507)				315
Purchase of 2,372,300 shares of treasury stock						(137,473)
Other comprehensive earnings					9,030	
Net earnings			346,324			
Cash dividends paid ($0.920 per share)			(82,663)			
Balance at December 31, 2005	$ 54,834	$ 451,578	$ 2,722,103	$ (17,280)	$ 27,082	$ (949,341)

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W.W. Grainger, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY CONTINUED

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

	Common Stock	Additional Contributed Capital	Retained Earnings	Unearned Restricted Stock Compensation	Accumulated Other Comprehensive Earnings (Losses)	Treasury Stock
Balance at December 31, 2005	$ 54,834	$ 451,578	$ 2,722,103	$ (17,280)	$ 27,082	$ (949,341)
Exercise of stock options		(3,984)				68,421
Tax benefits on stock options exercised		13,989				
Stock option expense		19,904				
Issuance of other stock-based compensation awards		33,726		(33,726)		
Tax benefits on other vested stock-based compensation awards		947				
Remeasurement of stock options and other stock-based compensation awards		488		(488)		
Cancellation of other stock-based compensation awards	(5)	(2,431)		2,436		
Amortization of unearned compensation on other stock-based compensation awards				13,845		
Vesting of restricted stock						(4,263)
Settlement of other stock-based compensation awards		(1,003)				592
Purchase of 6,983,000 shares of treasury stock						(482,114)
Other comprehensive earnings					(1,148)	
Adjustment to initially apply SFAS No. 158 to postretirement benefit plans, net of tax benefit of $14,280					(22,503)	
Change in interest joint venture		453				
Net earnings			383,399			
Cash dividends paid			(97,896)			

($1.110 per share)												
Balance at December 31, 2006	$	54,829	$	513,667	$	3,007,606	$	(35,213)	$	3,431	$	(1,366,705)

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

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W.W. Grainger, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006, 2005 and 2004

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.

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.

RECLASSIFICATIONS

Certain amounts in the 2005 and 2004 financial statements, as previously reported, have been reclassified to conform to the presentation adopted in 2006. The Company reclassified certain employment-related benefits on its consolidated balance sheets in 2005 and 2004 which were previously presented as current liabilities to noncurrent liabilities. The amounts reclassified totalled $31.6 million and $26.4 million in 2005 and 2004, respectively. The Company also reclassified the related current deferred income tax assets to noncurrent deferred income tax assets. The amounts reclassified totalled $12.3 million and $10.3 million in 2005 and 2004, respectively. The reclassifications did not change consolidated net income or net cash flows from operations for the years presented.

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.

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 Note 2 to 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.

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.

VENDOR CONSIDERATION

The Company accounts for vendor consideration in accordance with Emerging Issues Task Force (EITF) Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor (Issue 02-16). 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.

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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.

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

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R). SFAS No. 123R revised SFAS No. 123 to require companies to measure all stock-based compensation awards using a fair value method and recognize the related compensation cost in their financial statements. Effective January 1, 2006, the Company adopted SFAS No. 123R using the modified prospective method. Under this transition method, compensation cost recognized in 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 adoption of SFAS No. 123R primarily resulted in compensation expense being recorded for stock options. The results for prior periods have not been restated.

For the year ended December 31, 2006, the Company recorded pretax compensation expense of $19.9 million ($12.2 million net of tax, or $0.14 per basic and diluted share) related to the expensing of the Company s non-qualified stock options. For 2006, the fair value of options was estimated using a binomial lattice model. If the tax deductions realized in the Company s income tax return exceed the amount of the tax benefit recognized in the financial statements, the excess tax benefit is recorded as an increase to additional contributed capital. For the year ended December 31, 2006, $13.4 million of excess tax benefits were realized and reflected as a source of cash from financing activities in the condensed consolidated statements of cash flows. If SFAS No. 123R had not been adopted, this $13.4 million would have been reflected as a source of cash from operating activities.

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 years ended December 31, 2005 and 2004, 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 Years Ended December 31,	
	2005	2004
	(In thousands of dollars, except for per share amounts)	
Net earnings, as reported	$ 346,324	$ 286,923
Deduct: Total stock-based employee compensation	(16,733)	(20,940)

expense determined under the fair value based method		
for all awards, net of related tax		
Add: Stock-based employee compensation cost, net of		
related tax, included in net earnings, as reported	6,644	7,256
Net earnings, pro forma	$ 336,235	$ 273,239
Earnings per share:		
Basic as reported	$ 3.87	$ 3.18
Basic pro forma	$ 3.75	$ 3.03
Diluted as reported	$ 3.78	$ 3.13
Diluted pro forma	$ 3.65	$ 2.97

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ADVERTISING

Advertising costs are expensed in the year the related advertisement is first presented. Advertising expense was $115.4 million, $102.3 million and $98.2 million for 2006, 2005 and 2004, 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, 2006, 2005 and 2004 were $30.2 million, $20.8 million and $18.2 million, respectively.

SOFTWARE COSTS

The Company does not sell, lease or market software.

INCOME TAXES

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for 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 (losses) on postretirement and other employment-related benefit plans. Through the third quarter of 2004, the foreign currency translation adjustments were partially offset by the after-tax effects of a designated hedge.

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

	As of December 31,		
	2006	2005	2004
Foreign currency translation adjustments	$ 26,254	$ 27,435	$ 18,052
Effect of adopting SFAS No. 158 related to postretirement benefit plans	(22,503)		
Unrecognized (losses) on other employment-related benefit plans	(320)	(353)	
Total accumulated other comprehensive earnings (losses)	$ 3,431	$ 27,082	$ 18,052

As described in Note 2 NEW ACCOUNTING STANDARDS, the Company adopted SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. SFAS No. 158 requires a transition year disclosure of the effect of applying the new standard.

The following table shows the effects of applying SFAS No. 158 on comprehensive earnings and other individual line items in the consolidated financial statements of the Company.

	Incremental Effect of Applying SFAS No. 158 December 31, 2006 (In thousands of dollars)		
	Before Application of SFAS No. 158	Effect of SFAS No. 158 Adoption	After Application of SFAS No. 158
Accrued employment-related benefit costs	$ (114,237)	$ (36,783)	$ (151,020)
Deferred income taxes	$ 34,513	$ 14,280	$ 48,793
Accumulated other comprehensive earnings (losses), net of tax	$ (25,934)	$ 22,503	$ (3,431)
Total shareholders equity	$ (2,200,118)	$ 22,503	$ (2,177,615)
Total liabilities and equity	$ (3,068,591)	$ 22,503	$ (3,046,088)

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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. The investments are issued from high credit quality issuers. The marketable securities are recorded at cost which is considered to approximate fair value. These investments have an original maturity date of more than 90 days.

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

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 77% 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 $0.3 million, $0.3 million and $0.2 million in 2006, 2005 and 2004, 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

The Company follows SFAS No. 142, Goodwill and Other Intangible Assets, in accounting for goodwill and other intangibles. Under SFAS No. 142, 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 the 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,		
	2006	2005	2004
Beginning balance	$ 3,763	$ 3,428	$ 2,863
Returns	(7,641)	(9,179)	(9,908)
Provisions	8,529	9,514	10,473
Ending balance	$ 4,651	$ 3,763	$ 3,428

NEW ACCOUNTING STANDARDS

In February 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140. SFAS No. 155 allows companies to elect to measure at fair value entire financial instruments containing embedded derivatives that would otherwise have to be accounted for separately. It also requires companies to identify interests in securitized financial assets that are freestanding derivatives or contain embedded derivatives that would have to be accounted for separately, clarifies which interest- and principal-only strips are subject to SFAS No. 133, and amends SFAS No. 140 to revise the conditions of a qualifying special purpose entity due to the new requirement to identify whether interests in securitized financial assets are freestanding derivatives or contain embedded derivatives. SFAS No. 155 is effective for all financial instruments acquired, issued or subject to a remeasurement event after the beginning of a company s first fiscal year that begins after September 15, 2006. The Company does not expect adoption of SFAS No. 155 to have a material effect on its results of operations or financial position.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140. SFAS No. 156 requires the recognition of a servicing asset or liability each time a company undertakes an obligation to service a financial asset in certain situations. It requires all separately recognized servicing assets and liabilities to be initially measured at fair value, if practical. SFAS No. 156 is effective as of the beginning of a company s first fiscal year that begins after September 15, 2006. The Company does not expect adoption of SFAS No. 156 to have a material effect on its results of operations or financial position.

In June 2006, the Emerging Issues Task Force (EITF) reached a consensus with respect to EITF Issue 06-2, Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, Accounting for Compensated Absences. Under Issue 06-2, an employee s right to a compensated absence under a sabbatical or similar benefit arrangement in which the employee is not required to perform any duties during the absence accumulates and therefore should be accounted for as a liability if the other conditions for recognition in SFAS No. 43 are met. The other conditions in SFAS No. 43 are that the obligation relates to services already rendered, payment is probable and the amount can be reasonably estimated. Issue 06-2 is effective for fiscal years beginning after December 15, 2006, with early application permitted. The Company does not expect adoption of Issue 06-2 to have a material effect on its results of operations or financial position.

In June 2006, the EITF reached a consensus with respect to EITF Issue 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation). Issue 06-3 permits the presentation of sales and other taxes on either a gross (included in revenues and costs) or net (excluded from revenues) basis and is an accounting policy decision that should be disclosed pursuant to APB Opinion No. 22, Disclosures of Accounting Policies. If reported on a gross basis, the amount of any such taxes should be disclosed in interim and annual financial statements. The effective date is for disclosures presented for interim and annual financial periods beginning after December 15, 2006. The Company does not expect to change its presentation of sales

and other taxes, which is currently on a net basis.

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In July 2006, the FASB issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. 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 measure 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. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect adoption of FIN 48 to have a material effect on its results of operations or financial position.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. 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 is currently evaluating the effect adoption may have on its results of operations or financial position.

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 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 income, net of tax, to the extent such changes are not recognized in earnings as components of net periodic benefit costs. SFAS No. 158 is effective for fiscal years ending after December 15, 2006. 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 of $22.5 million. See Note 2 OTHER COMPREHENSIVE EARNINGS (LOSSES) for further detail related to the effects of the adoption.

In September 2006, the EITF reached a consensus on Issue 06-5, Accounting for Purchases of Life Insurance Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance. Issue 06-5 provides guidance on how an entity should determine the amount that could be realized under an insurance contract at the balance sheet date. This guidance requires that the cash surrender value and any additional amounts provided by the contractual terms of the life insurance policy that are realizable at the balance sheet date should be considered in determining the amount that could be realized. This guidance is effective for reporting periods beginning after December 15, 2006. The Company does not expect adoption of Issue 06-5 to have a material effect on its results of operations or financial position.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements. SAB No. 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. SAB No. 108 requires an entity to quantify misstatements using a balance sheet and income statement approach, and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. The adoption of SAB No. 108 is effective for fiscal years ending on or after November 15, 2006. The Company adopted SAB No. 108 during the fourth quarter of 2006. The adoption of SAB No. 108 did not have a material effect on the Company s results of operations or financial position.

NOTE 3 BUSINESS ACQUISITIONS

On November 17, 2006, Lab Safety Supply, Inc. (Lab Safety), a wholly owned subsidiary of the Company, acquired substantially all of the assets and assumed certain liabilities of Professional Inspection Equipment, Inc. (Professional Equipment) and Construction Book Express, Inc. (Construction Book). 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 approximately $20.5 million in cash and $1.7 million in assumed liabilities. The estimated goodwill recognized in the transaction amounted to $18.4 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,		
	2006	2005	2004
Balance at beginning of period	$ 18,401	$ 23,375	$ 24,736
Provision for uncollectible accounts	6,057	1,326	5,159
Write-off of uncollectible accounts, less recoveries	(5,660)	(6,380)	(6,662)
Foreign currency exchange impact	3	80	142
Balance at end of period	$ 18,801	$ 18,401	$ 23,375

NOTE 5 INVENTORIES

Inventories primarily consist of merchandise purchased for resale.

Inventories would have been $270.0 million, $246.3 million and $238.4 million higher than reported at December 31, 2006, 2005 and 2004, respectively, if the FIFO method of inventory accounting had been used for all Company inventories. Net earnings would have increased by $14.5 million, $4.9 million and $2.4 million for the years ended December 31, 2006, 2005 and 2004, 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.	USI-AGI Prairies Inc.	Total
Balance at January 1, 2004	$ 2,874	$ 19,948	$ 22,822
Equity (loss) earnings	(1,107)	2,103	996
Foreign currency gain	524	1,784	2,308
Balance at December 31, 2004	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	453		453
Foreign currency (loss) gain	(209)	1,112	903
Balance at December 31, 2006	$ 8,492	$	$ 8,492
Ownership interest at December 31, 2006	38%	0%	

The Company has investments in two Asian companies accounted for under the equity method of accounting. At December 31, 2006, the ownership percentages of the two investments were 49% and 38%. In the fourth quarter of 2003, the Company wrote off its investment in the joint venture in Korea (49% ownership interest) and suspended recognition of equity income. Even though the business is marginally profitable and self-funding, it currently has only one significant customer (the other party in the joint venture) and will need to secure sufficient capital funding in order to grow.

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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 20, 2007, was $40.1 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 $12.6 million, $7.6 million and $10.7 million for the years ended December 31, 2006, 2005 and 2004, 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. In 2004, the Company determined certain capitalized amounts were no longer recoverable and wrote down their carrying value by $1.0 million.

NOTE 8 SHORT-TERM DEBT

The Company and its subsidiaries had committed lines of credit totaling $250.0 million at December 31, 2006, 2005 and 2004, for which the Company compensated a bank through a commitment fee of 0.04% in 2006 and 0.07% in 2005 and 2004. There were no borrowings under the committed lines of credit.

The Company also had $8.6 million, $8.6 million and $8.3 million of uncommitted lines of credit denominated in Canadian dollars at December 31, 2006, 2005 and 2004, respectively. There were no borrowings under the committed lines of credit.

The Company had $15.8 million, $15.8 million and $16.0 million of letters of credit at December 31, 2006, 2005 and 2004, respectively, primarily related to the Company s casualty insurance program. The Company also had $3.3 million, $1.4 million and $0.9 million at December 31, 2006, 2005 and 2004, 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 $114.3 million, $92.8 million and $74.2 million for the years ended December 31, 2006, 2005 and 2004, 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, with subsidy payments beginning January 1, 2006. The Company first reflected the effect of the subsidy in 2004. As a result of the subsidy, the APBO has been reduced by $33.4 million, $30.6 million and $20.8 million as of December 31, 2006, 2005 and 2004, respectively. The net periodic benefit costs have been reduced by approximately $5.6 million, $4.4 million and $3.8 million for the years ended December 31, 2006, 2005 and 2004, respectively.

The net periodic benefits costs charged to operating expenses, which were valued with a measurement date of January 1 for each year, including the effect of the Medicare Act in 2006, 2005 and 2004, consisted of the following components:

	For the Years Ended December 31,		
	2006	2005	2004
	(In thousands of dollars)		
Service cost	$ 9,737	$ 7,577	$ 6,380
Interest cost	7,599	6,287	5,292
Expected return on assets	(2,790)	(2,502)	(2,064)
Amortization of transition asset	(143)	(143)	(143)
Amortization of unrecognized losses	2,903	1,923	1,371
Amortization of prior service cost	(858)	(858)	(858)
Net periodic benefits costs	$ 16,448	$ 12,284	$ 9,978

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 2006.

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:

	2006	2005	2004
	(In thousands of dollars)		
Benefit obligation at the beginning of the year	$ 127,598	$ 103,381	$ 107,710
Service cost	9,737	7,577	6,380
Interest cost	7,599	6,287	5,292
Plan participant contributions	1,670	1,527	1,364
Amendments	5,559		(2,843)
Actuarial losses (gains)	7,359	12,843	(11,194)
Benefits paid	(4,277)	(4,017)	(3,328)
Medicare Part D Subsidy payments received	108		
Benefit obligation at the end of the year	155,353	127,598	103,381
Fair value of plan assets at the beginning of the year	46,503	41,706	34,405
Actual returns on plan assets	6,192	1,515	3,026
Employer contributions	17,398	5,772	6,239
Plan participant contributions	1,670	1,527	1,364
Benefits paid	(4,277)	(4,017)	(3,328)
Fair value of plan assets at the end of the year	67,486	46,503	41,706
Funded status	(87,867)	(81,095)	(61,675)
Unrecognized transition asset		(1,285)	(1,428)
Unrecognized net actuarial losses		38,065	26,157
Unrecognized prior service cost		(8,014)	(8,872)
Accrued postretirement benefits cost	$ (87,867)	$ (52,329)	$ (45,818)

The benefit obligation was determined by applying the terms of the plan and actuarial models required by SFAS No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions. 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, historical experience and the requirements of SFAS No. 106.

The plan amendment effective January 1, 2007 (reflected in the 2006 valuation above) changed the retiree contributions percentages for certain age groups.

The plan amendment effective January 1, 2004, changed the retiree co-payments, coinsurance amounts and out-of-pocket maximums for participants.

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

	2006	2005	2004
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 net periodic benefit cost for years ended December 31:

	2006	2005	2004
Discount rate	5.50%	5.75%	6.00%
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	2016	2016	2016

The discount rate assumptions reflect the rates available on high-quality fixed income debt instruments on December 31 of each year. 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, 2006 results:

	1 Percentage Point	
	Increase	(Decrease)
	(In thousands of dollars)	
Effect on total of service and interest cost	$ 4,102	$ (3,164)
Effect on accumulated postretirement benefit obligation	30,382	(24,130)

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 $17.4 million, $5.8 million and $6.2 million, for the years ended December 31, 2006, 2005 and 2004, respectively. During those years, $2.6 million, $2.5 million and $2.0 million, respectively, were used directly for benefit payments. 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
2007	$ 3,496	$ (324)
2008	3,964	(391)
2009	4,556	(461)
2010	5,255	(545)
2011	6,102	(635)
2012 2016	$ 47,708	$ (5,027)

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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,		
	2006	2005	2004
	(In thousands of dollars)		
Service cost	$ 361	$ 277	$ 242
Interest cost	850	791	869
Amortization of unrecognized losses	154	69	185
Net periodic benefits costs	$ 1,365	$ 1,137	$ 1,296

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:

	2006	2005	2004
	(In thousands of dollars)		
Benefit obligation at the beginning of the year	$ 15,222	$ 13,921	$ 14,660
Service cost	361	277	242
Interest cost	850	791	869
Actuarial (gains) losses	(1,095)	562	(1,126)
Benefits paid	(432)	(329)	(724)
Benefit obligation at the end of the year	14,906	15,222	13,921
Fair value of plan assets at the beginning of the year			
Employer contributions	432	329	724
Benefits paid	(432)	(329)	(724)
Fair value of plan assets at the end of the year			
Benefit obligation	(14,906)	(15,222)	(13,921)
Unrecognized net actuarial losses		1,485	992
Accrued postretirement benefits cost	$ (14,906)	$ (13,737)	$ (12,929)

The benefit obligation was determined by applying the terms of the plan and actuarial models required by SFAS No. 87, Employers Accounting for Pensions. 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, historical experience and the requirements of SFAS No. 87.

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

	2006	2005	2004
Discount rate used to determine benefit obligation	5.90%	5.50%	5.75%
Discount rate used to determine net periodic benefit cost	5.50%	5.75%	6.00%
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 on December 31 of each year. 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
2007	$ 454
2008	551
2009	604
2010	658
2011	715
2012 2016	$ 4,632

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,		
	2006	2005	2004
	(In thousands of dollars)		
Interest cost	$ 573	$ 610	$ 659
Amortization of unrecognized losses	184	108	28
Net periodic benefits costs	$ 757	$ 718	$ 687

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:

	2006	2005	2004
	(In thousands of dollars)		
Benefit obligation at the beginning of the year	$ 11,419	$ 11,550	$ 11,401
Interest cost	573	610	659
Actuarial losses	129	179	394
Benefits paid	(1,176)	(920)	(904)
Benefit obligation at the end of the year	10,945	11,419	11,550
Fair value of plan assets at the beginning of the year			
Employer contributions	1,176	920	904
Benefits paid	(1,176)	(920)	(904)
Fair value of plan assets at the end of the year			
Benefit obligation	(10,945)	(11,419)	(11,550)
Unrecognized net actuarial losses		579	508
Accrued postretirement benefits cost	$ (10,945)	$ (10,840)	$ (11,042)

The benefit obligation was determined by applying the terms of the plan and actuarial models required by SFAS No. 87, Employers Accounting for Pensions. 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, historical experience and the requirements of SFAS No. 87.

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

	2006	2005	2004
Discount rate used to determine benefit obligation	5.50%	5.25%	5.50%
Discount rate used to determine net periodic benefit cost	5.25%	5.50%	6.00%

The discount rate assumptions reflect the rates available on high-quality fixed income debt instruments on December 31 of each year. These rates have been selected due to their similarity to the projected cash flows of the Executive Deferred Compensation Plans.

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Projected future benefit payments (in thousands of dollars):

	Benefit Payments
2007	$ 1,229
2008	1,205
2009	1,205
2010	1,165
2011	1,133
2012 2016	$ 5,254

Other Postretirement Benefits

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,		
	2006	2005	2004
	(In thousands of dollars)		
Industrial development revenue and private activity bonds	$ 9,485	$ 9,485	$ 9,485
Less current maturities	4,590	4,590	9,485
	$ 4,895	$ 4,895	$

During 2002, the Company issued commercial paper in support of a cross-currency swap (derivative instrument). This derivative instrument was designated as a partial hedge of the net investment in the Company s Canadian subsidiary and was recognized on the balance sheet at its fair value.

On September 27, 2004, the two-year cross-currency swap and related commercial paper debt matured and were liquidated with payments totalling US$140.8 million. While the cross-currency swap was outstanding, the Company formally assessed, on a quarterly basis, whether the cross-currency swap was effective at offsetting changes in the fair value of the underlying exposure. Because of the high degree of effectiveness between the hedging instrument and the underlying exposure being hedged, exchange rate changes in the value of the cross-currency swap were generally offset by changes in the value of the net investment. Under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, changes in the fair value of this instrument were recognized in foreign currency translation adjustments, a component of Accumulated other comprehensive earnings (losses), to offset the change in the value of the net investment of the Canadian investment being hedged. During 2004, the Company recognized a US$0.6 million net of tax loss related to this hedge, which included the settlement of the cross-currency swap, in Accumulated other comprehensive earnings (losses). The impact to 2004 resulting from the ineffective portion of the hedge was immaterial.

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, 2006, the weighted average interest rate was 4.14%. 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, 2006, 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, 2006. The Company classified $4.6 million, $4.6 million and $9.5 million of bonds currently subject to redemption options in current maturities of long-term debt at December 31, 2006, 2005 and 2004, respectively.

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, 2006.

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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, 2006. 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, 2006, the approximate future minimum lease payments for all operating leases were as follows (in thousands of dollars):

	Future Minimum Lease Payments	
2007	$	34,221
2008	28,630	
2009	23,272	
2010	17,351	
2011	19,541	
Thereafter	45,885	
Total minimum payments required	168,900	
Less amounts representing sublease income	(274)	
	$	168,626

Rent expense, including items under lease and items rented on a month-to-month basis, was $33.4 million, $28.6 million and $22.3 million for 2006, 2005 and 2004, respectively. These amounts are net of sublease income of $0.5 million, $0.4 million and $0.5 million for 2006, 2005 and 2004, 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 nonqualified stock options, stock appreciation rights, restricted stock, stock units and other stock-based awards. As of December 31, 2006, restricted stock, restricted stock units, performance shares 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, 2006, there were 5,975,176 shares available for grant under the Plan.

Options

In 2006, 2005 and 2004, the Company provided broad-based stock option grants covering 187,900, 231,500 and 181,200 shares, respectively, to those employees who reached major service milestones and were not participants in other stock option programs.

In 2006, 2005 and 2004, the Company issued stock option grants to employees as part of their incentive compensation. Stock option grants were 1,234,400, 1,183,650 and 1,034,850 for the years 2006, 2005 and 2004, respectively.

In 2004, nonemployee Directors received an annual grant denominated in dollars but settled with options to purchase shares of common stock. The number of options issued was equal to the dollar amount of the grant divided by the fair market value of a share of common stock at the time of the award, rounded to the next ten-share increment. The number of options was 13,360 for 2004. The options were fully exercisable upon award and have a ten-year term.

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 and generally expire ten years from the grant date.

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Transactions involving stock options are summarized as follows:

	Shares Subject to Option	Weighted Average Price Per Share	Options Exercisable
Outstanding at January 1, 2004	10,413,932	$44.91	4,148,846
Granted	1,229,410	$53.25	
Exercised	(1,885,415)	$40.08	
Canceled or expired	(552,133)	$47.54	
Outstanding at December 31, 2004	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

All options were issued at the closing market price on the last trading day preceding the date of grant. Options were issued in 2006, 2005 and 2004 with initial vesting periods ranging from immediate to three years.

At December 31, 2006, there was $21.8 million of total unrecognized compensation expense related to nonvested option awards which the Company expects to recognize over a weighted average period of 1.9 years.

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

	For the years ended December 31,		
	2006	2005	2004
Fair value of options exercised	$ 18,152	$ 20,668	$ 22,395
Total intrinsic value of options exercised	38,906	31,577	29,807
Fair value of options vested	15,295	25,574	24,613
Cash received upon exercise of options	64,437	65,997	72,275
Tax benefit realized from exercise of options	14,936	11,962	12,068

Information about stock options outstanding and exercisable as of December 31, 2006, is as follows:

	Options Outstanding				Options Exercisable			
		Weighted Average				Weighted Average		
Range of Exercise	Number	Remaining Contractual	Exercise Price	Intrinsic Value	Number	Remaining Contractual	Exercise Price	Intrinsic Value

Prices		Life		(000 s)		Life		(000 s)
$30.88-44.91	1,913,226	3.83 Years	$40.34	$ 56,635	1,655,516	3.76 Years	$40.78	$ 48,277
$45.50-51.69	1,906,787	4.86 Years	$47.28	$ 43,205	1,756,027	4.67 Years	$47.21	$ 39,916
$52.29-54.45	1,951,196	7.78 Years	$53.15	$ 32,763	113,221	6.19 Years	$53.56	$ 1,855
$54.61-76.61	2,683,660	7.57 Years	$65.97	$ 10,660	1,102,485	5.34 Years	$54.70	$ 16,799
	8,454,869	6.16 Years	$53.00	$ 143,263	4,627,249	4.54 Years	$46.85	$ 106,847

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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 2006, using a binomial lattice model, was $18.91. The fair value of each option granted in 2006, based on a binomial lattice model, used the following assumptions:

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

The weighted average fair value of the stock options granted during 2005 and 2004 was $13.36 and $13.08, respectively. The fair value of each option estimated on the date of grant, based on a Black-Scholes valuation model, used the following assumptions:

	Year Ended December 31, 2005	Year Ended December 31, 2004
Risk-free interest rate	4.1%	4.1%
Expected life	7 years	7 years
Expected volatility	20.1%	20.1%
Expected dividend yield	1.8%	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 volatilities are based upon implied and historical volatility of the Company s monthly stock closing prices over a period equal to the expected life of each option grant.

Performance Shares

On February 22, 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 (fiscal 2006), will be issued at the end of the third year (fiscal 2008) if the Company s average target ROIC is achieved for the fiscal period 2006 through 2008. The total number of shares earned for 2006 was 40,416. The amount expensed for the year ended December 31, 2006 was $0.9 million, based upon the number of shares earned.

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 certificates in exchange for the performance shares on a one-for-one basis.

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.

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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:

	2006	2005	2004
Beginning nonvested shares outstanding	270,000	322,000	682,000
Issuances			10,000
Shares Converted to Restricted Stock Units			(215,000)
Cancellations	(10,000)	(5,000)	(5,000)
Vesting	(155,000)	(47,000)	(150,000)
Ending nonvested shares outstanding	105,000	270,000	322,000
Weighted average per share value of issuances	NA	NA	$50.66
Fair value of shares vested	$11.1 million	$3.0 million	$8.3 million
Restricted stock compensation expense	$ 0.9 million	$1.0 million	$4.3 million

At December 31, 2006, there was $0.9 million of total unrecognized compensation expense related to nonvested restricted stock which the Company expects to recognize over a weighted average period of 2.3 years.

Restricted Stock Units (RSUs)

Awards of RSUs are provided for under the stock compensation plans. RSUs granted to management 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 certificates 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 granted to employees:

	2006		2005		2004	
		Weighted		Weighted		Weighted
	Shares	Average	Shares	Average	Shares	Average
Beginning nonvested units	517,000	$49.74	369,800	$47.70		
Issuances	408,300	$75.54	239,675	$53.96	227,300	$53.43
Restricted Stock converted to RSUs					215,000	$43.68
Cancellations	(26,750)	$66.84	(22,375)	$52.25	(23,600)	$53.32
Vestings	(74,550)	$69.56	(70,100)	$52.54	(48,900)	$54.14
Ending nonvested units	824,000	$60.18	517,000	$49.74	369,800	$47.70
RSUs compensation expense	$12.0 million		$7.9 million		$4.7 million	

The total fair value of shares vested during 2006, 2005 and 2004, was $5.2 million, $3.7 million and $2.6 million, respectively.

At December 31, 2006, there was $33.7 million of total unrecognized compensation expense related to nonvested RSUs which the Company expects to recognize over a weighted average period of 4.8 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, 2006, 2005 and 2004, there were eleven, ten 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):

	2006		2005		2004	
	Units	Dollars	Units	Dollars	Units	Dollars
Beginning Balance	51,977	$ 3,696	39,398	$ 2,625	39,506	$ 1,872
Dividends	902	64	722	45	555	30
Deferred Fees	14,844	1,128	15,039	856	1,532	86
Retirement Distributions	(6,481)	(461)	(3,182)	(198)	(2,195)	(104)
Unit (Depreciation) / Appreciation		(144)		368		741
Ending Balance	61,242	$ 4,283	51,977	$ 3,696	39,398	$ 2,625

In 2004, a retainer fee for board service was paid to nonemployee directors in the form of an annual award of unrestricted shares of common stock. The number of shares awarded was equal to the retainer fee divided by the fair market value of a share of common stock at the time of the award, rounded up to the next ten-share increment. Total shares granted were 5,510. The weighted average fair market value of these grants was $54.54. In 2005, the Directors retainer reverted to a cash basis.

NOTE 13 CAPITAL STOCK

The Company had no shares of preferred stock outstanding as of December 31, 2006, 2005 and 2004. The activity of outstanding common stock and common stock held in treasury was as follows:

	2006		2005		2004	
	Outstanding		Outstanding		Outstanding	
	Common Stock	Treasury Stock	Common Stock	Treasury Stock	Common Stock	Treasury Stock
Balance at beginning of period	89,715,641	19,952,297	90,597,427	19,075,511	91,020,989	18,356,227
Exercise of stock options	1,390,461	(1,390,461)	1,503,259	(1,503,259)	1,825,085	(1,319,363)
Issuance and vesting of restricted stock, net of 59,297, 15,493 and 45,647 shares retained, respectively	(59,297)	59,297	(15,493)	15,493	(35,647)	45,647
Settlement of restricted stock units, net of 6,228, 3,017 and 1,015 shares retained, respectively	13,822	(13,822)	7,748	(7,748)	2,490	(2,490)
Cancellation of restricted shares	(10,000)		(5,000)		(5,000)	
Conversion of restricted stock to restricted stock units					(215,000)	
Purchase of treasury shares,	(6,983,000)	6,983,000	(2,372,300)	2,372,300	(1,995,490)	1,995,490

net of 0, 0 and 5,510 shares issued, respectively						
Balance at end of period	84,067,627	25,590,311	89,715,641	19,952,297	90,597,427	19,075,511

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NOTE 14 INCOME TAXES

The Company accounts for income taxes under the provisions of SFAS No. 109, Accounting for Income Taxes. SFAS No. 109 requires recognition of 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,		
	2006	2005	2004
Current provision:			
Federal	$ 172,961	$ 134,194	$ 135,391
State	31,725	27,517	24,815
Foreign	5,080	976	2,460
Total current	209,766	162,687	162,666
Deferred tax provision (benefit):			
Federal	8,996	17,575	(5,986)
State	1,636	3,298	(684)
Foreign	(774)	2,790	2,220
Total deferred	9,858	23,663	(4,450)
Total provision	$ 219,624	$ 186,350	$ 158,216

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,		
	2006	2005	2004
Deferred tax assets:			
Inventory	$ 13,809	$ 28,817	$ 37,927
Accrued expenses	28,606	30,463	31,219
Accrued employment-related benefits	99,006	71,446	65,760
Foreign operating loss carryforwards	9,530	9,272	9,616
Other	8,582	7,364	5,441
Deferred tax assets	159,533	147,362	149,963
Less valuation allowance	(13,461)	(10,872)	(10,265)
Deferred tax assets, net of valuation allowance	$ 146,072	$ 136,490	$ 139,698
Deferred tax liabilities:			
Purchased tax benefits	$ (7,715)	$ (8,965)	$ (10,090)
Property, buildings and equipment	(4,303)	(17,423)	(9,594)
Intangibles	(14,182)	(10,219)	
Software	(10,627)	(7,177)	(623)
Prepaids	(14,111)	(1,950)	
Other	(4,453)	(4,599)	(8,073)
Deferred tax liabilities	(55,391)	(50,333)	(28,380)
Net deferred tax asset	$ 90,681	$ 86,157	$ 111,318
The net deferred tax asset is classified as follows:			
Current assets	$ 48,123	$ 76,474	$ 86,632
Noncurrent assets	48,793	16,702	29,168
Noncurrent liabilities (foreign)	(6,235)	(7,019)	(4,482)
Net deferred tax asset	$ 90,681	$ 86,157	$ 111,318

At December 31, 2006, the Company had $20.5 million of foreign operating loss carryforwards related to foreign operations, 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 due to capital loss limitations.

The purchased tax benefits represent lease agreements acquired in prior years under the provisions of the Economic Recovery Act of 1981.

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

	For the Years Ended December 31,		
	2006	2005	2004
Beginning balance	$ 10,872	$ 10,265	$ 14,919
(Decrease) increase related to foreign net operating loss carryforwards	(70)	607	(632)
Unrealized (realized) capital losses	2,659		(4,022)
Ending balance	$ 13,461	$ 10,872	$ 10,265

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,		
	2006	2005	2004
Federal income tax at the statutory rate	$ 211,058	$ 186,436	$ 155,799
State income taxes, net of federal income tax benefit	22,795	20,030	16,130
Resolution of prior year tax contingencies	(12,200)	(9,700)	(3,356)
Other net	(2,029)	(10,416)	(10,357)
Income tax expense	$ 219,624	$ 186,350	$ 158,216
Effective tax rate	36.4%	35.0%	35.5%

Undistributed earnings of foreign subsidiaries at December 31, 2006, amounted to $1.3 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.

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 2003. Additionally, the Company is routinely involved in state and local income tax audits, and on occasion, foreign jurisdiction tax audits. The Company expects to resolve these audits within the amounts paid and/or reserved for these liabilities.

NOTE 15 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 1.36 million, 0.04 million and 2.68 million for the years ended December 31, 2006, 2005 and 2004, 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,		
	2006	2005	2004
	(In thousands, except for per share amounts)		
Net earnings	$ 383,399	$ 346,324	$ 286,923
Denominator for basic earnings per share weighted average shares	87,839	89,569	90,207
Effect of dilutive securities stock-based compensation	2,685	2,019	1,466
Denominator for diluted earnings per share weighted average shares adjusted for dilutive securities	90,524	91,588	91,673
Basic earnings per common share	$ 4.36	$ 3.87	$ 3.18
Diluted earnings per common share	$ 4.24	$ 3.78	$ 3.13

NOTE 16 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 a 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 17 SEGMENT INFORMATION

Effective January 1, 2006, Grainger revised its segment disclosure. Acklands Grainger, which had previously been included in Branch-based Distribution, is now being reported as a separate segment. Operations are managed and reported in three segments. The three reportable segments are Grainger Branch-based, Acklands Grainger Branch-based and Lab Safety. Prior year segment amounts have been restated to maintain comparability. 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.

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The following segment information has been modified for all periods presented in order to conform to the new presentation (in thousands of dollars).

		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
		2004		
	Grainger Branch-based	Acklands Grainger Branch-based	Lab Safety	Total
Total net sales	$ 4,283,272	$ 434,258	$ 336,720	$ 5,054,250
Intersegment net sales	(2,387)		(2,078)	(4,465)
Net sales to external customers	4,280,885	434,258	334,642	5,049,785
Segment operating earnings	444,574	20,967	45,467	511,008
Segment assets	1,667,862	366,779	144,471	2,179,112
Depreciation and amortization	70,490	5,118	7,870	83,478
Additions to long-lived assets	$ 138,457	$ 16,709	$ 2,910	$ 158,076

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

	2006	2005	2004
Operating earnings:			
Total operating earnings for reportable segments	$ 660,980	$ 589,350	$ 511,008
Unallocated expenses	(82,909)	(70,361)	(69,754)
Total consolidated operating earnings	$ 578,071	$ 518,989	$ 441,254
Assets:			
Total assets for reportable segments	$ 2,548,492	$ 2,386,953	$ 2,179,112
Unallocated assets	497,596	720,968	630,461
Total consolidated assets	$ 3,046,088	$ 3,107,921	$ 2,809,573

	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

	2004		
	Segment Totals	Unallocated	Consolidated Total
Other significant items:			
Depreciation and amortization	$ 83,478	$ 14,778	$ 98,256
Additions to long-lived assets	$ 158,076	$ 2,682	$ 160,758

	Revenues	Long-lived Assets
Geographic information:		
United States	$ 4,507,030	$ 808,564
Canada	436,877	165,240
Other foreign countries	105,878	4,236
	$ 5,049,785	$ 978,040

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 nonoperating cash and cash equivalents, certain prepaid expenses and property, buildings and equipment net.

Unallocated expenses increased $12.5 million in the year ended December 31, 2006, when compared with the prior year primarily due to increases in payroll and benefits at headquarters driven by stock-based compensation related to the adoption of SFAS No. 123R. Unallocated assets decreased $223.4 million in the year ended December 31, 2006, when compared with the prior year primarily due to a lower cash balance.

The change in the carrying amount of goodwill by segment from January 1, 2004 to December 31, 2006, is as follows:

Goodwill, net by Segment	Acklands Grainger Branch-based	Lab Safety	Total
Balance at January 1, 2004	$ 108,341	$ 47,928	$ 156,269
Translation	8,742		8,742
Balance at December 31, 2004	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

NOTE 18 SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

A summary of selected quarterly information for 2006 and 2005 is as follows:

	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
	2005 Quarter Ended (In thousands of dollars, except for per share amounts)				
	March 31	June 30	September 30	December 31	Total
Net sales	$ 1,334,880	$ 1,372,808	$ 1,428,342	$ 1,390,606	$ 5,526,636
Cost of merchandise sold	836,004	845,679	880,180	803,232	3,365,095
Gross profit	498,876	527,129	548,162	587,374	2,161,541
Warehousing, marketing and administrative expenses	385,919	400,936	412,280	443,417	1,642,552
Operating earnings	112,957	126,193	135,882	143,957	518,989
Net earnings	72,792	81,589	88,109	103,834	346,324
Earnings per share - basic	0.81	0.91	0.98	1.17	3.87
Earnings per share - diluted	$ 0.79	$ 0.89	$ 0.97	$ 1.13	$ 3.78

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.

In the fourth quarter of 2005, the gross profit margins were higher than the first three quarters. This primarily related to favorable inventory adjustments from fourth quarter physicals ($18.6 million) and favorable adjustments related to the year-end LIFO calculations ($9.5 million). Due to the improved methodology to capture data related to certain inventory transactions and estimates, these types of adjustments were spread throughout the year in 2006 as opposed to being recorded in the fourth quarter.

In the fourth quarter of 2005, the Company reduced its income tax rate for the year to 35.0% from its previous projection of 37.0%. This reduction was primarily due to the recognition of tax benefits related to a favorable revision to the estimate of income taxes for various state and local taxing jurisdictions and the resolution of federal and state tax contingencies. The reduction was not determinable until the fourth quarter when these items were finalized and their effect on the rate quantified.

NOTE 19 UNCLASSIFIED NET

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

	For the Years Ended December 31,		
	2006	2005	2004
Income items	$ 359	$ 25	$ 384
Expense items	(228)	(168)	(233)
Unclassified net	$ 131	$ (143)	$ 151

NOTE 20 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 17, 2007, the Company is named in cases filed on behalf of approximately 3,100 plaintiffs in which there is an allegation of exposure to asbestos and/or silica. In addition, five cases alleging exposure to cotton dust were amended during 2004 to add allegations relating to asbestos, but during 2006 the pleadings in those cases were amended and no longer contain allegations of asbestos exposure.

The Company has denied, or intends to deny, the allegations in all of the above-described lawsuits. In 2006, lawsuits relating to asbestos and/or silica and involving approximately 300 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.

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, including current inquiries relating 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.