WELLS REAL ESTATE INVESTMENT TRUST II INC
Form 424B3
November 13, 2006

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WELLS REAL ESTATE INVESTMENT TRUST II, INC.

SUPPLEMENT NO. 5 DATED NOVEMBER 13, 2006

TO THE PROSPECTUS DATED APRIL 26, 2006

This document supplements, and should be read in conjunction with, our prospectus dated April 26, 2006 relating to our offering of 475,000,000 shares of common stock, as supplemented by supplement no. 1 dated May 16, 2006, supplement no. 2 dated August 11, 2006, supplement no. 3 dated September 22, 2006 and supplement no. 4 dated November 1, 2006. Capitalized terms used in this supplement have the same meanings as set forth in the prospectus. The purpose of this supplement is to disclose:

- the status of our public offerings;
- information regarding our indebtedness;
- information regarding a revision to suitability standards in Kansas;
- risks related to our dependence on key personnel of our advisor;
- the election of directors at our annual meeting;
- Management s Discussion and Analysis of Financial Condition and Results of Operations similar to that filed in our Quarterly Report on Form 10-Q for the period ended September 30, 2006, filed on November 8, 2006; and
- our unaudited financial statements as of and for the three and nine months ended September 30, 2006.

Status of Our Public Offerings

We commenced our initial public offering of 785 million shares of common stock on December 1, 2003, which consisted of a 600 million-share primary offering and a 185 million-share offering under our dividend reinvestment plan. We stopped making offers under the primary offering on November 26, 2005. We raised gross offering proceeds of approximately $2.0 billion from the sale of approximately 197.1 million shares in our initial public offering, including shares sold under the dividend reinvestment plan after the primary offering terminated.

On November 10, 2005, we commenced our follow-on offering of 300.6 million shares of common stock. Of these shares, we are offering 300 million shares in a primary offering and 0.6 million shares under our dividend reinvestment plan. On April 14, 2006, we amended the registration statements for our follow-on offering and our initial public offering in order to offer in a combined prospectus the 300.6 million shares registered under the follow-on offering and the 174.4 million unsold dividend reinvestment plan shares registered under the initial public offering. As of November 8, 2006, we had received gross offering proceeds of approximately $739.3 million from the sale of approximately

73.9 million shares in our follow-on offering, including dividend reinvestment plan shares sold under the combined prospectus.

As of November 8, 2006, we had received aggregate gross offering proceeds of approximately $2.7 billion from the sale of approximately 271.0 million shares in our public offerings. After incurring approximately $54.0 million in acquisition fees, approximately $253.5 million in selling commissions and dealer manager fees, approximately $40.7 million in other organization and offering expenses, and funding common stock redemptions of approximately $45.6 million pursuant to the share redemption program, as of November 8, 2006, we had raised aggregate net offering proceeds available for investment in properties of approximately $2.3 billion, substantially all of which had been invested in real estate properties.

Indebtedness

As of November 8, 2006, our leverage ratio, that is, the ratio of total debt to total purchase price of real estate assets plus cash and cash equivalents, was approximately 26%. As of November 8, 2006, total indebtedness was approximately $834.4 million, which consisted of fixed-rate mortgages on certain properties of approximately $560.5 million, approximately $259.0 million outstanding under our $400.0 million line of credit with Wachovia Bank, N.A. (the Wachovia Line of Credit) and approximately $14.9 million outstanding under our construction

line of credit. Based on the value of our borrowing-base properties, we had approximately $128.5 million in remaining capacity under the Wachovia Line of Credit, of which approximately $2.0 million was pledged in the form of letters of credit for future tenant improvements and leasing costs.

Revision to Suitability Standards in Kansas

As of November 13, 2006, we will not sell shares to investors in Kansas unless they meet the following special suitability standards:

Investors must have either (1) a net worth of at least $225,000, or (2) gross annual income of at least $60,000 and a net worth of at least $60,000.

Furthermore, it is recommended by the Office of the Kansas Securities Commissioner that Kansas investors not invest, in the aggregate, more than 10% of their liquid net worth in this and similar direct participation investments. Liquid net worth is defined as that portion of net worth, which consists of cash, cash equivalents and readily marketable securities.

For purposes of determining suitability of an investor, net worth in all cases should be calculated excluding the value of an investor s home, furnishings and automobiles. In the case of sales to fiduciary accounts, these suitability standards must be met by the fiduciary account, by the person who directly or indirectly supplied the funds for the purchase of the shares if such person is the fiduciary or by the beneficiary of the account.

Those selling shares on our behalf must make every reasonable effort to determine that the purchase of shares in this offering is a suitable and appropriate investment for each stockholder based on information provided by the stockholder regarding the stockholder s financial situation and investment objectives.

Risks Related to Our Dependence on Key Personnel of Wells Capital

The following risk factor relates to our dependence on key personnel of Wells Capital and should be read together with the risk factors disclosed in the prospectus.

Our inability to retain the services of key personnel could cause our operations to suffer.

We rely on Wells Capital, our advisor, and its affiliates for the day-to-day operation of our business. We believe that our success is significantly dependent upon the contributions of the key personnel of Wells Capital and its affiliates, including among others Leo F. Wells, III, Douglas P. Williams, and Randall D. Fretz, each of whom would be difficult to replace. Such key personnel dedicate attention to multiple programs sponsored by Wells Real Estate Funds, Inc. (WREF) and, as a result, experience conflicts of interest in allocating their time among us and other WREF-sponsored programs with which they are involved.

The charter of Wells Real Estate Investment Trust, Inc. (Wells REIT), a Wells-sponsored program, requires that it begin the process of liquidating its investments if its shares are not listed on a national securities exchange by January 30, 2008. If the board of directors of Wells REIT should decide to list its securities on a national securities exchange prior to January 30, 2008, Wells REIT might seek to become self-managed prior to listing due to the market s apparent preference for self-managed REITs. In so doing, Wells REIT might consider acquiring a portion of Wells Capital s business in an effort to become self-managed. In the event that Wells Real Estate Investment Trust, Inc. or another WREF-sponsored program were to sever ties with WREF, there is a risk that certain of these key personnel may cease their affiliation with us, Wells Capital, or its affiliates. In such event, we may be unable to find suitable replacement personnel, and our operating results could suffer as a result.

Election of Directors

On July 19, 2006, we held our annual meeting of stockholders at The Atlanta Athletic Club in Duluth, Georgia. Our stockholders elected the following individuals to the board of directors: Leo Wells, III; Douglas Williams; Charles Brown; Richard Carpenter; Bud Carter; Donald Moss; Jack Pinkerton; Neil Strickland; and Wayne Woody. The board of directors also solicited proxies for the re-election of Walter W. Sessoms to the board. Mr. Sessoms passed away prior to the annual stockholders meeting and his name was withdrawn. The board of directors has not made a decision to fill the vacancy on the board.

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Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the accompanying consolidated financial statements and notes thereto contained in this supplement no. 5, as well as our consolidated financial statements and notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2005 included in the prospectus. This discussion contains forward-looking statements, which can be identified with the use of forward-looking terminology such as may, will, intend or similar words. Actual results may differ from those described in forward-looking statements. For a discussion of the factors that could cause actual results to differ from those anticipated, see Risk Factors in the prospectus and Risks Related to Our Dependence on Key Personnel of Wells Capital in this supplement.

We were formed on July 3, 2003. During 2004, we began acquiring real estate assets and receiving investor proceeds under our initial public offering of common stock. We continued receiving investor proceeds and investing in real estate assets through September 30, 2006. Thus, our results of operations for the three months and nine months ended September 30, 2006 and 2005, respectively, reflect growing operational revenues and expenses, fluctuating interest expense, and general and administrative expenses. The increased operational revenues and expenses result from acquiring real properties, while the fluctuations in interest expense arise from using varying levels of short-term and long-term debt financing for our acquisitions. Our general and administrative expenses have declined as a percentage of total revenues for the nine months ended September 30, 2006, as compared to the nine months ended September 30, 2005, commensurate with the operational growth of the enterprise.

Liquidity and Capital Resources

Overview

From January 2004 through September 2006, we raised significant funds through the sale of our common stock under our public offerings. We primarily used the proceeds from these sales of common stock, net of offering costs and other expenses, to acquire real properties and fund certain capital improvements identified at the time of acquisition. We anticipate receiving proceeds from the sale of our common stock under this offering in the future, and investing such proceeds in future acquisitions of real properties. We also anticipate receiving proceeds from the sale of our common stock under our dividend reinvestment plan in the future, and using a significant portion of such proceeds to fund redemptions of our common stock under our share redemption program. We expect that our primary source of future operating cash flows will be cash generated from the operations of the properties currently in our portfolio and those to be acquired in the future. The amount of future dividends to be paid to our stockholders will be largely dependent upon the amount of cash generated from our operating activities, our expectations of future cash flows, and our determination of near-term cash needs for capital improvements, tenant re-leasing, redemptions of our common stock, and debt repayments.

The competition to acquire high-quality commercial office properties remains high. Timing differences arise between acquiring properties and raising capital and between making operating payments and collecting operating receipts. Accordingly, we may periodically be required to borrow funds on a short-term basis to meet our dividend payment schedule. Our primary focus, however, is to continue to maintain the quality of our portfolio. Thus, in this intensely competitive environment, we may opt to lower the dividend rather than compromise that quality or accumulate significant borrowings to meet a dividend level higher than operating cash flow would support. We will continue to carefully monitor our cash flows and market conditions and their impact on our earnings and future dividend projections.

Short-term Liquidity and Capital Resources

During the nine months ended September 30, 2006, we generated net cash flows from operating activities of approximately $102.1 million, which is primarily comprised of receipts for rental income, tenant reimbursements, hotel income, and interest and other income, partially offset by payments for operating costs, interest expense, asset and property management fees, and general and administrative expenses. Such net cash flows from operating activities were primarily used to pay dividends to stockholders of approximately $100.6 million during the same period. We generated net cash flows from financing activities of approximately $349.7 million during the nine months ended September 30, 2006, primarily as a result of raising proceeds from the sale of common stock under our public offerings, net of commissions, dealer-manager fees, and other offering costs of approximately $567.7 million, reduced by net debt repayments and prepayment penalties of approximately $92.0 million and redemptions of common stock of approximately $24.4 million. Such net cash flows from financing activities and cash on hand were used primarily to invest approximately $401.9 million in real estate and pay acquisition fees of approximately

$14.7 million. We expect to utilize the residual cash balance of approximately $72.9 million as of September 30, 2006 to satisfy current liabilities, pay future dividends, fund future acquisitions of real properties, or reduce indebtedness.

We intend to continue to generate capital from the sale of common stock under this offering and from third-party borrowings, and to use such capital primarily to fund future acquisitions of real estate. We expect that we will use a significant portion of the proceeds from sales under our dividend reinvestment plan to fund redemptions under the share redemption program. As of November 8, 2006, we held cash balances of approximately $46.6 million and had outstanding borrowings under the Wachovia Line of Credit of approximately $259.0 million. As of November 8, 2006, after consideration of a letter of credit pledged against the Wachovia Line of Credit, we had a remaining borrowing capacity of approximately $126.5 million under the Wachovia Line of Credit. Accordingly, we believe that we have adequate capacity to continue to expand our portfolio and meet our future operating cash flow needs. We expect to use substantially all of our future operating cash flow, after payments for certain capital expenditures, to pay dividends to stockholders.

On September 5, 2006, our board of directors declared a daily dividend for stockholders of record from September 16, 2006 through December 15, 2006 in an amount equal to an annualized dividend of $0.60 per share, which is consistent with the rate of dividends declared for each quarter of 2005 and the first three quarters of 2006 on a per share basis. Such dividend will be paid during December 2006.

Long-term Liquidity and Capital Resources

We expect that our primary sources of capital over the long term will include proceeds from the sale of our common stock, proceeds from secured or unsecured borrowings from third-party lenders, and net cash flows from operations. We expect that our primary uses of capital will be for property acquisitions, either directly or through investments in joint ventures, tenant improvements, offering-related costs, operating expenses, including interest expense on any outstanding indebtedness, and dividends.

In determining how and when to allocate cash resources, we initially consider the source of the cash. We expect that substantially all future net operating cash flows, after payments for certain capital expenditures such as tenant improvements and leasing commissions, will be used to pay dividends. However, we may temporarily use other sources of cash, such as short-term borrowings, to fund dividends from time to time (see Liquidity and Capital Resources Overview above). We expect to use substantially all net cash flows generated from raising equity or debt financing to fund acquisitions, certain capital expenditures identified upon acquisition, the repayment of outstanding borrowings, and the redemption of shares under the share redemption program. If sufficient equity or debt capital is not available, our future investments in real estate will be lower.

To the extent that future cash flows provided by operations are lower due to lower returns on properties, future dividends paid may be lower as well. Our cash flow from operations depends significantly on market rents and our tenants ability to make rental payments. We believe that the diversity of our tenant base and the concentration of creditworthy tenants in our portfolio help to mitigate the risk of a tenant defaulting on a lease. However, general economic downturns, or downturns in one or more of our core markets, could adversely impact the ability of our tenants to make lease payments and our ability to re-lease space on favorable terms when leases expire. In the event of either situation, our cash flow and consequently our ability to meet capital needs, could adversely affect our ability to pay dividends in the future.

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Contractual Commitments and Contingencies

As of September 30, 2006, our contractual obligations are as follows (in thousands):

		Payments Due During the Years Ending December 31,			
		Remainder			
Contractual Obligations	**Total**	**of 2006**	**2007-2008**	**2009-2010**	**Thereafter**
Outstanding debt obligations [1]	$ 743,689	$ 118	$ 303,274	$ 25,029	$ 415,268
Capital lease obligations	105,870	1,170	9,360	9,360	85,980
Purchase obligations [2]	193,600	193,600			
Operating lease obligations	3,135	15	120	120	2,880
Total	$ 1,046,294	$ 194,903	$ 312,754	$ 34,509	$ 504,128

(1) Amounts include principal payments only. We made interest payments of $26.3 million during the nine months ended September 30, 2006 and expect to pay interest in future periods on outstanding debt obligations based on the rates and terms disclosed in Note 4 to our consolidated financial statements for the year ended December 31, 2005 included in the prospectus and in Note 4 to our accompanying consolidated financial statements in this supplement.

(2) Represents a purchase commitment for the International Financial Tower, which was under contract at September 30, 2006. Refer to Note 8 of our accompanying consolidated financial statements in this supplement for further explanation.

Results of Operations

Overview

Our results of operations are not indicative of those expected in future periods, as we expect that rental income, tenant reimbursements, property operating costs, asset and property management fees, depreciation, amortization, and net income will increase in future periods as a result of owning the assets we acquired prior to and during the periods presented for an entire period and as a result of future acquisitions of real estate assets that are anticipated.

We commenced our initial public offering on December 1, 2003. Following the receipt and acceptance of subscriptions for the minimum offering of $2,500,000 on January 22, 2004, we acquired 18 properties during the year ended December 31, 2004 and acquired 21 properties during the year ended December 31, 2005. During the nine months ended September 30, 2006, we acquired 7 properties and completed construction of the LakePointe 3 building, bringing our total portfolio to 47 properties as of September 30, 2006. Accordingly, the results of operations presented for the three months and nine months ended September 30, 2006 and 2005, respectively, are not directly comparable.

Comparison of the three months ended September 30, 2005 versus the three months ended September 30, 2006

Rental income and tenant reimbursements increased from approximately $35.8 million and $8.5 million, respectively, for the three months ended September 30, 2005 to approximately $61.3 million and $13.3 million, respectively, for the three months ended September 30, 2006, primarily as a result of the growth in the portfolio during the last three months of 2005 and the first nine months of 2006. Rental income and tenant reimbursements are expected to continue to increase in future periods, as compared to historical periods, as a result of owning the assets acquired during the last three months of 2005 and the first nine months of 2006 for an entire period and future acquisitions of real estate assets.

Hotel income and hotel operating costs of approximately $7.4 million and $5.5 million, respectively, were recognized for the three months ended September 30, 2006 and reflect earnings on one hotel property located in Cleveland, Ohio, which we acquired during the fourth quarter of 2005.

Property operating costs and asset and property management fees increased from approximately $13.1 million and $3.5 million, respectively, for the three months ended September 30, 2005 to approximately $22.3 million and $6.4 million, respectively, for the three months ended September 30, 2006, primarily as a result of the growth in the portfolio during the last three months of 2005 and the first nine months of 2006. Property operating costs and asset and property management fees are expected to continue to increase in future periods, as compared to historical periods, due to owning the assets acquired during the last three months of 2005 and the first nine months of 2006 for an entire period and future acquisitions of additional real estate assets.

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Depreciation of real estate and amortization of related lease costs increased from approximately $6.5 million and $11.7 million, respectively, for the three months ended September 30, 2005 to approximately $11.9 million and $20.5 million, respectively, for the three months ended September 30, 2006, primarily due to the acquisition of properties during the last three months of 2005 and the first nine months of 2006. We expect depreciation and amortization to continue to increase in future periods, as compared to historical periods, due to future acquisitions of real estate assets.

General and administrative expenses increased from approximately $1.5 million for the three months ended September 30, 2005 to approximately $2.9 million for the three months ended September 30, 2006, primarily due to increases in salary expense reimbursements payable to Wells Capital and Wells Management as a result of increasing the size of our portfolio of real estate assets during the last three months of 2005 and the first nine months of 2006.

Lease termination expense of approximately $1.8 million was recognized for the three months ended September 30, 2006 due to a noncash partial write-off of intangible lease assets resulting from an amendment to a lease agreement that reduced base rent in exchange for the removal of a lease termination option.

Interest expense increased from approximately $5.5 million for the three months ended September 30, 2005 to approximately $9.4 million for the three months ended September 30, 2006, primarily due to new mortgage notes and mortgage notes assumed in connection with property acquisitions, as well as an increase in average borrowings under our line of credit. There were no borrowings on the line of credit during the three months ended September 30, 2005 compared to average borrowings of approximately $173.1 million during the three months ended September 30, 2006. Future levels of interest expense will vary primarily based on the amounts of future borrowings and the costs of borrowings. Future borrowings will be used primarily to fund future acquisitions of real estate or interests therein. Accordingly, the amounts of future borrowings and future interest expense will largely depend on the level of additional proceeds we raise in this offering and any future offerings, the opportunities to acquire real estate assets consistent with our investment objectives, and the timing of such future acquisitions.

Net income and net income per share decreased from approximately $5.2 million and $0.03, respectively, for the three months ended September 30, 2005 to approximately $2.6 million and $0.01, respectively, for the three months ended September 30, 2006, primarily as a result of the increases in lease termination expense and interest expense described above. We expect future real estate acquisitions to result in an increase in net income in future periods and expect future net income per share to fluctuate primarily based on the level of proceeds raised in this offering and any future offerings and the rate at which we are able to invest such proceeds in income-generating real estate assets.

Comparison of the nine months ended September 30, 2005 versus the nine months ended September 30, 2006

Rental income and tenant reimbursements increased from approximately $90.7 million and $19.7 million, respectively, for the nine months ended September 30, 2005 to approximately $176.1 million and $40.7 million, respectively, for the nine months ended September 30, 2006, primarily as a result of the growth in the portfolio during the last three months of 2005 and the first nine months of 2006. Rental income and tenant reimbursements are expected to continue to increase in future periods, as compared to historical periods, as a result of owning the assets acquired during the last three months of 2005 and the first nine months of 2006 for an entire period and future acquisitions of real estate assets.

Hotel income and hotel operating costs of approximately $17.8 million and $13.5 million, respectively, were recognized for the nine months ended September 30, 2006 and reflect earnings on one hotel property located in Cleveland, Ohio, which we acquired during the fourth quarter of 2005.

Property operating costs and asset and property management fees increased from approximately $31.3 million and $8.9 million, respectively, for the nine months ended September 30, 2005 to approximately $65.3 million and $18.4 million, respectively, for the nine months ended September 30, 2006, primarily as a result of the growth in the portfolio during the last three months of 2005 and the first nine months of 2006. Property operating costs and asset and property management fees are expected to continue to increase in future periods, as compared to historical periods, due to owning the assets acquired during the last three months of 2005 and the first nine months of 2006 for an entire period and future acquisitions of additional real estate assets.

Depreciation of real estate and amortization of related lease costs increased from approximately $15.8 million and $29.7 million, respectively, for the nine months ended September 30, 2005 to approximately $33.8 million and

$60.0 million, respectively, for the nine months ended September 30, 2006, primarily due to the acquisition of properties during the last three months of 2005 and the first nine months of 2006. We expect depreciation and amortization to continue to increase in future periods, as compared to historical periods, due to future acquisitions of real estate assets.

Lease termination expense of approximately $1.8 million was recognized for the nine months ended September 30, 2006 due to a noncash partial write-off of intangible lease assets resulting from an amendment to a lease agreement that reduced base rent in exchange for the removal of a lease termination option.

General and administrative expenses increased from approximately $6.1 million for the nine months ended September 30, 2005 to approximately $8.8 million for the nine months ended September 30, 2006, primarily due to increases in salary expense reimbursements payable to Wells Capital and Wells Management as a result of increasing the size of our portfolio of real estate assets during the last three months of 2005 and the first nine months of 2006. General and administrative expenses as a percent of total revenues decreased from approximately 6% for the nine months ended September 30, 2005 to approximately 4% for the nine months ended September 30, 2006.

Interest expense increased from approximately $16.7 million for the nine months ended September 30, 2005 to approximately $30.8 million for the nine months ended September 30, 2006, primarily due to new mortgage notes and mortgage notes assumed in connection with property acquisitions, as well as an increase in average borrowings under our line of credit. Average borrowings under our line of credit increased from approximately $13.2 million during the first nine months of 2005 to $202.3 million during the first nine months of 2006. Future levels of interest expense will vary primarily based on the amounts of future borrowings and the costs of borrowings. Future borrowings will be used primarily to fund future acquisitions of real estate or interests therein. Accordingly, the amounts of future borrowings and future interest expense will largely depend on the level of additional proceeds we raise in this offering and any future offerings, the opportunities to acquire real estate assets consistent with our investment objectives, and the timing of such future acquisitions.

We recognized a loss on early extinguishment of debt of approximately $1.1 million during the nine months ended September 30, 2006 in connection with prepaying the University Circle Buildings mortgage note in January 2006. The loss resulted from a prepayment penalty of approximately $5.7 million and a write-off of approximately $0.6 million in deferred financing costs, partially offset by a write-off of the unamortized fair value adjustment to debt of approximately $5.2 million.

Net income and net income per share decreased from approximately $7.5 million and $0.06, respectively, for the nine months ended September 30, 2005 to approximately $5.8 million and $0.03, respectively, for the nine months ended September 30, 2006, primarily as a result of the loss on early extinguishment of debt, the lease termination expense, and the increase in interest expense described above. We expect future real estate acquisitions to result in an increase in net income in future periods and expect future net income per share to fluctuate primarily based on the level of proceeds raised in this offering and any future offerings and the rate at which we are able to invest such proceeds in income-generating real estate assets.

Funds From Operations

Funds from operations (FFO) is a non-GAAP financial measure and should not be viewed as an alternative measurement of our operating performance to net income. We believe that FFO is a beneficial indicator of the performance of equity REITs. Specifically, FFO calculations exclude factors such as depreciation and amortization of real estate assets and gains or losses from sales of operating real estate assets. As such factors can vary among owners of identical assets in similar conditions based on historical cost accounting and useful-life estimates, FFO may provide a valuable comparison of operating performance between periods and with other REITs. Management believes that accounting for real estate assets in accordance with GAAP implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values have historically risen or fallen with market conditions, many industry investors and analysts have considered the presentation of operating results for real estate companies that use historical cost accounting to be insufficient by themselves. As a result, we believe that the use of FFO, together with the required GAAP presentation, provides a more complete understanding of our performance relative to our competitors and a more informed and appropriate basis on which to make decisions involving operating, financing, and investing activities. We calculate FFO in accordance with the current National Association of Real Estate Investment Trust (NAREIT) definition. However, other REITs may not define FFO in accordance with the NAREIT definition, or may interpret the current NAREIT definition differently than we do.

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As presented below, FFO is adjusted to exclude the impact of certain noncash items, such as depreciation, amortization, and gains on the sale of real estate assets. Reconciliations of net income to FFO are presented below (in thousands):

	For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
Net income	**$ 2,637**	$ 5,246	**$ 5,842**	$ 7,484
Add:				
Depreciation of real assets	**11,937**	6,542	**33,846**	15,773
Amortization of lease-related costs	**20,475**	11,655	**59,988**	29,659
FFO	**$ 35,049**	$ 23,443	**$ 99,676**	$ 52,916
Weighted-average shares outstanding	**247,285**	161,770	**226,983**	123,903

Set forth below is additional information related to certain cash and noncash items included in or excluded from net income above, which may be helpful in assessing our operating results. In addition, cash flows generated from FFO may be used to fund all or a portion of certain capitalizable items that are excluded from FFO, such as capitalized interest, tenant improvements, building improvements, and deferred lease costs. Please see the accompanying consolidated statements of cash flows for detail of our operating, investing, and financing cash activities.

Noncash Items Included in Net Income:

Straight-line rental revenue of approximately $5.1 million and $4.4 million was recognized for the three months ended September 30, 2006 and 2005, respectively, and approximately $16.1 million and $9.9 million was recognized for the nine months ended September 30, 2006 and 2005, respectively;

Amortization of above-market and below-market in-place leases was recognized as net decreases to rental income of approximately $2.8 million and $0.8 million for the three months ended September 30, 2006 and 2005, respectively, and approximately $8.5 million and $2.5 million for the nine months ended September 30, 2006 and 2005, respectively;

Amortization of deferred financing costs of approximately $0.2 million and $0.2 million was recognized as interest expense for the three months ended September 30, 2006 and 2005, respectively, and approximately $0.7 million and $1.2 million was recognized as interest expense for the nine months ended September 30, 2006 and 2005, respectively;

Approximately $1.1 million was recognized as a loss on early extinguishment of debt for the nine months ended September 30, 2006 in connection with prepayment of the University Circle Buildings mortgage note during January 2006 resulting from a prepayment penalty of $5.7 million and a write-off of $0.6 million in deferred financing costs, partially offset by a write-off of the unamortized fair value adjustment to debt of approximately $5.2 million; and

Approximately $1.8 million was recognized as lease termination expense for the three months and nine months ended September 30, 2006 due to a noncash partial write-off of intangible lease assets resulting from an amendment to a lease agreement that reduced base rent in exchange for the removal of a lease termination option.

Cash Item Excluded from Net Income:

Master lease proceeds relating to previous acquisitions of approximately $5.7 million and $8.2 million were collected during the three months ended September 30, 2006 and 2005, respectively, and approximately $6.0 million and $15.1 million were collected during the nine months ended September 30, 2006 and 2005, respectively. Master lease proceeds are recorded as an adjustment to the basis of real

estate assets during the period acquired and, accordingly, are not included in net income or FFO. We consider master lease proceeds when determining cash available for dividends to our stockholders.

Election as a REIT

We have elected to be taxed as a REIT under the Code, as amended, and have operated as such beginning with our taxable year ended December 31, 2003. To qualify as a REIT, we must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of our adjusted taxable income, as defined in the Code, to our stockholders, computed without regard to the dividends-paid deduction and by excluding our net capital gain. As a REIT, we generally will not be subject to federal income tax on income that we distribute to our stockholders. If we fail to qualify as a REIT in any taxable year, we will then be subject to federal income taxes on our taxable income for that year and for the four years following the year during which qualification is lost, unless the Internal Revenue Service grants us relief under certain statutory provisions. Such an event could materially adversely affect our net income and net cash available for distribution to our stockholders. However, we believe that we are organized and operate in such a manner as to qualify for treatment as a REIT for federal income tax purposes.

On October 4, 2005, we created Wells TRS II, LLC (Wells TRS), a wholly owned subsidiary organized as a Delaware limited liability company, which owns, among other things, an interest in a full-service hotel. We have elected to treat Wells TRS as a taxable REIT subsidiary. We may perform additional, non-customary services for tenants of buildings that we own through Wells TRS, including any real estate or non-real estate related services; however, any earnings related to such services are subject to federal and state income taxes. In addition, in order for us to continue to qualify as a REIT, our investments in taxable REIT subsidiaries cannot exceed 20% of the value of our total assets. Wells TRS had net operating income on an income tax basis for the three months and nine months ended September 30, 2006. The related deferred tax liability as of September 30, 2006 is included in accounts payable, accrued expense, and accrued capital expenditures, and the related deferred tax asset as of December 31, 2005 is included in prepaid and other assets in the accompanying consolidated balance sheets. The related income tax expense for the three months and nine months ended September 30, 2006 is included in the accompanying consolidated statements of income.

No provision for federal income taxes has been made in our accompanying consolidated financial statements, other than the provision relating to Wells TRS, as we made distributions in excess of taxable income for the periods presented. We are subject to certain state and local taxes related to property operations in certain locations, which have been provided for in our accompanying consolidated financial statements.

Inflation

We are exposed to inflation risk, as income from long-term leases is the primary source of our cash flows from operations. There are provisions in the majority of our tenant leases that are intended to protect us from, and mitigate the risk of, the impact of inflation. These provisions include rent steps, reimbursement billings for operating expense pass-through charges, real estate tax and insurance reimbursements on a per-square-foot basis, or in some cases, annual reimbursement of operating expenses above a certain per-square-foot allowance. However, due to the long-term nature of the leases, the leases may not re-set frequently enough to fully cover inflation.

Application of Critical Accounting Policies

Our accounting policies have been established to conform with GAAP. The preparation of financial statements in conformity with GAAP requires management to use judgment in the application of accounting policies, including making estimates and assumptions. These judgments affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. If our judgment or interpretation of the facts and circumstances relating to various transactions had been different, it is possible that different accounting policies would have been applied, thus resulting in a different presentation of the financial statements. Additionally, other companies may utilize different estimates that may impact comparability of our results of operations to those of companies in similar businesses.

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Investment in Real Estate Assets

We are required to make subjective assessments as to the useful lives of our depreciable assets. We consider the period of future benefit of the asset to determine the appropriate useful lives. These assessments have a direct impact on net income. The estimated useful lives of our assets by class are as follows:

Buildings	40 years
Building improvements	5-25 years
Tenant improvements	Shorter of economic life or lease term
Intangible lease assets	Lease term

Allocation of Purchase Price of Acquired Assets

Upon the acquisition of real properties, we allocate the purchase price of properties to acquired tangible assets, consisting of land and building, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases and the value of in-place leases, based in each case on our estimate of their fair values.

The fair values of the tangible assets of an acquired property (which includes land and building) are determined by valuing the property as if it were vacant, and the as-if-vacant value is then allocated to land and building based on our determination of the relative fair value of these assets. We determine the as-if-vacant fair value of a property using methods similar to those used by independent appraisers. Factors we consider in performing these analyses include an estimate of carrying costs during the expected lease-up periods considering current market conditions and costs to execute similar leases, including leasing commissions and other related costs. In estimating carrying costs, we include real estate taxes, insurance, and other operating expenses during the expected lease-up periods based on current market conditions.

The fair values of above-market and below-market in-place leases are recorded based on the present value (using a discount rate that reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) our estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining terms of the leases. The capitalized above-market and below-market lease values are recorded as intangible lease assets or liabilities and amortized as an adjustment to rental income over the remaining terms of the respective leases.

The fair values of in-place leases include direct costs associated with obtaining a new tenant, opportunity costs associated with lost rentals that are avoided by acquiring an in-place lease, and tenant relationships. Direct costs associated with obtaining a new tenant include commissions, tenant improvements, and other direct costs and are estimated based on our consideration of current market costs to execute a similar lease. These direct costs are included in deferred lease costs in the accompanying consolidated balance sheets and are amortized to expense over the remaining terms of the respective leases. The value of opportunity costs is calculated using the contractual amounts to be paid pursuant to the in-place leases over a market absorption period for a similar lease. Customer relationships are valued based on expected renewal of a lease or the likelihood of obtaining a particular tenant for other locations. These lease intangibles are included in intangible lease assets in the accompanying consolidated balance sheets and are amortized to expense over the remaining terms of the respective leases.

Estimates of the fair values of the tangible and intangible assets require us to estimate market lease rates, property operating expenses, carrying costs during lease-up periods, discount rates, market absorption periods, and the number of years the property is held for investment. The use of inappropriate estimates would result in an incorrect assessment of our purchase price allocations, which would impact the amount of our reported net income.

Valuation of Real Estate Assets

We continually monitor events and changes in circumstances that could indicate that the carrying amounts of the real estate and related intangible assets of both operating properties and properties under construction, in which we have an ownership interest, either directly or through investments in joint ventures, may not be recoverable. When indicators of potential impairment are present that suggest that the carrying amounts of real estate and related intangible assets may not be recoverable, we assess the recoverability of these assets by determining whether the carrying value will be recovered through the undiscounted future operating cash flows expected from the use of the asset and its eventual disposition. In the event that such expected undiscounted future cash flows do not exceed the carrying value, we decrease the carrying value of the real estate and related intangible assets to the estimated fair

values, as defined by Statement of Financial Accounting Standard No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, and recognize an impairment loss. Estimated fair values are calculated based on the following information, in order of preference, dependent upon availability: (i) recently quoted market prices, (ii) market prices for comparable properties, or (iii) the present value of undiscounted cash flows, including estimated salvage value. We have determined that there has been no impairment in the carrying value of our real estate assets during the nine months ended September 30, 2006 and 2005.

Projections of expected future operating cash flows require that we estimate future market rental income amounts subsequent to the expiration of current lease agreements, property operating expenses, the number of months it takes to re-lease the property, and the number of years the property is held for investment, among other factors. The subjectivity of assumptions used in the future cash flow analysis, including discount rates, could result in an incorrect assessment of the property s fair value and could result in the misstatement of the carrying value of our real estate and related intangible assets and net income.

Related-Party Transactions and Agreements

We have entered into agreements with our advisor, Wells Capital, and its affiliates, whereby we pay certain fees and reimbursements to Wells Capital or its affiliates, for acquisition fees, commissions, dealer-manager fees, asset and property management fees, construction fees, reimbursement of organizational and offering costs, and reimbursement of operating costs. See Note 7 to our accompanying consolidated financial statements included herein for a discussion of the various related-party transactions, agreements, and fees.

Commitments and Contingencies

We are subject to certain commitments and contingencies with regard to certain transactions. Refer to Note 8 of our accompanying consolidated financial statements in this supplement for further explanation. Examples of such commitments and contingencies include:

- Take-Out Agreements;
- Property under contract;
- Commitments under existing lease agreements; and
- Litigation.

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WELLS REAL ESTATE INVESTMENT TRUST II, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

	(Unaudited) September 30, 2006	December 31, 2005
Assets:		
Real estate assets, at cost:		
Land	**$ 332,570**	$ 277,097
Buildings and improvements, less accumulated depreciation of $65,807 and $31,961 as of September 30, 2006 and December 31, 2005, respectively	**1,797,446**	1,589,689
Intangible lease assets, less accumulated amortization of $89,839 and $43,538 as of September 30, 2006 and December 31, 2005, respectively	**415,679**	390,001
Construction in progress	**1,085**	6,040
Total real estate assets	**2,546,780**	2,262,827
Cash and cash equivalents	**72,948**	35,352
Tenant receivables, net of allowance for doubtful accounts of $1,358 and $735 as of September 30, 2006 and December 31, 2005, respectively	**47,687**	27,887
Prepaid expenses and other assets	**41,949**	44,033
Deferred financing costs, less accumulated amortization of $1,278 and $614 as of September 30, 2006 and December 31, 2005, respectively	**2,791**	3,231
Deferred lease costs, less accumulated amortization of $43,250 and $20,929 as of September 30, 2006 and December 31, 2005, respectively	**285,004**	237,553
Investment in bonds	**78,000**	78,000
Total assets	**$ 3,075,159**	$ 2,688,883
Liabilities:		
Line of credit and notes payable	**$ 743,689**	$ 832,402
Accounts payable, accrued expenses, and accrued capital expenditures	**32,258**	31,694
Due to affiliates	**2,866**	8,220
Dividends payable	**6,310**	5,142
Deferred income	**8,458**	8,387
Intangible lease liabilities, less accumulated amortization of $8,172 and $3,894 as of September 30, 2006 and December 31, 2005, respectively	**93,172**	62,560
Obligations under capital leases	**78,000**	78,000
Total liabilities	**964,753**	1,026,405
Commitments and Contingencies		
Minority Interest	**3,203**	2,724
Redeemable Common Stock	**33,156**	
Stockholders Equity:		
Common stock, $0.01 par value; 900,000,000 shares authorized; 258,275,700 and 197,403,280 shares issued and outstanding as of September 30, 2006 and December 31, 2005, respectively	**2,583**	1,974
Additional paid-in capital	**2,296,001**	1,752,162

Cumulative distributions in excess of earnings	**(190,269)**	(94,382)
Redeemable common stock	**(33,156)**	
Other comprehensive loss	**(1,112)**	
Total stockholders equity	**2,074,047**	1,659,754

Total liabilities, minority interest, redeemp; vertical-align: text-bottom; text-align: left">

Net income per common share:				
Basic	$0.45	$0.82	$1.61	$2.27
Diluted	$0.44	$0.81	$1.59	$2.23
Weighted average shares used in computing net income per common share:				
Basic	61,838	62,820	61,710	64,306
Diluted	62,553	63,709	62,506	65,201
Cash dividend declared per common share	$0.20	$0.18	$0.60	$0.54

See accompanying notes to condensed consolidated financial statements.

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MSC INDUSTRIAL DIRECT CO., INC.

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY
Thirty-Nine Weeks Ended May 30, 2009
(In Thousands)
(Unaudited)

See accompanying notes to condensed consolidated financial statements.

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MSC INDUSTRIAL DIRECT CO., INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)
(Unaudited)

	Thirty-Nine Weeks Ended	
	May 30, 2009	May 31, 2008
Cash Flows from Operating Activities:		
Net income	$99,128	$145,711
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20,075	20,445
Stock-based compensation	7,800	7,822
Loss on disposal of property, plant and equipment		3
Provision for doubtful accounts	3,574	2,360
Deferred income taxes	4,630	2,546
Excess tax benefits from stock-based compensation	(1,575)	(2,109)
Changes in operating assets and liabilities:		
Accounts receivable	51,869	(12,797)
Inventories	58,389	(8,331)
Prepaid expenses and other current assets	3,232	2,171
Other assets	7,734	5,940
Accounts payable and accrued liabilities	(15,735)	(19,336)
Total adjustments	139,993	(1,286)
Net cash provided by operating activities	239,121	144,425
Cash Flows from Investing Activities:		
Expenditures for property, plant and equipment	(18,048)	(11,209)
Proceeds from sale of property, plant and equipment	448	
Net cash used in investing activities	(17,600)	(11,209)
Cash Flows from Financing Activities:		
Purchases of treasury stock	(1,200)	(120,444)
Payment of cash dividends	(37,355)	(35,019)
Excess tax benefits from stock-based compensation	1,575	2,109
Proceeds from sale of Class A common stock in connection with associate stock purchase plan	2,096	2,075
Proceeds from exercise of Class A common stock options	5,761	4,579
Net borrowings under revolving loans from credit facility	4,000	35,000
Repayments of notes payable under the credit facility and other notes	(30,875)	(23,182)

Net cash used in financing activities	(55,998)	(134,882)
Effect of foreign exchange rate changes on cash and cash equivalents	(174)	(27)
Net increase (decrease) in cash and cash equivalents	165,349	(1,693)
Cash and cash equivalents beginning of period	42,843	7,797
Cash and cash equivalents end of period	$208,192	$6,104
Supplemental Disclosure of Cash Flow Information:		
Cash paid for income taxes	$43,652	$82,416
Cash paid for interest	$3,685	$6,982

See accompanying notes to condensed consolidated financial statements.

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MSC INDUSTRIAL DIRECT CO., INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Dollar Amounts and Shares in Thousands, Except per Share Data) (Unaudited)

Note 1. Basis of Presentation

The accompanying condensed consolidated financial statements include MSC Industrial Direct Co., Inc. (MSC) and all of its subsidiaries (hereinafter referred to collectively as the Company). All intercompany balances and transactions have been eliminated in consolidation.

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation (consisting of normal recurring adjustments) have been included. Operating results for the first thirty-nine weeks of fiscal 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending August 29, 2009. For further information, refer to the financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended August 30, 2008.

The Company s fiscal year ends on a Saturday close to August 31 of each year.

The following provides a reconciliation of information used in calculating the net income per common share amounts:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	May 30, 2009	May 31, 2008	May 30, 2009	May 31, 2008
Numerator:				
Net income	$27,755	$ 51,385	$99,128	$ 145,711
Denominator:				
Weighted average shares outstanding	61,838	62,820	61,710	64,306
Effect of dilutive associate stock options and awards	715	889	796	895
Adjusted weighted average shares outstanding for diluted earnings per share	62,553	63,709	62,506	65,201

Net income per common share:				
Basic	$0.45	$0.82	$1.61	$2.27
Diluted	$0.44	$0.81	$1.59	$2.23

Note 2. Associate Benefit Plans

Stock-Based Compensation

The Company records stock-based compensation in accordance with the provisions of Statement of Financial Accounting Standards No. 123, as amended (FAS 123R). The stock-based compensation expense related to the stock option plans and the Associate Stock Purchase Plan included in operating expenses was $1,249 and $1,644 for the thirteen week periods ended May 30, 2009 and May 31, 2008, respectively, and $4,059 and $5,072 for the thirty-nine week periods ended May 30, 2009 and May 31, 2008, respectively. Tax benefits related to these expenses for the thirteen week periods ended May 30, 2009 and May 31, 2008 were $471 and $528, respectively, and for the thirty-nine week periods ended May 30, 2009 and May 31, 2008 were $1,477 and $1,623, respectively. The tax benefit recorded for the stock-based compensation expense is at a lower rate than the Company s current effective tax rate because a portion of the options are Incentive Stock Options (ISO). In accordance with Statement of Financial Accounting Standards No. 109, Accounting for

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MSC INDUSTRIAL DIRECT CO., INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Dollar Amounts and Shares in Thousands, Except per Share Data) (Unaudited)

Note 2. Associate Benefit Plans (continued)

Income Taxes, no tax benefit is recorded for an ISO unless upon exercise a disqualifying disposition occurs. All options granted after March 30, 2004 have been Non-Qualified Stock Options.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Thirty-Nine Weeks Ended	
	May 30, 2009	May 31, 2008
Expected life (in years)	4.8	4.8
Risk-free interest rate	2.72 %	4.07 %
Expected volatility	30.3 %	28.5 %
Expected dividend yield	1.40 %	1.40 %

A summary of the activity of the Company s stock option plans for the thirty-nine weeks ended May 30, 2009 is as follows:

	Options	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (In Years)	Aggregate Intrinsic Value
Outstanding on August 30, 2008	2,644	$ 30.56		
Granted	497	38.07		
Exercised	(339)	17.03		
Canceled	(17)	42.59		
Outstanding on May 30, 2009	2,785	$ 33.47	4.20	$ 17,400

Exercisable on May 30, 2009	1,656	$ 27.69	3.31	$ 17,400

The weighted-average grant-date fair values for the thirty-nine week periods ended May 30, 2009 and May 31, 2008 were $10.05 and $13.18, respectively. The total intrinsic value of options exercised during the thirty-nine week periods ended May 30, 2009 and May 31, 2008 were $6,482 and $6,945, respectively. The unrecognized share-based compensation cost related to stock option expense at May 30, 2009 is $9,841 and will be recognized over a weighted average period of 2.54 years.

A summary of the activity of the non-vested share-based compensation awards granted under the Company s 1995 Restricted Stock Plan and 2005 Omnibus Equity Plan (the Plans) for the thirty-nine weeks ended May 30, 2009 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Non-vested at August 30, 2008	446	$ 44.36
Granted	207	37.83
Vested	(86)	39.52
Forfeited/Canceled	(8)	41.51
Non-vested at May 30, 2009	559	$ 41.47

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MSC INDUSTRIAL DIRECT CO., INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Dollar Amounts and Shares in Thousands, Except per Share Data) (Unaudited)

Note 2. Associate Benefit Plans (continued)

Stock-based compensation expense recognized for the non-vested share-based compensation awards was $1,291 and $958 for the thirteen week periods ended May 30, 2009 and May 31, 2008, respectively, and $3,741 and $2,750 for the thirty-nine week periods ended May 30, 2009 and May 31, 2008, respectively. The unrecognized compensation cost related to these non-vested share-based compensation awards granted under the Plans at May 30, 2009 was $13,380 and will be recognized over a weighted-average period of 3.33 years.

Note 3. Comprehensive Income

The Company complies with the provisions of Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income, which establishes standards for the reporting of comprehensive income and its components. The components of comprehensive income, net of tax are as follows:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	May 30, 2009	May 31, 2008	May 30, 2009	May 31, 2008
Net income as reported	$27,755	$51,385	$99,128	$145,711
Cumulative foreign currency translation adjustment	1,445	(44)	(1,540)	(229)
Comprehensive income	$29,200	$51,341	$97,588	$145,482

Note 4. Fair Value

Effective August 31, 2008, the Company adopted SFAS 157, Fair Value Measurements (SFAS 157), except as it applies to the non-financial assets and non-financial liabilities subject to FASB Staff Position 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2). SFAS 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 Include other inputs that are directly or indirectly observable in the marketplace.

Level 3 Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

As of May 30, 2009, the only assets that the Company held that are required to be measured at fair value on a recurring basis are cash equivalents consisting of money market funds for which market prices are readily available (Level 1) and that invest primarily in United States government and government agency securities and municipal bond securities, which aggregated $196,669.

Note 5. Notes Payable

The Company has an unsecured credit facility that consists of a revolving credit line commitment and term loan facility (the Credit Facility) which expires on June 8, 2011. The Company s revolving credit line commitment is $150,000, of which $95,000 was outstanding at May 30, 2009. The interest rate payable for borrowings under the revolving loans is currently 40 basis points over LIBOR rates. The weighted average borrowing rate in effect for the revolving loans at May 30, 2009 was 0.74%. The Company is also charged a

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MSC INDUSTRIAL DIRECT CO., INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Dollar Amounts and Shares in Thousands, Except per Share Data) (Unaudited)

Note 5. Notes Payable (continued)

fee of 10 basis points on the borrowed and unborrowed balances of the revolving loans. The loans under the revolving credit line are generally due in thirty days, although, sixty, ninety and one hundred eighty day increments are available.

At May 30, 2009, the Company had term loan borrowings outstanding under its term loan facility of $110,938. Principal payments consist of quarterly installments of approximately $12,813 in each of the following four quarters commencing in June 2009, $20,500 in each of the following two quarters commencing in June 2010, and a final payment of approximately $18,686 due in December 2010. Optional prepayments may be made at any time, or from time to time, in whole or part, without premium or penalty. The interest rate payable for borrowings under the term loan facility is currently 50 basis points over LIBOR rates. The borrowing rate in effect for the term loan borrowings at May 30, 2009 was 0.92%.

Under the terms of the Credit Facility, the Company is subject to various operating and financial covenants, including a maximum consolidated leverage ratio and a minimum consolidated interest coverage ratio. At May 30, 2009, the Company is in compliance with the operating and financial covenants of the Credit Facility.

The Company also has a long-term note payable in the amount of $386 to the Pennsylvania Industrial Development Authority, which is secured by the land on which the Harrisburg, Pennsylvania customer fulfillment center is located, which bears interest at 3% per annum and is payable in monthly installments of $15 (includes principal and interest) through September 2011.

Note 6. Dividend

The Company paid dividends of $37,355 for the thirty-nine weeks ended May 30, 2009. On June 30, 2009, the Board of Directors declared a dividend of $0.20 per share payable on July 28, 2009 to shareholders of record at the close of business on July 14, 2009. The dividend will result in a payout of approximately $12,520, based on the number of shares outstanding at June 30, 2009.

Note 7. Product Warranties

The Company generally offers a maximum one-year warranty, including parts and labor, for some of its machinery products. The specific terms and conditions of those warranties vary depending upon the product sold. The Company may be able to recoup some of these costs through product warranties it holds with its original equipment manufacturers, which typically range from thirty to ninety days. In general, many of the Company s general merchandise products are covered by third party original equipment manufacturers warranties. The Company s warranty expense for the thirty-nine week periods ended May 30, 2009 and May 31, 2008 has been minimal.

Note 8. Income Taxes

During the thirteen and thirty-nine week periods ended May 30, 2009, the amount of gross unrecognized tax benefits increased by $171 and $767, respectively. The total amount of gross unrecognized tax benefits was $6,589 as of May 30, 2009, all of which would affect the effective tax rate if recognized.

With limited exceptions, the Company is no longer subject to Federal income tax examinations through fiscal 2005 and State jurisdictions through fiscal 2004. Currently, the Company is under Federal examination for fiscal 2006.

The Company recognizes interest expense and penalties in the provision for income taxes. The provision for the thirteen and thirty-nine week periods ended May 30, 2009 includes interest and penalties of $60 and $177, respectively. The Company has accrued $585 for interest and penalties as of May 30, 2009.

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MSC INDUSTRIAL DIRECT CO., INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollar Amounts and Shares in Thousands, Except per Share Data)
(Unaudited)

Note 9. Legal Proceedings

There are various claims, lawsuits, and pending actions against the Company incidental to the operation of its business. Although the outcome of these matters is currently not determinable, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company s consolidated financial position, results of operations, or liquidity.

As a government contractor, from time to time the Company is subject to governmental or regulatory inquiries or audits. There is an audit currently pending by the General Services Administration (GSA) Office of Inspector General (OIG) relating to government sales under the Company s Multiple Award Schedule Contract with the GSA and compliance with the Trade Agreements Act of 1979. By letters dated December 17, 2008 and April 22, 2009, the U.S. Department of Justice has advised the Company that GSA OIG s audit identified non-compliant sales and a potential liability arising therefrom. The amount of potential liability, if any, is not estimable at this time. However, management does not expect the ultimate resolution of this matter to have any material adverse effect on the Company s consolidated financial position, results of operations or liquidity.

On November 15, 2007, a purported shareholder derivative action captioned *Plymouth County Retirement Association v. Schroeder et. al.* (the Litigation), was filed in the United States District Court for the Eastern District of New York (the Court), on the Company s behalf, against the Company as nominal defendant, and certain of the Company s current and former directors and officers. The plaintiff derivatively claims violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, as well as breach of fiduciary duties, waste of corporate assets and unjust enrichment in connection with certain stock options granted from 1997 to 2001. The plaintiff seeks unspecified damages, disgorgement of stock options and any proceeds received from the exercise of misdated stock options, an accounting of stock option grants and costs, including attorneys fees and expenses. On February 1, 2008, the Company and the individually named defendants filed motions to dismiss the Litigation. By memorandum and order dated September 5, 2008, the Court granted in part and denied in part those motions. On December 22, 2008, the plaintiff filed an amended complaint, which allegations are substantially similar as to those contained in the initial complaint. On or about January 26, 2009, the Company and the individually named defendants filed an answer to the amended complaint. Based on the allegations in the amended complaint, the Company believes the plaintiff s claims are without merit.

Note 10. New Accounting Pronouncements

In May 2009, the Financial Accounting Standards Board (FASB) issued SFAS No. 165 (SFAS No. 165), Subsequent Events. SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. SFAS No. 165 is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. The Company does not anticipate that the adoption of SFAS No. 165 will have an impact on the Company s consolidated financial position, results of operations or cash flows.

In June 2008, the FASB issued FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. This FSP provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform with the provisions in this FSP. Early application of this FSP is prohibited. The Company s unvested restricted stock is considered a participating security. Therefore, the

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MSC INDUSTRIAL DIRECT CO., INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Dollar Amounts and Shares in Thousands, Except per Share Data) (Unaudited)

Note 10. New Accounting Pronouncements (continued)

Company, upon adoption, will calculate earnings per share pursuant to the two-class method, and restate all prior periods if required. The Company is currently evaluating the impact this adoption may have on both previously reported and current calculations of earnings per share, but does not expect it will have a material impact.

In April 2008, the FASB issued FSP FAS 142-3, Determination of the Useful Life of Intangible Assets (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets. FSP FAS 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company is currently evaluating the impact this adoption may have on its results of operations and financial condition, but does not expect it will have a material impact, if any.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) (SFAS No. 141R), Business Combinations. SFAS No. 141R significantly changes the accounting for business combinations in a number of areas, including the treatment of contingent consideration, preacquisition contingencies, transaction costs, in-process research and development and restructuring costs. In addition, under SFAS No. 141R, changes in an acquired entity s deferred tax assets and uncertain tax positions after the measurement period will impact income tax expense. SFAS No. 141R is effective for fiscal years beginning after December 15, 2008. This standard will change the Company s accounting treatment for business combinations on a prospective basis.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. In February 2008, the FASB issued FASB Staff Position 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2). FSP 157-2 delays the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until fiscal years beginning after November 15, 2008. Effective August 31, 2008, the Company adopted SFAS No. 157 for financial assets and liabilities. The Company has not yet determined the impact, if any, that the adoption of the provisions of SFAS No. 157, when it is applied to non-financial assets and non-financial liabilities, which was deferred for the Company until the first quarter of fiscal 2010 by FSP 157-2, will have on the Company s results of operations or financial condition.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following is intended to update the information contained in the Company s Annual Report on Form 10-K for the fiscal year ended August 30, 2008 and presumes that readers have access to, and will have read, Management s Discussion and Analysis of Financial Condition and Results of Operations contained in such Annual Report on Form 10-K.

Overview

MSC Industrial Direct Co., Inc. (together with its subsidiaries, MSC, the Company, we, our, or us) is one of largest direct marketers of a broad range of industrial products to industrial customers throughout the United States. We distribute a full line of industrial products intended to satisfy our customers requirements for maintenance, repair and operations (MRO) supplies, which includes our metalworking products.

MSC is one of the largest direct marketers of a broad range of industrial products to small and mid-sized industrial customers throughout the United States. We offer approximately 590,000 stock-keeping units (SKUs) through our master catalogs; weekly, monthly and quarterly specialty and promotional catalogs; newspapers; brochures; and the Internet, including our websites, *MSCDirect.com*, *MSCJLMetalworking.com* and *Use-Enco.com* (the MSC Websites). We service our customers from five customer fulfillment centers and 96 branch offices. Most of our products are carried in stock, and orders for these in-stock products are typically fulfilled the day on which the order is received. Effective in September 2008, we improved our service levels to customers in the contiguous United States. We now offer a nationwide cutoff time of 8:00 PM Eastern time on qualifying orders, which will be delivered to the customer the next day at no additional cost.

Net sales decreased by 23.3% and 14.7% for the thirteen and thirty-nine week periods ended May 30, 2009, as compared to the same periods in fiscal 2008, as our business was impacted by the global economic recession. Severe disruptions in the financial markets, together with continued tightening in the credit markets impacted, and are expected to continue to have a significant impact on our sales as this affects our customers ability to raise debt or equity capital. This continues to reduce the amount of liquidity available to our customers which, in turn, limits their ability to make purchases. This global economic recession has impacted both our core manufacturing customers and our national account and government program (the Large Account Customer). There is also uncertainty over the direction of the U.S. and global economies as a result of slower growth rates, higher unemployment and weak housing markets. We are continuing to monitor the economic conditions for their impact on our customers and markets and assessing both risks and opportunities that may affect our business. See discussion below describing recent fluctuations in economic indicators and the possible impact on our future sales and margins.

Our gross profit margins were 45.9% and 46.6%, respectively, for the thirteen and thirty-nine week periods ended May 30, 2009, as compared to 46.0% and 46.3% for the same periods in fiscal 2008. The increase in gross margin for the thirty-nine week period ended May 30, 2009 was driven by our increase in pricing on certain SKUs. This is partially offset by the change in customer and product mix as our Large Account Customers, which typically generate lower margins and also purchase more of our lower margin products, constitute a larger portion of our total sales.

Operating expenses decreased for the thirteen and thirty-nine week periods ended May 30, 2009, as compared to the same periods in fiscal 2008, as a result of decreased freight expenses due to lower sales, a decrease in the Company s annual incentive plan bonus accrual as a result of the Company s performance relating to the current economic

conditions, and a decrease in sales associate commissions as a result of decreased sales. This is partially offset by an increase in payroll. This increase in payroll is primarily due to an increase in the field sales force compensation relating to additional sales force associates hired during the fiscal fourth quarter of 2008 and fiscal 2009, partially offset by the cost savings related to the reduced workforce hours in the customer fulfillment centers, call-centers, and branches. As a result of the decrease in sales, our operating margins decreased for the thirteen and thirty-nine week periods ended May 30, 2009 to 12.9% and 14.3%, respectively, as compared to 18.5% and 18.1% for the same periods in fiscal 2008.

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We will continue to work proactively to manage and control discretionary spending as we closely monitor economic conditions. In an effort to reduce operating expenses, the Company has implemented several cost containment measures. In general, except for certain strategic hiring opportunities, the Company has instituted strict restrictions on all hiring. In addition, effective January 1, 2009, the Company has implemented a salary freeze for all associates and effective in March 2009, the Company reduced its workforce hours in the customer fulfillment centers, call-centers, and branches, and has temporarily suspended its matching contribution under its 401(k) savings plan for all associates. We will also continue to opportunistically seek growth investments that will help position us for future expansion. We anticipate cash flows from operations, available cash and funds available under the revolving credit facility will be adequate to support our operations for the next 12 months.

The Institute for Supply Management (ISM) index, which measures the economic activity of the U.S. manufacturing sector, is important to our planning because it historically has been an indicator of our manufacturing customers activity. Approximately 69% of our revenues (excluding the UK operations of J&L, which we refer to as J&L UK) came from sales to the manufacturing sector during the thirty-nine week period ended May 30, 2009. An ISM reading below 50.0% generally indicates that the manufacturing sector is contracting. The ISM was 42.8% for the month of May 2009. Details released with the most recent index indicate that economic activity in the manufacturing sector failed to grow in May 2009 for the sixteenth consecutive month. This is a result of employment and inventories continuing to decline at a rapid rate as a result of lower sales volumes. In addition, the prices that manufacturers pay for raw materials and services continued to decline. We believe that the impact of volatile energy prices, the credit crisis, interest rate fluctuations, along with the general condition of the United States economy, will continue to have an adverse effect on our sales and margins throughout the remainder of fiscal 2009. We are uncertain as to the long term impact of this economic cycle, but we will continue to look for opportunities to increase market share and deliver value added services to our customers. We believe that our strong balance sheet will enable us to continue to extend credit to our credit worthy customers during this credit crisis, while many of our smaller competitors in our fragmented industry may struggle to meet their cash needs. We also believe that companies will be seeking cost reductions and shorter cycle times from their suppliers. Our business model focuses on providing overall procurement cost reduction and just-in-time delivery to meet our customers needs. To meet our customers needs and our business goals, we will seek to continue to drive cost reduction throughout our business through cost saving strategies and increased leverage from our existing infrastructure, and continue to provide additional procurement cost savings solutions to our customers through technology such as with our Customer Managed Inventory and Vendor Managed Inventory programs.

Results of Operations

Net Sales

	Thirteen Weeks Ended			Thirty-Nine Weeks Ended		
	May 30, 2009	May 31, 2008	Percentage Change	May 30, 2009	May 31, 2008	Percentage Change
	(Dollars in Thousands)					
Net Sales	$ 350,489	$ 457,238	(23.3)%	$ 1,135,421	$ 1,331,278	(14.7)%

Net sales decreased by approximately $107 million and $196 million for the thirteen and thirty-nine week periods ended May 30, 2009, respectively, as compared to the same periods in fiscal 2008, related to our business being impacted by the global economic recession. For the thirteen and thirty-nine week periods ended May 30, 2009, we estimate that this decrease is comprised of a core business decline of approximately $88 million and $197 million, respectively, and a decline in our Large Account Customer programs of approximately $27 million and $32 million,

respectively, partially offset by approximately $8 million and $33 million, respectively, attributable to our increase in prices on certain stock keeping units (SKUs).

The global economic recession has negatively impacted our net sales, as mentioned above, as well as resulted in a decrease in average order size to approximately $293 (excluding J&L UK) in the third quarter of fiscal 2009 from $308 (excluding J&L UK) in the third quarter of fiscal 2008. We believe that our ability to transact with our customers through various portals and directly through the MSC Websites, gives us a competitive advantage over smaller suppliers. Sales through the MSC Websites were $102.4 million for the third

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quarter of fiscal 2009, representing 29.2% of consolidated net sales. We grew our field sales associate headcount to 927 at May 30, 2009, an increase of approximately 5.9% from field sales associates of 875 at May 31, 2008, in order to support our strategy to acquire new accounts and expand existing accounts across all customer types. We will continue to manage the timing of field sales associate increases and branch openings based on economic conditions.

In the fiscal 2009 MSC catalog, distributed in September 2008, we added approximately 20,000 new SKUs and removed approximately 15,000 SKUs. We believe that the new SKUs improve the overall quality of our offering.

Gross Profit

	Thirteen Weeks Ended			Thirty-Nine Weeks Ended		
	May 30, 2009	May 31, 2008	Percentage Change	May 30, 2009	May 31, 2008	Percentage Change
	(Dollars in Thousands)					
Gross Profit	$ 161,019	$ 210,445	(23.5)%	$ 528,892	$ 616,073	(14.2)%
Gross Profit Margin	45.9 %	46.0 %		46.6 %	46.3 %	

Gross profit margin for the thirteen week period ended May 30, 2009 declined slightly from the comparable period in fiscal 2008. Gross profit margin for the thirty-nine week period ended May 30, 2009 increased from the comparable period in fiscal 2008. This is primarily a result of increases in pricing on certain SKUs based on market conditions. This is partially offset by supplier cost increases on certain products and the change in customer and product mix as our Large Account Customers, which typically generate lower margins and which also purchase more of our lower margin products, continue to increase as a percentage of our total sales.

Operating Expenses

	Thirteen Weeks Ended			Thirty-Nine Weeks Ended		
	May 30, 2009	May 31, 2008	Percentage Change	May 30, 2009	May 31, 2008	Percentage Change
	(Dollars in Thousands)					
Operating Expenses	$ 115,778	$ 125,632	(7.8)%	$ 365,981	$ 374,675	(2.3)%
Percentage of Net Sales	33.0 %	27.5 %		32.2 %	28.1 %	

The decrease in operating expenses in dollars for the thirteen and thirty-nine week periods ended May 30, 2009 as compared to the same periods in fiscal 2008, was a result of decreased freight expenses due to lower sales, a decrease in the Company s annual incentive plan bonus accrual as a result of the Company s performance relating to the current economic conditions, and a decrease in sales associate commissions as a result of decreased sales. This was partially offset by an increase in payroll, primarily due to an increase in the field sales force.

Payroll and payroll related costs continue to make up a significant portion of our operating expenses. These costs, excluding sales commissions, increased for the thirteen and thirty-nine week periods ended May 30, 2009, as compared to the same periods in the prior fiscal year, primarily as a result of an increase in headcount and annual payroll increases, partially offset by the reduction in associate hours in volume sensitive areas, such as fulfillment and call centers. The increase in headcount is primarily the result of the increase in sales associates as part of our overall growth strategy to build sales. We will continue to manage the timing of sales force headcount increases based on economic conditions. However, as a result of the current economic conditions and the Company s implementation of hiring restrictions, total headcount has decreased sequentially during the first three quarters of fiscal 2009.

The increases in the operating expenses as a percentage of net sales for the thirteen and thirty-nine week periods ended May 30, 2009, as compared to the same periods in fiscal 2008, was primarily due to our increased payroll costs in addition to various fixed costs distributed over a smaller revenue base.

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Income from Operations

	Thirteen Weeks Ended			Thirty-Nine Weeks Ended		
	May 30, 2009	May 31, 2008	Percentage Change	May 30, 2009	May 31, 2008	Percentage Change
	(Dollars in Thousands)					
Income from Operations	$ 45,241	$ 84,813	(46.7)%	$ 162,911	$ 241,398	(32.5)%
Percentage of Net Sales	12.9 %	18.5 %		14.3 %	18.1 %	

The decrease in income from operations for the thirteen week period ended May 30, 2009, as compared to the same period in fiscal 2008, was primarily attributable to the decrease in net sales, offset in part by the decrease in operating expenses as described above. As a percentage of net sales, the decrease is primarily the result of the distribution of expenses over a smaller revenue base.

The decrease in income from operations for the thirty-nine week period ended May 30, 2009, as compared to the same period in fiscal 2008, was primarily attributable to the decrease in net sales, offset in part by the decrease in operating expenses as described above and the increase in gross profit margin as described above. As a percentage of net sales, the decrease is primarily the result of the distribution of expenses over a smaller revenue base.

Interest Expense

	Thirteen Weeks Ended			Thirty-Nine Weeks Ended		
	May 30, 2009	May 31, 2008	Percentage Change	May 30, 2009	May 31, 2008	Percentage Change
	(Dollars in Thousands)					
Interest Expense	$ (544)	$ (1,850)	(70.6)%	$ (3,212)	$ (6,773)	(52.6)%

The decrease in interest expense for the thirteen and thirty-nine week periods ended May 30, 2009, as compared to the same periods in fiscal 2008, was primarily due to lower average interest rates. Average loan balances outstanding for the term loan and revolving loans for the thirteen and thirty-nine week periods ended May 30, 2009 were approximately $209.3 million and $212.9 million, respectively, as compared to approximately $212.7 million and $195.9 million for the same periods in fiscal 2008. The decrease in the average loan balances for the thirteen week period is primarily a result of increased scheduled quarterly principal payments made on the Term Loan in fiscal 2009. The increase in the average loan balances for the thirty-nine week period primarily resulted from draw downs of the credit line commitment to enable the Company to maintain a highly liquid position during the current economic environment.

Interest Income

	Thirteen Weeks Ended			Thirty-Nine Weeks Ended		
	May 30, 2009	May 31, 2008	Percentage Change	May 30, 2009	May 31, 2008	Percentage Change
	(Dollars in Thousands)					
Interest Income	$ 164	$ 125	31.2 %	$ 710	$ 500	42.0 %

The increase in interest income for the thirteen and thirty-nine week periods ended May 30, 2009, as compared to the same periods in fiscal 2008, is a result of higher average cash and cash equivalent balances.

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Provision for Income Taxes

	Thirteen Weeks Ended			Thirty-Nine Weeks Ended		
	May 30, 2009	May 31, 2008	Percentage Change	May 30, 2009	May 31, 2008	Percentage Change
	(Dollars in Thousands)					
Provision for Income Taxes	$ 17,171	$ 31,671	(45.8)%	$ 61,325	$ 89,458	(31.4)%
Effective Tax Rate	38.22 %	38.13 %		38.22 %	38.04 %	

The effective tax rate for the thirteen and thirty-nine week periods ended May 30, 2009 was 38.22% as compared to 38.13% and 38.04%, respectively, for the comparable periods in fiscal 2008. The increase in the rates is primarily attributable to an increase in the State tax rate.

Net Income

	Thirteen Weeks Ended			Thirty-Nine Weeks Ended		
	May 30, 2009	May 31, 2008	Percentage Change	May 30, 2009	May 31, 2008	Percentage Change
	(Dollars in Thousands)					
Net Income	$ 27,755	$ 51,385	(46.0)%	$ 99,128	$ 145,711	(32.0)%
Diluted Earnings Per Share	$ 0.44	$ 0.81	(45.7)%	$ 1.59	$ 2.23	(28.7)%

The factors which affected net income for the thirteen and thirty-nine week periods ended May 30, 2009, as compared to the same periods in fiscal 2008, have been discussed above. In addition to the decrease in net income, the diluted earnings per share for the thirteen and thirty-nine week periods ended May 30, 2009 was affected by the repurchase of shares of our Class A common stock in fiscal 2008, which resulted in fewer shares outstanding at May 30, 2009 as compared to May 31, 2008.

Liquidity and Capital Resources

As of May 30, 2009, we held $208.2 million in cash and cash equivalent funds. As of May 30, 2009, cash equivalents consisted of money market funds that invest primarily in U.S. government and government agency securities and municipal bond securities and contain portfolios with average maturities of less than three months. We maintain a substantial portion of our cash and cash equivalents with a well-known financial institution. The Company s investments in the municipal bond securities money market fund are guaranteed by the U.S. Federal Government under the U.S. Department of Treasury temporary guarantee program (the Program). The Program is currently set to expire on September 18, 2009.

Historically, our primary capital needs have been to fund the working capital requirements necessitated by our sales growth, adding new products, and facilities expansions and in the past, our primary sources of financing have been cash generated from operations. Borrowings under the Credit Facility, together with cash generated from operations, have been used to fund our working capital needs, repurchase shares of our Class A common stock, and pay dividends. At May 30, 2009, total borrowings outstanding were $206.3 million, as compared to $187.5 million at May 31, 2008.

We have an unsecured Credit Facility that consists of a revolving credit line commitment and term loan facility that expires on June 8, 2011. We have a $150.0 million revolving credit line commitment, of which we had $95.0 million

outstanding at May 30, 2009. The interest rate payable for borrowings under the revolving credit line commitment is currently 40 basis points over LIBOR rates and the weighted average borrowing rate in effect at May 30, 2009 was 0.74%. We are also charged a fee of 10 basis points on the borrowed and unborrowed balances of the revolving loans. The loans under the revolving credit line commitment are generally due in thirty days, although, sixty, ninety and one hundred eighty day increments are available.

At May 30, 2009, under our Credit Facility, we had term loan borrowings outstanding of $110.9 million. Remaining payments consist of quarterly installments of approximately $12.8 million in each of the following four quarters commencing in June 2009, $20.5 million in each of the following two quarters commencing in June 2010, and a final payment of approximately $18.7 million due in December 2010. Optional prepayments may be made at any time, or from time to time, in whole or part, without premium or penalty. The interest

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rate payable for borrowings under the term loan is currently 50 basis points over LIBOR rates. The borrowing rate in effect for the term loan borrowings at May 30, 2009 was 0.92%.

Under the terms of the Credit Facility, we are subject to various operating and financial covenants, including a maximum consolidated leverage ratio and a minimum consolidated interest coverage ratio. At May 30, 2009, we were in compliance with the operating and financial covenants of the Credit Facility.

Net cash provided by operating activities for the thirty-nine week periods ended May 30, 2009 and May 31, 2008 was $239.1 million and $144.4 million, respectively. The increase of $94.7 million in net cash provided by operating activities resulted primarily from a reduction of accounts receivable and inventory, partially offset by the decline in net income.

Net cash used in investing activities for the thirty-nine week periods ended May 30, 2009 and May 31, 2008 was $17.6 million and $11.2 million, respectively. The increase of $6.4 million is due primarily to higher expenditures for property, plant and equipment that occurred during the thirty-nine week period ended May 30, 2009.

Net cash used in financing activities for the thirty-nine week periods ended May 30, 2009 and May 31, 2008 was $56.0 million and $134.9 million, respectively. The decrease in net cash used in financing activities for the thirty-nine week period ended May 30, 2009 was primarily attributable to the decrease in repurchases of shares of Class A common stock, offset by lower net borrowings from the revolving credit line commitment and by higher repayments of notes payable under the term loan borrowings.

We paid a dividend of $12.5 million on April 28, 2009, $12.5 million on February 3, 2009 and $12.4 million on November 13, 2008, to shareholders of record at the close of business on April 14, 2009, January 20, 2009 and October 30, 2008, respectively. On June 30, 2009, the Board of Directors declared a dividend of $0.20 per share payable on July 28, 2009 to shareholders of record at the close of business on July 14, 2009. The dividend will result in a payout of approximately $12.5 million, based on the number of shares outstanding at June 30, 2009.

The continued weakening of current economic conditions could negatively impact our overall business, and as a result, could negatively impact our liquidity. In addition, the recent turmoil in the financial markets could limit our access to additional capital resources, if needed, and could increase associated costs. We believe based on our current business plan that our existing cash, cash equivalents, funds available under the revolving credit facility, and cash flow from operations will be sufficient to fund our planned capital expenditures and operating cash requirements for at least the next 12 months.

Related Party Transactions

We are affiliated with two real estate entities (together, the Affiliates), which lease property to us. The Affiliates are owned and controlled by our principal shareholders, Mitchell Jacobson, our Chairman, and his sister Marjorie Gershwind. We paid rent under operating leases to the Affiliates for the first thirty-nine weeks of fiscal 2009 of approximately $1.7 million, in connection with our occupancy of our Atlanta Customer Fulfillment Center and one branch office. In the opinion of our management, based on its market research, the leases with Affiliates are on terms which approximate fair market value.

Contractual Obligations

Certain of our operations are conducted on leased premises, two of which are leased from Affiliates, as noted above. The leases (most of which require us to provide for the payment of real estate taxes, insurance and other operating costs) are for varying periods, the longest extending to the year 2030, at May 30, 2009. In addition, we are obligated under certain equipment and automobile operating leases, which expire on varying dates through 2013.

Off-Balance Sheet Arrangements

We have not entered into any off-balance sheet arrangements.

Critical Accounting Estimates

We make estimates, judgments and assumptions in determining the amounts reported in the condensed consolidated financial statements and accompanying notes. Estimates are based on historical experience and on

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various other assumptions that are believed to be reasonable under the circumstances. The estimates are used to form the basis for making judgments about the carrying values of assets and liabilities and the amount of revenues and expenses reported that are not readily apparent from other sources. Actual results may differ from these estimates. Our significant accounting policies are described in the notes to the consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended August 30, 2008. The accounting policies described below are impacted by our critical accounting estimates.

Allowance for Doubtful Accounts

We perform periodic credit evaluations of our customers financial condition and collateral is generally not required. We evaluate the collectibility of accounts receivable based on numerous factors, including past transaction history with customers and their credit-worthiness. We estimate an allowance for doubtful accounts as a percentage of net sales based on historical bad debt experience and adjust it for changes in the overall aging of accounts receivable as well as specifically identified customers that are having difficulty meeting their financial obligations (e.g., bankruptcy, etc.). Historically, there has not been significant volatility in our bad debt expense due to strict adherence to our credit policy.

Inventory Valuation Reserve

Inventories consist of merchandise held for resale and are stated at the lower of weighted average cost or market. Management evaluates the need to record adjustments to reduce inventory to net realizable value on a quarterly basis. The reserve is initially provided for based on a percentage of sales. Each quarter, items to be liquidated are specifically identified and written-down, using historical data and reasonable assumptions, to their estimated market value, if less than their cost. Inherent in the estimates of market value are management s estimates related to customer demand, technological and/or market obsolescence, possible alternative uses and ultimate realization of excess inventory.

Sales Returns

We establish a reserve for anticipated sales returns based on historical return rates. The return rates are periodically analyzed for changes in current return trends. Historically, material adjustments to the estimated sales reserve have rarely been required based on actual returns. If future returns are materially different than estimated returns, an adjustment to the sales return reserve may be required.

Reserve for Self-Insured Group Health Plan

We have a self-insured group health plan. We are responsible for all covered claims up to a maximum liability of $300,000 per participant during a September 1 plan year. Benefits paid in excess of $300,000 are reimbursed to the plan under our stop loss policy. Due to the time lag between the time claims are incurred and the time claims are paid by us, a reserve for those claims incurred but not reported (IBNR) is established. The amount of this reserve is reviewed quarterly and is evaluated based on a historical analysis of claim trends, reporting and processing lag times and medical costs inflation.

New Accounting Pronouncements

See Note 10 to the accompanying financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to our exposures to market risks since August 30, 2008. Please refer to the 2008 Annual Report on Form 10-K for the fiscal year ended August 30, 2008 for a complete discussion of our exposures to market risks.

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Item 4. Controls and Procedures

Our senior management is responsible for establishing and maintaining a system of disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Exchange Act) designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer s management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

In accordance with Exchange Act Rules 13a-15 and 15d-15, we carried out an evaluation, with the participation of the Chief Executive Officer and Chief Financial Officer, as well as other key members of our management, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective, as of the end of the period covered by this report, to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is (i) accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer as appropriate to allow timely decisions regarding required disclosure and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms.

No change occurred in our internal controls over financial reporting (as defined in Rule 13a-15(f) and Rule 15d-15(f) promulgated under the Exchange Act) during the fiscal quarter ended May 30, 2009 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

There are various claims, lawsuits, and pending actions against the Company incidental to the operation of its business. Although the outcome of these matters is currently not determinable, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company s consolidated financial position, results of operations, or liquidity.

As a government contractor, from time to time the Company is subject to governmental or regulatory inquiries or audits. There is an audit currently pending by the General Services Administration (GSA) Office of Inspector General (OIG) relating to government sales under the Company s Multiple Award Schedule Contract with the GSA and compliance with the Trade Agreements Act of 1979. By letters dated December 17, 2008 and April 22, 2009, the U.S. Department of Justice has advised the Company that GSA OIG s audit identified non-compliant sales and a potential liability arising therefrom. The amount of potential liability, if any, is not estimable at this time. However, management does not expect the ultimate resolution of this matter to have any material adverse effect on the Company s consolidated financial position, results of operations or liquidity.

On November 15, 2007, a purported shareholder derivative action captioned *Plymouth County Retirement Association v. Schroeder et. al.* (the Litigation), was filed in the United States District Court for the Eastern District of New York (the Court), on the Company s behalf, against the Company as nominal defendant, and certain of the Company s current and former directors and officers. The plaintiff derivatively claims violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, as well as breach of fiduciary duties, waste of corporate assets and unjust enrichment in connection with certain stock options granted from 1997 to 2001. The plaintiff seeks unspecified damages, disgorgement of stock options and any proceeds received from the exercise of misdated stock options, an accounting of stock option grants and costs, including attorneys fees and expenses. On February 1, 2008, the Company and the individually named defendants filed motions to dismiss the Litigation. By memorandum and order dated September 5, 2008, the Court granted in part and denied in part those motions. On December 22, 2008, the plaintiff filed an amended complaint, which allegations are substantially similar as to those contained in the initial complaint. On or about January 26, 2009, the Company and the individually named defendants filed an answer to the amended complaint. Based on the allegations in the amended complaint, the Company believes the plaintiff s claims are without merit.

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Item 1A. Risk Factors

In addition to the other information set forth in this Report, consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended August 30, 2008, which could materially affect our business, financial condition or future results. The risks described in the aforementioned report are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be not material also may materially adversely affect our business, financial condition and/or operating results.

Given the recent developments in the global economy, the risk factor set forth below has been added or updated to provide additional information. This risk factor should be read in conjunction with the other risk factors disclosed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended August 30, 2008.

Our operating results, cash flows, and liquidity are susceptible to uncertainties arising from the length and severity of the global economic recession, as well as the timing and strength of the subsequent recovery.

The global economy is currently experiencing a severe recession, which has negatively impacted our sales volumes and results of operations. The markets we serve have experienced significant declines in the current global economic downturn. As a result of the slowing economy, the credit market crisis, declining consumer and business confidence, increased unemployment, reduced levels of capital expenditures, fluctuating commodity prices, bankruptcies, and other challenges affecting the global economy, our customers may experience deterioration of their businesses, cash flow shortages, and difficulty obtaining financing. As a result, existing or potential customers may delay or cancel plans to purchase. Further, our vendors may be experiencing similar conditions, which may impact their ability to fulfill their obligations to us. Although governments around the world are enacting various economic stimulus programs, there can be no assurance as to the timing or effectiveness of such programs. If the worldwide economic downturn continues for a significant period or there is further deterioration in the global economy, our results of operations, financial position, and cash flows could be materially adversely affected.

Item 6. Exhibits

Exhibits:

31.1	Chief Executive Officer s Certificate, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Chief Financial Officer s Certificate, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith.
Furnished herewith.

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SIGNATURES

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

	MSC INDUSTRIAL DIRECT CO., INC. (Registrant) By:
Dated: July 2, 2009	/s/ David Sandler President and Chief Executive Officer (Principal Executive Officer) By:
Dated: July 2, 2009	/s/ Charles Boehlke Executive Vice President and Chief Financial Officer (Principal Financial Officer)

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