

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

**FORM 10-K  
ANNUAL REPORT**

- (Mark One)  
 ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2001  
OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 1-5684

**W.W. Grainger, Inc.**  
(Exact name of registrant as specified in its charter)

Illinois  
(State or other jurisdiction of  
incorporation or organization)

100 Grainger Parkway, Lake Forest, Illinois 60045-5201  
(Address of principal executive offices) (Zip Code)

36-1150280  
(I.R.S. Employer  
Identification No.)

Registrant's telephone number including area code: 847/535-1000

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

The aggregate market value of the voting stock held by non-affiliates of the registrant was \$4,611,782,578 as of the close of trading reported on the Consolidated Transaction Reporting System on March 4, 2002.

APPLICABLE ONLY TO CORPORATE REGISTRANTS

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Common Stock \$0.50 par value 93,551,269 shares outstanding as of March 4, 2002

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement relating to the annual meeting of shareholders of the registrant to be held on April 24, 2002, are incorporated by reference into Part III hereof.

The Exhibit Index appears on page 15 in the sequential numbering system.

**(The Securities and Exchange Commission has not approved or disapproved of this report nor has it passed on the accuracy or adequacy hereof.)**

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## PART I

### Item 1: Business

#### The Company

The registrant, W.W. Grainger, Inc., was incorporated in the State of Illinois in 1928. It is the leading North American distributor of products used by businesses and institutions to maintain, repair, and operate their facilities. W.W. Grainger, Inc. regards itself as being in the service business. As used herein, "Company" means W.W. Grainger, Inc. and/or its subsidiaries as the context may require.

The Company offers a breadth of maintenance, repair, and operating (MRO) solutions by combining products, services, and information. It tailors its capabilities with a view toward providing the lowest total cost MRO solution to select customer groups. The Branch-based Distribution Businesses primarily serve the needs of North American businesses for MRO supplies. Lab Safety Supply serves customers who choose to purchase safety and other industrial products through a direct marketing company. The Other Businesses of the Company serve customers who seek to outsource their MRO supply procurement and management processes.

The Company also has internal business support functions which provide coordination and guidance in the areas of Accounting, Administrative Services, Business Development, Communications, Compensation and Benefits, Employee Development, Enterprise Systems, Finance, Human Resources, Industrial Relations, Investor Relations, Insurance and Risk Management, Internal Audit, International Operations, Legal, Real Estate and Construction Services, Security and Safety, Taxes, and Treasury services. These services are provided in varying degrees to all of the business units.

A number of Company-wide capabilities assist business units in serving their respective markets. These capabilities include technology and information management, supplier partnerships, supply chain management skills, and an understanding of the customers' MRO environments.

The Company does not engage in basic or substantive product research and development activities. New items are added regularly to the Company's product lines on the basis of market information, recommendations of its employees, customers, and suppliers, and other factors. The Company's research and development efforts are focused on methods of serving customers and the product distribution process.

In January 2001, the Company announced it had consolidated three of its digital businesses into a separate organization. TotalMRO.com, FindMRO, and MROverstocks.com were combined to create Material Logic, which was designed to allow large customers to access a single, networked catalog. Material Logic sought funding participation from other industrial distributors and investors. Economic and market conditions made it difficult to find funding partners and in April 2001, the Company announced it was discontinuing the operations of Material Logic. All of Material Logic's branded e-commerce sites were shut down with the exception of FindMRO, which remains as an integrated sourcing service for the Company's customers.

#### Branch-based Distribution Businesses

The Company's Branch-based Distribution Businesses provide customers with solutions to their immediate and/or planned MRO purchase needs throughout North America. Logistics networks are configured for rapid availability. A broad selection of MRO products is offered at local branches, through catalogs, and via the Internet. The Branch-based Distribution Businesses consist of Grainger Industrial Supply, Grainger.com, Acklands-Grainger Inc. (Canada), FindMRO, Grainger Export, Grainger Global Sourcing, Grainger Parts, Grainger, S.A. de C.V. (Mexico), and Grainger Caribe Inc. (Puerto Rico). Described below are the more significant of these businesses.

##### Grainger Industrial Supply

The focus of Grainger Industrial Supply is to provide the best combination of product selection, local availability, speed of delivery, and simplicity of ordering at a competitive price to United States businesses and institutions of all sizes. Its primary customers are small and medium-sized companies, but it also addresses large-sized organizations' MRO needs.

Grainger Industrial Supply operates 388 branches in all 50 states. These branches are located within 20 minutes of the majority of U.S. businesses and carry inventory to support their local market needs. Products are available for immediate pickup or for shipment.

On average, a branch is 20,000 square feet, has 12 employees, and handles about 239 transactions per day. During 2001, an average of approximately 93,000 sales transactions were completed daily. Grainger Industrial Supply's branches range in size from small "storefront branches" to large "master branches." Storefront branches are used to fulfill will-call needs and customer service. Grainger Industrial Supply has five master branches which range in size from 43,000 square feet to 109,000 square feet and stock the fastest selling 30,000 items. In 2001, Grainger Industrial Supply invested more than \$4,000,000 in new branches, branch relocations, and branch additions. During the year, 13 new branches were opened, seven were relocated, seven were closed, and a number of remodeling projects were completed.

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Grainger Industrial Supply currently operates four Distribution Centers and two new highly automated distribution centers (DCs). DCs ship orders directly to customers for all branches located in their service area, including Internet orders, and replenish branch inventories. Two Regional Distribution Centers located in Greenville County, South Carolina, and Kansas City, Missouri, replenish DC inventories and some branches not served by a DC. A National Distribution Center, located in Niles, Illinois, is a centralized storage and shipping facility serving customers and the entire network with slower moving inventory items.

In 2000, Grainger Industrial Supply began a multi-year redesign and expansion of its distribution network that will allow the Company to remove a warehousing step from the current distribution system. This redesign is not only intended to reduce costs but also to increase capacity. As part of the redesign, Grainger Industrial Supply is transitioning its existing zone and regional warehouses into more highly automated distribution centers. Five new and four redesigned facilities will take over most of the shipping currently handled by the branches. When the transition is complete, each distribution center will average more than 300,000 square feet in size, employ state-of-the-art equipment and processes, and stock 60,000 to 70,000 of the fastest selling items.

Grainger Industrial Supply sells principally to service shops, industrial and commercial maintenance departments, manufacturers, hotels, government, contractors, and health care and educational facilities. Sales transactions during 2001 were made to approximately 1,300,000 customers. It is estimated that approximately 23% of 2001 sales consisted of items bearing the Company's registered trademarks, including DAYTON® (principally electric motors, heating and ventilation equipment), TEEL® (liquid pumps), SPEEDAIRE® (air compressors), AIR HANDLER® (air filtration equipment), DEM-KOTE® (spray paints), WESTWARD® (hand and power tools), and LUMAPRO® (task and outdoor lighting), as well as other of the Company's trademarks. The Company has taken steps to protect these trademarks against infringement and believes that they will remain available for future use in its business. Sales of remaining items generally consisted of products carrying the names of other well-recognized brands.

The Grainger Industrial Supply catalog offers almost 100,000 MRO products from more than 1,100 suppliers, most of whom are manufacturers. Approximately 1.8 million copies of the catalog were produced in 2001. The most current edition was issued in February 2002. The largest supplier in 2001, a diversified manufacturer through 18 of its divisions, accounted for about 9% of Grainger Industrial Supply's purchases. No significant difficulty has been encountered with respect to sources of supply.

The Grainger Industrial Supply CD-ROM catalog is designed to bring directly to the customer's place of business a fast, easy way to select products. Through the CD-ROM catalog, the customer can use a variety of ways to describe a needed product, and then review Grainger Industrial Supply's offerings, complete with specifications, prices, and pictures. Another CD-ROM catalog feature includes a cross-reference function that allows customers to retrieve product information using their own stock numbers. Approximately 1.4 million copies of the CD-ROM catalog were produced in 2001. The CD-ROM catalog is also used at the branches as a training tool and resource for helping customers identify appropriate products for their applications.

Customers can also utilize Grainger.com, one of the industry's first MRO websites. This website is an "e-storefront" or "point of access" into the Grainger Industrial Supply business. Grainger.com, however, offers more products than the Grainger Industrial Supply catalog, as well as automated search and customer personalization. It also is available 24 hours a day, seven days a week, providing real-time product availability, customer-specific pricing, multiple product search capabilities, and linkage to customer support and the fulfillment system. For large customers interested in connecting to Grainger.com using sophisticated purchasing platforms, Grainger.com has a universal connection. This technology translates the different data formats used by electronic marketplaces, exchanges, and e-procurement systems and allows information from these systems to be fed directly into Grainger Industrial Supply's operating platform.

The Grainger.com site serves as a prominent service channel for Grainger Industrial Supply. Customers have access to a much larger selection of MRO products through Grainger.com, which has more than 260,000 products available. Orders processed through Grainger.com resulted in sales of approximately \$333,000,000 in 2001, \$267,000,000 in 2000, and \$101,000,000 in 1999.

#### Acklands-Grainger Inc. (AGI)

AGI, acquired in December 1996, is Canada's leading broad-line distributor of industrial, fleet, and safety supplies. It serves customers through 184 branches and six distribution centers across Canada. AGI distributes tools, lighting, HVAC, safety supplies, pneumatics, instruments, welding equipment and supplies, motors, and shop equipment, as well as many other items. A comprehensive catalog, printed in both English and French, is used to showcase the product line and to help customers select products. This catalog, with over 70,000 products listed, supports the efforts of approximately 260 field sales representatives throughout Canada. During 2001, an average of approximately 18,000 sales transactions were completed daily. On February 1, 2002, the Company finalized a joint venture agreement combining AGI's automotive aftermarket parts division and the Western Division of Uni-Select Inc., a Canadian distributor of automotive and industrial supplies. The Company has a 50 percent stake in the new company, which is managed by Uni-Select.

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### FindMRO

FindMRO is a sourcing center for indirect material spot buys. Through sophisticated search technologies, and the sourcing expertise of its professionals, FindMRO facilitates the location of MRO products when a source is unknown to the buyer. With access to a database of more than 8,000 suppliers and 5,000,000 products, FindMRO sources hard-to-find facilities maintenance supplies for their customers providing them with a one-stop shopping experience.

### Grainger Global Sourcing

Grainger Global Sourcing procures competitively priced, high-quality products produced outside the United States. These items are sold primarily under private label by Grainger Industrial Supply and the Company's other businesses. Products obtained through Grainger Global Sourcing in 2001 include WESTWARD® tools and LUMAPRO® lighting products, as well as products bearing other trademarks.

### Grainger Parts

Grainger Parts provides access to over 440,000 parts and accessories through its centralized warehouse located in Northbrook, Illinois. Trained representatives have access to more than 260,000 pages of detailed parts diagrams online. Customers can purchase over the telephone or online at Grainger.com. Grainger Parts handled about 1,740,000 customer calls in 2001 through its call centers in Northbrook, Illinois, and Waterloo, Iowa.

Grainger Parts has been ISO 9002 certified since 1995. Grainger Parts' 100% compliance with ISO 9002 standards ranked it among the top 10% of all ISO-certified companies.

### Grainger, S.A. de C.V.

Grainger, S.A. de C.V. serves the MRO product needs of customers in Mexico. The business employed 51 sales representatives at December 31, 2001. From its five branches, the business provides delivery of over 70,000 products throughout Mexico. Three new branches were opened in 2001 in Tijuana, Mexico City, and Puebla. The largest branch, an 80,000 square foot facility, is located outside of Monterrey.

## **Digital Businesses**

In January 2001, the Company announced it had consolidated three of its digital businesses into a separate organization. TotalMRO.com, FindMRO, and MROverstocks.com were combined to create Material Logic, which was designed to allow large customers to access a single, networked catalog. Material Logic sought funding participation from other industrial distributors and investors. Economic and market conditions made it difficult to find funding partners and in April 2001, the Company announced it was discontinuing the operations of Material Logic. All of Material Logic's branded e-commerce sites were shut down with the exception of FindMRO, which remains as an integrated sourcing service for Grainger's customers, under the Branch-based Businesses segment.

## **Lab Safety Supply, Inc.**

Lab Safety Supply is a direct marketer of safety and other industrial products to U.S. and Canadian businesses. Located in Janesville, Wisconsin, Lab Safety Supply primarily reaches its customers through its General Catalog, targeted catalogs, and other marketing materials, which are distributed throughout the year.

Lab Safety Supply offers extensive product depth, technical support, and high service levels. It is a primary safety supplier for many small and medium-sized companies and a critical backup supplier for many larger companies. Customers have access to over 41,000 products in Lab Safety Supply's General Catalog. In addition, customers can access products using a CD-ROM version of the catalog or online via the web at LabSafety.com. In 2001, Lab Safety Supply acquired The Ben Meadows Co., a \$20 million business-to-business direct marketer of equipment for the natural resources and forestry management market.

## **Other Businesses**

In prior years, the Other Businesses category included a number of operating entities. For 2001, Grainger Integrated Supply is the only entity in the Other Businesses category.

### Grainger Integrated Supply

Grainger Integrated Supply serves customers who have chosen to outsource components or all of their indirect materials management processes. The service offering is designed to enable customers to focus on their core business objectives.

Grainger Integrated Supply offers a full complement of on-site outsourcing solutions, including business process reengineering, inventory and tool crib management, supply chain management, purchasing management, and information management. Grainger Integrated Supply provides its clients with access to more than 5,000,000 products through its relationships with respected manufacturers, service providers, Grainger Industrial Supply, and other distributors.

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## Industry Segments

For 2001 the Company is reporting three industry segments: Branch-based Distribution, Digital, and Lab Safety Supply. For segment information and the Company's consolidated net sales and operating earnings see "Item 7: Management's Discussion and Analysis of Financial Condition and the Results of Operations," and "Item 8: Financial Statements and Supplementary Data." The total year-end assets of the Company for the last five years were: 2001, \$2,331,246,000; 2000, \$2,459,601,000; 1999, \$2,564,826,000; 1998, \$2,103,966,000; and 1997, \$2,000,116,000.

## Competition

The Company faces competition in all the markets it serves, from manufacturers (including some of the Company's own suppliers) that sell directly to certain segments of the market, from wholesale distributors, from catalog houses, from certain Internet-based businesses and product fulfillment mechanisms, and from certain retail enterprises.

The principal means by which the Company competes with manufacturers and other distributors are by local stock availability, efficient service, account managers, competitive pricing, its several catalogs, which include product descriptions and in certain cases, extensive technical and application data, electronic and Internet commerce technology, and other efforts to assist customers in lowering their total MRO costs. The Company believes that it can effectively compete on a price basis with its manufacturing competitors on small orders, but that such manufacturers may enjoy a cost advantage in filling large orders.

The Company serves a number of diverse markets and is able in some markets to reasonably estimate the Company's competitive position within that market. However, taken as a whole, the Company is unable to determine its market share relative to others engaged in whole or in part in similar activities.

## Employees

As of December 31, 2001, the Company had 15,385 employees, of whom 13,342 were full-time and 2,043 were part-time or temporary. The Company has never had a major work stoppage and considers its employee relations generally to be good.

## Item 2: Properties

As of December 31, 2001, the Company's owned and leased facilities totaled 17,886,000 square feet, an increase of 1.5% over 2000. Grainger Industrial Supply and Acklands-Grainger Inc. (AGI) accounted for the majority of the total square footage. Grainger Industrial Supply facilities are located throughout the United States. AGI facilities are located throughout Canada.

Grainger Industrial Supply branches range in size from 1,200 to 109,000 square feet and average 20,000 square feet. Most are located in or near major metropolitan areas. Many are in industrial parks. Typically, a branch is on one floor, is of masonry construction, consists primarily of warehouse space, contains an air-conditioned office and sales area, and has off-the-street parking for customers and employees. The Company considers that its properties are generally in good condition and well maintained and are suitable and adequate to carry on the Company's business.

The significant facilities of the Company are briefly described below:

Location	Facility and Use	Size in Square Feet
Chicago Area (1)	General Offices & National Distribution Center	2,041,000
Kansas City, MO (1)	Regional Distribution Center	1,435,000
Greenville County, SC (1)	Regional Distribution Center	1,090,000
United States (1)	Six Distribution Centers	1,709,000
United States (2)	388 Grainger Industrial Supply branch locations	7,631,000
United States and Mexico (3)	All other facilities	1,710,000
Canada (4)	184 AGI facilities	2,270,000
	Total square feet	<u>17,886,000</u>

- (1) These facilities are either owned or leased with most leases expiring between 2002 and 2011. The owned facilities are not subject to any mortgages.
- (2) Grainger Industrial Supply branches consist of 285 owned and 103 leased properties. The owned facilities are not subject to any mortgages.
- (3) Other facilities represent owned and leased general branch offices, distribution centers, and branches. Two branches are located in Puerto Rico and five are located in Mexico. The owned facilities are not subject to any mortgages.
- (4) AGI facilities consist of general offices, distribution centers, and branches that are either owned or leased. The owned facilities are not subject to any mortgages.

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**Item 3: Legal Proceedings**

There are pending various legal and administrative proceedings involving the Company that are incidental to the business. It is not expected that the outcome of any such proceeding will have a material adverse effect upon the Company's consolidated financial position or its results of operations.

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

No matters were submitted to a vote of security holders during the fourth quarter of 2001.

**Executive Officers of the Company**

Following is information about the Executive Officers of the Company as of March 1, 2002. Executive Officers of the Company generally serve until the next annual election of officers, or until earlier resignation or removal.

Name and Age	Positions and Offices Held and Principal Occupations and Employment During the Past Five Years
Wesley M. Clark (49)	President and Chief Operating Officer, a position assumed in 2001 after serving as Group President. Before assuming the last-mentioned position in 1997, Mr. Clark served as Senior Vice President, Operations and Quality.
Timothy M. Ferrarell (45)	Senior Vice President, Enterprise Systems, a position assumed in 2001 after serving as Vice President, Quality and Business Planning. Before assuming the last mentioned position in 1998, Mr. Ferrarell served as Vice President, Marketing Communications. Previously, he served as Vice President, Marketing.
Nancy A. Hobor (55)	Vice President, Communications and Investor Relations. Before joining the Company in 1999, Ms. Hobor was Vice President, Corporate Communications and Investor Relations of Morton International, Inc.
John L. Howard (44)	Senior Vice President and General Counsel. Before joining the Company in 2000, Mr. Howard was Vice President and General Counsel of Tenneco Automotive, a position assumed after serving as Vice President, Law and Assistant General Counsel of Tenneco, Inc.
Richard L. Keyser (59)	Chairman of the Board, a position assumed in 1997, and Chief Executive Officer, a position assumed in 1995. Previously, Mr. Keyser served as the Company's President and Chief Operating Officer.
Larry J. Loizzo (47)	Vice President of the Company and President of Lab Safety Supply, Inc.
P. Ogden Loux (59)	Senior Vice President, Finance and Chief Financial Officer, positions assumed in 1997 after serving as Vice President, Finance.
Peter M. Perez (48)	Senior Vice President, Human Resources. Before joining the Company in 2002, Mr. Perez was Chief Human Resource Officer at Alliant Exchange/Clayton Dublier and Rice. Previously, he was Senior Vice President, Human Resources of Whitman Corporation/Pepsi Cola.
James T. Ryan (43)	Executive Vice President, Marketing, Sales and Service. Until assuming his current role in 2001, Mr. Ryan served as Vice President of the Company and President of Grainger.com. Previously, he served as Vice President, Information Services.
John A. Schweig (44)	Senior Vice President, Business Development and International.
John W. Slayton, Jr. (56)	Senior Vice President, Supply Chain Management, a position assumed in 1997 after serving as Senior Vice President, Product Management.

## PART II

### Item 5: Markets for Registrant's Common Equity and Related Shareholder Matters

The Company's common stock is traded on the New York Stock Exchange and the Chicago Stock Exchange, with the ticker symbol GWW. The high and low sales prices for the common stock and the dividends declared and paid for each calendar quarter during 2001 and 2000 are shown below.

Quarters		Prices		Dividends
		High	Low	
2001	First	\$39.78	\$29.51	\$0.170
	Second	48.00	32.00	0.175
	Third	45.25	36.86	0.175
	Fourth	48.99	37.85	0.175
	Year	\$48.99	\$29.51	\$0.695
2000	First	\$56.88	\$37.25	\$0.160
	Second	55.69	29.38	0.170
	Third	34.75	25.13	0.170
	Fourth	40.00	24.31	0.170
	Year	\$56.88	\$24.31	\$0.670

The approximate number of shareholders of record of the Company's common stock as of March 4, 2002 was 1,700.

### Item 6: Selected Financial Data

	Years Ended December 31,				
	(In thousands of dollars except for per share amounts)				
	2001	2000	1999	1998	1997
Net sales.....	\$4,754,317	\$4,977,044	\$4,636,275	\$4,438,975	\$4,226,941
Net earnings.....	174,530	192,903	180,731	238,504	231,833
Net earnings per basic share.....	1.87	2.07	1.95	2.48	2.30
Net earnings per diluted share.....	1.84	2.05	1.92	2.44	2.27
Total assets.....	2,331,246	2,459,601	2,564,826	2,103,966	2,000,116
Long-term debt .....	118,219	125,258	124,928	122,883	131,201
Cash dividends paid per share.....	\$ 0.695	\$ 0.670	\$ 0.630	\$ 0.585	\$ 0.530

The results for 2001 included a non-recurring after-tax charge of \$36,650,000, or \$0.39 per share.

The results for 2000 included an after-tax gain of \$17,860,000, or \$0.19 per share, related to sales of investment securities. For further information see Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations, and Note 3 and Note 9 to the Consolidated Financial Statements.

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

#### RESULTS OF OPERATIONS

The following table is included as an aid to understanding changes in the Company's Consolidated Statements of Earnings.

	Years Ended December 31,				
	Items in Consolidated Statements of Earnings as a Percent of Net Sales			Percent of Increase (Decrease) from Prior Year	
	2001	2000	1999	2001	2000
Net sales .....	100.0%	100.0%	100.0%	(4.5)%	7.4%
Cost of merchandise sold .....	66.6	68.2	67.4	(6.7)	8.5
Operating expenses.....	26.3	25.1	25.8	0.0	4.8
Operating earnings .....	7.1	6.7	6.8	1.0	5.6
Other deductions, net .....	0.8	0.0	0.3	1,071.4	(73.8)
Income taxes.....	2.6	2.8	2.6	(11.5)	12.7
Net earnings.....	3.7%	3.9%	3.9%	(9.5)%	6.7%

## W.W. Grainger, Inc., and Subsidiaries

### CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands of dollars except for per share amounts)

	Years Ended December 31,		
	2001	2000	1999
Net sales .....	\$4,754,317	\$4,977,044	\$4,636,275
Cost of merchandise sold .....	<u>3,165,030</u>	<u>3,391,707</u>	<u>3,125,647</u>
Gross profit .....	1,589,287	1,585,337	1,510,628
Warehousing, marketing, and administrative expenses .....	1,211,644	1,250,217	1,193,400
Restructuring charges .....	<u>39,070</u>	<u>—</u>	<u>—</u>
Total operating expenses .....	<u>1,250,714</u>	<u>1,250,217</u>	<u>1,193,400</u>
Operating earnings .....	338,573	335,120	317,228
Other income or (deductions)			
Interest income .....	2,827	1,891	1,606
Interest expense .....	(10,674)	(24,403)	(15,596)
Equity in loss of unconsolidated entities .....	(7,205)	(10,855)	—
Loss on liquidation of equity in unconsolidated entity .....	(20,123)	—	—
Unclassified—net .....	<u>(6,118)</u>	<u>29,842</u>	<u>512</u>
	<u>(41,293)</u>	<u>(3,525)</u>	<u>(13,478)</u>
Earnings before income taxes .....	297,280	331,595	303,750
Income taxes .....	<u>122,750</u>	<u>138,692</u>	<u>123,019</u>
Net earnings .....	<u>\$ 174,530</u>	<u>\$ 192,903</u>	<u>\$ 180,731</u>
Earnings per share:			
Basic .....	<u>\$ 1.87</u>	<u>\$ 2.07</u>	<u>\$ 1.95</u>
Diluted .....	<u>\$ 1.84</u>	<u>\$ 2.05</u>	<u>\$ 1.92</u>
Weighted average number of shares outstanding:			
Basic .....	<u>93,189,132</u>	<u>93,003,813</u>	<u>92,836,696</u>
Diluted .....	<u>94,727,868</u>	<u>94,223,815</u>	<u>94,315,479</u>

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

## W.W. Grainger, Inc., and Subsidiaries

### CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS

(In thousands of dollars)

	Years Ended December 31,		
	2001	2000	1999
Net earnings .....	\$ 174,530	\$ 192,903	\$ 180,731
Other comprehensive earnings (loss) net of tax:			
Foreign currency translation adjustments .....	(15,457)	(9,487)	9,672
Gain (loss) on investment securities:			
Unrealized holding gain (loss) .....	4,820	(60,066)	78,683
Reclassification adjustments for realized gains included in net earnings .....	<u>(84)</u>	<u>(18,070)</u>	<u>—</u>
	<u>(10,721)</u>	<u>(87,623)</u>	<u>88,355</u>
Comprehensive earnings .....	<u>\$ 163,809</u>	<u>\$ 105,280</u>	<u>\$ 269,086</u>

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

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**W.W. Grainger, Inc., and Subsidiaries****CONSOLIDATED BALANCE SHEETS**

(In thousands of dollars)

ASSETS	December 31,		
	2001	2000	1999
<b>CURRENT ASSETS</b>			
Cash and cash equivalents .....	\$ 168,846	\$ 63,384	\$ 62,683
Accounts receivable, less allowances for doubtful accounts of \$30,552 for 2001, \$23,436 for 2000, and \$18,369 for 1999 .....	454,180	608,297	561,786
Inventories .....	634,654	704,071	762,495
Prepaid expenses.....	37,477	25,173	18,387
Deferred income tax benefits .....	97,454	82,077	65,794
Total current assets.....	1,392,611	1,483,002	1,471,145
<b>PROPERTY, BUILDINGS, AND EQUIPMENT</b>			
Land .....	150,335	147,437	147,118
Buildings, structures, and improvements .....	722,043	711,392	683,426
Furniture, fixtures, machinery, and equipment .....	514,046	449,198	471,485
	1,386,424	1,308,027	1,302,029
Less accumulated depreciation and amortization .....	696,706	631,630	604,278
Property, buildings, and equipment—net .....	689,718	676,397	697,751
DEFERRED INCOME TAXES.....	—	8,820	—
INVESTMENTS IN UNCONSOLIDATED ENTITIES .....	4,776	23,838	—
<b>OTHER ASSETS</b>			
Goodwill.....	177,753	180,644	186,504
Customer lists and other intangibles .....	93,622	89,611	89,680
	271,375	270,255	276,184
Less accumulated amortization.....	115,892	111,094	102,913
	155,483	159,161	173,271
Investments.....	27,023	27,761	154,203
Capitalized software—net.....	39,207	56,118	49,431
Sundry .....	22,428	24,504	19,025
Other assets—net.....	244,141	267,544	395,930
<b>TOTAL ASSETS.....</b>	<u>\$2,331,246</u>	<u>\$2,459,601</u>	<u>\$2,564,826</u>

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## W.W. Grainger, Inc., and Subsidiaries

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2001, 2000, and 1999

#### NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### INDUSTRY INFORMATION

The Company is engaged in the distribution of maintenance, repair, and operating (MRO) supplies, services, and related information to businesses and institutions in North America.

##### PRINCIPLES OF CONSOLIDATION

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

##### INVESTMENTS IN UNCONSOLIDATED ENTITIES

For investments in which the Company owns or controls from 20 percent to 50 percent of the voting shares, the equity method of accounting is used. The Company also accounts for investments below 20 percent using the equity method when significant influence over operating and financial policies of the investee company can be exercised for those investments. (See Note 7 to the Consolidated Financial Statements.)

##### RECLASSIFICATIONS

Certain amounts in the 2000 and 1999 financial statements, as previously reported, have been reclassified to conform to the 2001 presentation.

##### 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 assets and liabilities, and revenues and expenses. Actual results could differ from those estimates.

##### FOREIGN CURRENCY TRANSLATION

The financial statements of the Company's foreign subsidiaries are generally 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, except for those from highly inflationary economies, are recorded as a separate component of shareholders' equity.

##### INVENTORIES

Inventories are valued at the lower of cost or market. Cost is determined primarily by the last-in, first-out (LIFO) method. For non-LIFO inventories, cost is determined by the first-in, first-out (FIFO) method.

##### COST OF MERCHANDISE SOLD

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

##### 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 used in determining depreciation are as follows:

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

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

The Company capitalized interest costs of \$1,323,000, \$747,000, and \$3,238,000, in 2001, 2000, and 1999, respectively.

##### LONG-LIVED ASSETS

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the fair value of an asset is determined to be less than the carrying amount of the asset, a loss is recognized for the difference.

##### 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 on the date products are shipped. Fee revenues are recognized on the date services are completed.

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## 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.

## PURCHASED TAX BENEFITS

The Company purchased tax benefits through leases as provided by the Economic Recovery Tax Act of 1981. Realized tax benefits, net of repayments, are included in Deferred Income Taxes.

## OTHER COMPREHENSIVE EARNINGS

The Company's other comprehensive earnings include unrealized gains on investments, net of tax, and foreign currency translation adjustments with no related income tax effects. The cumulative amount of other comprehensive (loss) earnings was \$(29,553,000), \$(18,832,000), and \$68,791,000, at December 31, 2001, 2000, and 1999, respectively.

## ADOPTION OF ACCOUNTING STANDARD

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Certain Derivative Instruments and Hedging Activities," effective January 1, 2001. The Company uses non-derivative financial instruments to help hedge its exposure for certain investments in foreign subsidiaries in which the net assets are exposed to currency exchange rate volatility. Adoption of SFAS No. 133 requires the Company to report the net amounts of gains and losses that arise from qualifying non-derivative hedging instruments in the cumulative translation adjustment during the reporting period. The Company's accounting treatment of SFAS No. 133 is consistent with the method it previously used under SFAS No. 52, "Foreign Currency Translation."

Currency exposure related to the Company's investment in the net assets of its Canadian subsidiary, Acklands-Grainger Inc. (AGI), is partially mitigated by a foreign currency denominated debt obligation of the parent. Gains and losses associated with the debt obligation offset gains and losses in the net investment in AGI.

The amount of gain (loss) related to the foreign currency denominated debt obligation for the years ended December 31, 2001, 2000, and 1999 was \$7,039,000, \$4,550,000, and \$(7,028,000), respectively, and were included in accumulated other comprehensive earnings.

## NEW ACCOUNTING PRONOUNCEMENTS

On July 20, 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Intangible Assets." SFAS No. 141 is effective for all business combinations completed after June 30, 2001. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001; however, certain provisions of this Statement apply to goodwill and other intangible assets acquired between July 1, 2001, and the effective date of SFAS No. 142. Major provisions of these Statements and their effective dates for the Company are as follows:

1. All business combinations initiated after June 30, 2001 must use the purchase method of accounting. The pooling of interest method of accounting is prohibited except for transactions initiated before July 1, 2001.
2. Intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented, or exchanged, either individually or as part of a related contract, asset, or liability.
3. Goodwill and other intangible assets with indefinite lives, acquired after June 30, 2001, are not amortized. Effective January 1, 2002, all previously recognized goodwill and intangible assets with indefinite lives will no longer be subject to amortization.
4. Effective January 1, 2002, goodwill and intangible assets with indefinite lives will be tested for impairment annually and whenever there is an impairment indicated.
5. All acquired goodwill must be assigned to reporting units for purposes of impairment testing and segment reporting.

At December 31, 2001, goodwill had a net carrying value of \$150 million. In 2001, amortization expense for goodwill was \$3,192,000 after-tax, or \$0.03 per share. The Company is currently evaluating the classification of other intangibles and the effect of impairment provisions of SFAS No. 142 and is in the process of assessing the impact of adoption on its consolidated financial statements.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 is effective for fiscal years beginning after December 15, 2001, and addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement supersedes SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for the disposal of a segment of a business. The Company plans to adopt SFAS No. 144 at January 1, 2002, and has determined that adoption will not have a material effect on its results of operations or financial position.

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**NOTE 2—BUSINESS ACQUISITION**

On February 26, 2001, Lab Safety Supply, Inc., the Company's wholly owned subsidiary, acquired The Ben Meadows Co., Inc. (Ben Meadows), of Canton, Georgia, for approximately \$14.4 million, including costs associated with the acquisition.

Ben Meadows, a privately held corporation with annual sales of \$20,000,000, is a business-to-business direct marketer specializing in equipment and supplies for the environmental and forestry management markets. The acquisition was accounted for under the purchase method of accounting. Results for Ben Meadows are included in the Company's results since the date of its acquisition. Given the size of the acquisition, pro forma disclosures are not considered necessary.

**NOTE 3—NON-RECURRING CHARGES**

On April 23, 2001, the Company announced its plans to shut down the operations of Material Logic and write down its investment in other digital activities. Material Logic was the business unit the Company formed to seek other equity participants in developing several digital operations. As a result of this action, the Company shut down all of Material Logic's branded e-commerce sites except FindMRO, which remains an integrated sourcing service for the Company's customers.

In connection with the closing of Material Logic, the Company took a non-recurring, pretax charge of \$39.1 million (after-tax \$23.2 million) in 2001. The Company provided a comprehensive separation package, including outplacement services, to the employees whose jobs were eliminated. As part of the shutdown, 166 employees were severed. Severance payments began in July 2001 and will continue until June 2004, when the last severance package expires.

In addition, the Company wrote down its investment in other digital enterprises and took a pretax charge of \$25.1 million (after-tax \$13.4 million). This included the loss on the divestiture of the Company's 40% investment in Works.com, Inc. The Company acquired its ownership in Works.com, Inc., an unrelated third party, on August 1, 2000, when the Company's OrderZone.com business unit was combined with Works.com.

The total effect of these non-recurring charges amounted to an after-tax cost of \$36.6 million, or \$0.39 per share.

The following table displays the activity and balance of the Material Logic restructuring reserve as of December 31, 2001:

	<u>Original Provision</u>	<u>Deductions</u>	<u>Adjustments</u>	<u>Balance</u>
Restructuring Reserve (Operating expenses):		(In thousands of dollars)		
Workforce reductions .....	\$17,200	\$ (9,264)	\$ (3,056)	\$ 4,880
Asset and equipment write-offs and disposals .....	5,800	(4,277)	(587)	936
Contractual obligations .....	5,000	(7,482)	2,482	—
Other shutdown costs .....	12,000	(8,570)	231	3,661
	<u>\$40,000</u>	<u>\$ (29,593)</u>	<u>\$ (930)</u>	<u>\$ 9,477</u>

Deductions reflect cash payments of \$17,597,000 and noncash charges of \$11,996,000. The amounts in the adjustments column are reclassifications and reductions to reflect management's current estimate of costs, by expense category.

**NOTE 4—CASH FLOWS**

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.

**NOTE 5—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.

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**NOTE 6—INVENTORIES**

Inventories primarily consist of merchandise purchased for resale.

Inventories would have been \$202,390,000, \$211,801,000, and \$211,490,000, higher than reported at December 31, 2001, 2000, and 1999, respectively, if the first-in, first-out (FIFO) method of inventory accounting had been used for all Company inventories. Net earnings would have (decreased) increased by \$(5,741,000), \$188,000, and \$(3,603,000), for the years ended December 31, 2001, 2000, and 1999, respectively, using the FIFO method of accounting. Inventories under FIFO approximate replacement cost.

**NOTE 7—INVESTMENTS IN UNCONSOLIDATED ENTITIES**

During 2001 and 2000, the Company made investments in several Internet related start-up joint ventures.

On August 1, 2000, the Company completed a transaction that combined the assets of its OrderZone.com business with Works.com. In addition, the Company invested \$21 million in cash in Works.com and agreed to make Works.com's purchasing management service and marketplace available to the Company's small and mid-size customers through Grainger.com. For its contributions, the Company received a 40% equity stake in the combined company, which was subject to certain voting and transfer restrictions. Subsequent to August 1, 2000, the Company accounted for its interest in Works.com using the equity method. Prior to August 1, 2000, the results of OrderZone.com were included in the consolidated results of the Company. In the second quarter of 2001, the Company divested its 40% ownership share of Works.com (See Note 3 to the Consolidated Financial Statements.)

The Company also made investments in three other joint ventures. The Company accounts for these joint ventures using the equity method of accounting. The Company's ownership percentages range from 11% to 49%. As start-up businesses, the time frame or the ultimate ability to achieve profitability is uncertain. Reaching profitability is also dependent upon the entities securing sufficient capital funding to support developmental activities.

The table below summarizes the activity of these investments. The losses reflect the start-up nature of these businesses.

	Investment Cost	Cumulative Equity Losses (after-tax)	Total
	(In thousands of dollars)		
Balance at January 1, 2000.....	\$ —	\$ —	\$ —
Works.com.....	32,284	(10,031)	22,253
Other equity-method investees .....	2,409	(824)	1,585
Balance at December 31, 2000 .....	34,693	(10,855)	23,838
Works.com.....	—	(4,608)	(4,608)
Other equity-method investees .....	5,764	(2,597)	3,167
Divestiture of Works.com.....	(17,621)	—	(17,621)
Balance at December 31, 2001 .....	<u>\$ 22,836</u>	<u>\$(18,060)</u>	<u>\$ 4,776</u>

**NOTE 8—INTANGIBLES**

Goodwill represents the cost in excess of net assets of acquired companies and was amortized on a straight-line basis over periods of five to forty years. The Company's goodwill is predominately denominated in Canadian dollars and, accordingly, the changes in the asset balance are due to foreign exchange rate fluctuations.

Customer lists and other intangibles are amortized on a straight-line basis over periods of seven to forty years.

Beginning in 2002, goodwill and intangible assets with indefinite lives will no longer be amortized but will be tested for impairment on an annual basis. (See Note 1 to the Consolidated Financial Statements—"New Accounting Pronouncements.")

**NOTE 9—INVESTMENTS**

Investments consist of marketable securities and non-publicly traded equity securities for which a market value is not readily determinable. Marketable securities are all classified as available-for-sale and are reported at fair value, with unrealized gains or losses on such securities reflected, net of taxes, as a separate component of shareholders' equity. Non-publicly traded equity securities are reported at lower of cost or estimated net realizable value. Adjustments to net realizable value are recognized in earnings. There have been no dividends earned on these investments. During 2001 and 2000, the Company sold a portion of its marketable securities investments. The gains on these sales were calculated using the specific identification method and were reported in Unclassified—net.

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The original cost, realized and unrealized gains (pretax), and fair value of investments are summarized as follows:

	December 31,		
	2001	2000	1999
	(In thousands of dollars)		
Marketable securities			
Cost .....	\$16,517	\$16,852	\$ 18,500
Unrealized gains .....	8,661	909	130,703
Fair value .....	25,178	17,761	149,203
Non-publicly traded equity securities .....	1,845	10,000	5,000
	<u>\$27,023</u>	<u>\$27,761</u>	<u>\$154,203</u>
Proceeds from sales .....	<u>\$ 1,015</u>	<u>\$31,665</u>	<u>\$ —</u>
Realized gain on sales .....	<u>\$ 138</u>	<u>\$30,017</u>	<u>\$ —</u>

#### NOTE 10—CAPITALIZED SOFTWARE

Amortization of capitalized software is predominately on a straight-line basis over five years. Amortization expense was \$19,483,000, \$16,249,000, and \$9,840,000 for the years ended December 31, 2001, 2000, and 1999, respectively.

#### NOTE 11—SHORT-TERM DEBT

The following summarizes information concerning short-term debt:

	2001	2000	1999
	(In thousands of dollars)		
<u>Bank Debt</u>			
Outstanding at December 31 .....	\$ 4,526	\$ 2,972	\$ 4,598
Maximum month-end balance during the year .....	\$ 4,559	\$ 4,818	\$ 4,675
Average amount outstanding during the year .....	\$ 3,645	\$ 4,191	\$ 3,263
Weighted average interest rate during the year .....	5.3%	6.9%	6.1%
Weighted average interest rate at December 31 .....	3.4%	7.4%	6.6%
<u>Commercial Paper</u>			
Outstanding at December 31 .....	\$ —	\$170,566	\$292,238
Maximum month-end balance during the year .....	\$128,632	\$300,607	\$292,250
Average amount outstanding during the year .....	\$ 64,438	\$247,640	\$193,674
Weighted average interest rate during the year .....	5.3%	6.5%	5.7%
Weighted average interest rate at December 31 .....	—%	6.6%	6.2%

The Company and its subsidiaries had committed lines of credit totaling \$417,564,000, \$518,344,000, and \$568,848,000 at December 31, 2001, 2000, and 1999, respectively, including \$12,564,000, \$13,344,000, and \$13,848,000 denominated in Canadian dollars. A Company subsidiary also had a \$15,705,000, \$16,680,000, and \$17,311,000 uncommitted line of credit denominated in Canadian dollars as of December 31, 2001, 2000, and 1999, respectively. At December 31, 2001, 2000, and 1999, borrowings under the subsidiary's committed lines of credit were \$4,526,000, \$2,972,000, and \$4,598,000, respectively. The Company has guaranteed these borrowings.

#### NOTE 12—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 based upon a formula related primarily to earnings before federal income taxes, limited to 15% of the total compensation paid to all eligible employees. The Company also sponsors additional defined contribution and defined benefit plans, which cover most of the other employees. Provisions under all plans were \$47,621,000, \$42,353,000, and \$55,007,000 for the years ended December 31, 2001, 2000, and 1999, respectively.

**POSTRETIREMENT BENEFITS.** The Company has a health care benefits plan that provides coverage to its retired employees and their dependents should they elect to maintain such coverage. A majority of the Company's employees become eligible for participation when they qualify for retirement while working for the Company.

The amounts charged to operating expense for postretirement health care benefits were \$5,348,000, \$3,767,000, and \$4,523,000 for the years ended December 31, 2001, 2000, and 1999, respectively. Components of the expense were:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
	(In thousands of dollars)		
Service cost .....	\$ 3,442	\$ 3,083	\$ 3,446
Interest cost .....	3,689	3,189	2,854
Expected return on assets .....	(1,421)	(1,563)	(1,302)
Amortization of transition asset (22-year amortization) .....	(143)	(143)	(143)
Amortization of unrecognized gain .....	(144)	(724)	(257)
Amortization of prior service cost .....	<u>(75)</u>	<u>(75)</u>	<u>(75)</u>
	<u>\$ 5,348</u>	<u>\$ 3,767</u>	<u>\$ 4,523</u>

Participation in the plan is voluntary at retirement and requires participants to make contributions toward the cost of the plan, as determined by the Company. The accounting for the health plan anticipates future cost-sharing changes to retiree contributions that will maintain the current cost-sharing ratio between the Company and the retirees.

A Group Benefit Trust has been established as the vehicle to process benefit payments. The assets of the trust are invested in Standard & Poor's 500 index funds. The assumed weighted average long-term rate of return is 6%, which is net of a 40.0% tax rate. 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, as amended, and was \$3,470,000, \$1,385,000, and \$1,686,000 for the years ended December 31, 2001, 2000, and 1999, respectively.

A reconciliation of the beginning and ending balances of the accumulated postretirement benefit obligation (APBO), the fair value of assets, and the funded status of the benefit obligation as of December 31, 2001, 2000, and 1999 is as follows:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
	(In thousands of dollars)		
Benefit obligation at the beginning of the year .....	\$ 49,044	\$ 40,394	\$ 43,675
Service cost .....	3,442	3,083	3,446
Interest cost .....	3,689	3,189	2,854
Plan participant contributions .....	882	762	535
Actuarial loss (gain) .....	7,960	3,598	(7,913)
Benefits paid .....	<u>(2,206)</u>	<u>(1,982)</u>	<u>(2,203)</u>
Benefit obligation at the end of the year .....	<u>62,811</u>	<u>49,044</u>	<u>40,394</u>
Fair value of plan assets at beginning of year .....	20,505	22,188	18,636
Actual return on plan assets .....	(2,785)	(1,848)	3,534
Employer contributions .....	3,470	1,385	1,686
Plan participant contributions .....	882	762	535
Benefits paid .....	<u>(2,206)</u>	<u>(1,982)</u>	<u>(2,203)</u>
Fair value of plan assets at the end of the year .....	<u>19,866</u>	<u>20,505</u>	<u>22,188</u>
Funded status .....	(42,945)	(28,539)	(18,206)
Unrecognized transition asset .....	(1,856)	(1,999)	(2,142)
Unrecognized net actuarial loss (gain) .....	8,863	(3,447)	(11,180)
Unrecognized prior service cost .....	<u>(702)</u>	<u>(777)</u>	<u>(852)</u>
Accrued postretirement benefits cost .....	<u>\$(36,640)</u>	<u>\$(34,762)</u>	<u>\$(32,380)</u>

To determine the APBO as of December 31, 2001, 2000, and 1999, the assumed weighted average discount rate used was 7.0%, 7.5%, and 7.8%, respectively. The assumed health care cost trend rate for 2002 is 8.1%. Beginning in 2003, the assumed health care cost trend rate declines on a straight-line basis until 2011, when the ultimate trend rate of 5.0% is achieved.