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PRESENTATION

Operator

Good day and welcome to the fourth-quarter and year-end 2014 conference call for Graco Inc. If you wish to access the replay for this call, you may do so by dialing 1-888-203-1112 within the United States or Canada. The dial-in number for the international callers is 719-457-0820. The conference ID is 2880728. The replay will be available through January 31, 2015.

Graco has additional information available in a PowerPoint slide presentation, which is available as part of the webcast player.

At the request of the Company, we will open the conference up for questions and answers after the opening remarks from management.

During this call various remarks may be made by management about their expectations, plans, and prospects for the future. These remarks constitute forward-looking statements for the purposes of the Safe Harbor provisions of the Private Securities Litigation Reform Act. Actual results may differ materially from those indicated, as a result of various risk factors including those identified in Item 1A of the Company's 2013 Annual Report on Form 10-K and in Item 1A of the Company's most recent quarterly report on Form 10-Q. These reports are available on the Company's website at www.Graco.com and the SEC's website at www.SEC.gov.

Forward-looking statements reflect management's current views and speak only as of the time they are made. The Company undertakes no obligation to update those statements in light of new information or future events. I will now turn the conference over to Ms. Caroline Chambers, Vice President, Corporate Controller and Information Systems. Please go ahead, ma'am.

Caroline Chambers - *Graco Inc. - VP, Corporate Controller and Information Systems*

Good morning, everyone. I'm here this morning with Pat McHale, Jim Graner, and Christian Rothe. I will provide a brief top-level summary of our quarter, and then we will turn the call over to Pat for additional discussion. Our conference call slides are on our website and provide additional information on our quarter.

Sales in the fourth quarter with $306 million, an increase of 13% from the prior year, and net earnings were $49 million, an increase of 10%. Diluted net earnings totaled $0.80 for the quarter. Changes in currency translation rates reduced sales by approximately $8 million and decreased net earnings by approximately $3 million for the quarter.

Sales from businesses acquired in 2014 were $15 million in the quarter or five percentage points of our overall growth. Regionally, sales in the Americas grew by 18%; sales in EMEA increased by 8%, or 14% at consistent translation rates; and sales in Asia-Pacific increased by 5%, or 8% in consistent translation rates.

Gross profit margins for the fourth quarter as a percentage of sales were 54%, down slightly from last year. The decrease was primarily due to the effects of purchase accounting, which totaled $2 million in the quarter, and lower margins from acquired businesses.

Operating earnings totaled $69 million, an increase of 10% from the fourth quarter last year. Operating earnings as a percentage of sales declined by 0.5% from the fourth quarter last year. A reconciliation of our operating earnings from the prior-year is included on page 8 of our slides. The effect of purchase accounting inventory step up, acquisition costs, and the effect of acquired businesses were unfavorable to operating earnings as a percentage of sales by two percentage points.

Incremental investment in regional and product growth initiatives totaled $2 million in the quarter and was also unfavorable to operating earnings by one percentage point. Offsetting these items were favorable volume, lower pension and stock compensation expense as compared to the quarter in the prior-year, and favorable expense leverage.

Other income includes dividends of $4 million from the liquid finishing businesses, consistent with the fourth quarter of 2013. As announced in October 2014, the Federal Trade Commission issued its final decision and order requiring the sale of the liquid finishing businesses. Shortly thereafter, we also announced a definitive agreement to sell the liquid finishing business assets in a $500 million cash transaction. The sale is subject to regulatory and other customary closing conditions. Until the sale has closed, we will continue to account for the liquid finishing businesses held separate as a cost investment.

The sale of the liquid finishing businesses is expected to be completed in the first half of [2015], and the timing of the close will affect the timing of the dividends to be received. When the sale of the liquid finishing businesses has been completed, there will be no further dividend income from the investment. Transaction costs related to the sale our expected to be $11 million to $13 million, most of which will be incurred when the transaction closes. Additional information on the Liquid Finishing businesses is included in our 2013 Form 10-K and our third-quarter 2014 Form 10-Q.

The effective tax rate for the quarter was 27% as compared to 28.5% last year. The decrease reflected the full-year effects of the federal R&D tax credit that was reinstated in the fourth quarter, partially offset the effect of a reduction in foreign earnings taxed at lower rates.

Cash provided by operating activities was $71 million in the fourth quarter. Use of working capital is in line with volume and seasonal trends and days of sales outstanding for accounts receivable remain consistent. In the quarter, capital expenditures were $5 million, dividends paid totaled $16 million, and share repurchases net of shares issued totaled $45 million.

A few other discussion points -- we have been monitoring the changes in currency exchange rates the past few weeks and months. We are the most affected by changes in the euro. If we were to assume the same volume, mix of products, and mix of business by currency as the full year in 2014, and currency translation rates stayed the same as they are this week, for the full-year sales would be decreased by approximately 4% and earnings would be decreased by 10%.

Corporate expenses are expected to be approximately $10 million higher in 2015, primarily due to increased pension expenses as well as the incremental $2 million related to the full year of operations in our new central warehouse and distributional costs. We expect capital expenditures to be approximately $35 million for the full year in 2015.

The annualized tax rate is expected to be approximately 32% to 33%, excluding any impact from post-tax dividends from the liquid finishing or gain on sale of the investment. The federal R&D tax credit has not an extended into 2015. If approved, the 2015 annualized tax rate is expected to be approximately 31% to 32%. I'll turn the call over to Pat now for further discussion.

Pat McHale - *Graco Inc. - President and CEO*

All right. Thanks, Carol, and good morning, everyone. Thanks to the efforts of our employees and our channel partners worldwide, we finished 2014 with a strong quarter, achieving new records in multiple categories for the quarter and the year.

On a constant currency basis, organic growth was double digits in Q4, our strongest growth quarter of the year. It was our strongest quarterly organic growth since 2011 and our 20th consecutive quarter of organic sales growth at consistent year-over-year exchange rates.

We continue to see a decent economy in the US, spotting improvement in Asia-Pacific and a mixed bag in EMEA with growth continuing in the West and significant declines in Russia.

Caroline highlighted a number of discrete cost related to acquisitions and regional and product expansion in her comments. You can also find more information on these costs in our slide deck and our press release. After adjusting for these costs, our incremental profit on our organic sales growth was solid for the quarter and for the year, both in the 40% range.

Acquisitions added five percentage points to our growth in Q4, reflecting contributions from QED and EcoQuip, which were acquired in December 2013, and Alco Valves, which was acquired early in the fourth quarter of 2014. When you add these acquisitions to our strong organic growth on a constant currency basis, Graco grew at a double-digit pace in every reportable segment and region during the fourth quarter except Asia-Pacific, which grew at a high-single-digit pace.

My review of the segments will focus on organic growth on a constant currency basis. Let's start with contractor. Our contractor business posted double-digit growth in the fourth quarter, driven by double-digit growth in Asia-Pacific and the Americas.

We have mentioned before that we are expecting to see variations in the growth rate of contractor Americas from quarter to quarter during recovery of the US housing market. However, the team was able to posted double-digit growth in the Americas in every quarter of 2014. That was against a 22% growth comp from 2013.

We are still cautious about variability but remain bullish on the long-term trajectory supported by the key growth of US construction markets. Sales increased to double digits in both the paint store and home center channels in North America this quarter. The contractor segment posted -- the contractor segment in both Asia-Pacific and EMEA achieved mid-single-digit growth for the year.

Moving on to industrial, our worldwide industrial segment posted high-single-digit organic growth in Q4, above the mid-single-digit growth that we achieved for the full year. In the Americas, our industrial business grew at a double-digit pace against our hardest comp of the year, exceeding expectations and pushing the region's full-year growth rate into the high single digits. The EMEA industrial business also outperformed in the quarter with a double-digit organic growth rate that help the region achieve mid-single-digit growth for the year. The Asia-Pacific industrial business grew at a low-single-digit pace in the fourth quarter, matching the growth rate for the full year.

If you recall, we started the year in the hole with a poor performance in the first quarter, and have made good strides to finish the year in positive territory. Worldwide industrial demand levels are good, and we continue to have nice contributions from nearly all product categories.

Next let's talk about lubrication. Worldwide, lube posted double-digit growth for the quarter driven by a strong 22% increase in the Americas and double-digit growth in Asia-Pacific. Nearly every product category in the Americas grew at a double-digit pace in the fourth quarter and contributed to the performance. In EMEA, lube was down year over year off a small base due to a large Q4 2013 shipment into the emerging markets that didn't recur.

Now moving on to some comments regarding our overall business in EMEA and Asia-Pacific. Similar to last quarter, our growth in EMEA came primarily from the developed economies in the West. Developed economies of the West grew at a pace in the low teens during the quarter. In the emerging markets Russia was down year over year in the low teens, consistent with the full-year pace. Q4 growth in the Middle East offset the declines in Russia while the other portions of emerging EMEA were relatively flat. Excluding Alco, our current sales split in EMEA remains close to the third quarter at 68% developed economies and 32% emerging markets.

The Asia-Pacific region grew mid-single-digits organically in the quarter against a strong double-digit comp from the fourth quarter of last year. Sales were flat in China and Australia and New Zealand, while every other geography in the region posted good levels of growth.

In China, overall performance was stronger than the headline numbers would indicate. Q4 of 2013 had a high level of shipments of powder coating equipment for the aluminum profile market. As we have discussed on many occasions, these projects are lumpy and can move growth rates around from quarter to quarter. Without that product category, growth in China would have been mid to high single digits in Q4.

We continue to see variability in bookings and billings by country in product line. The overall direction of the region is good, though, and I like how we exited the year.

Before commenting on our outlook for Q1 and for 2015, I want to take a moment to expand on our recent activities on the acquisition and divestiture front. Early in the fourth quarter, we announced and closed on the acquisition of Alco Valves, a UK-based manufacturer of high pressure, high quality valves for oil and natural gas and industrial process applications for a purchase price of GBP72 million. We also announced four other acquisitions which have now all closed.

First is GeoBlaster, while small, this businesses complementary to the EcoQuip that we acquired in 2013 and expands our abrasive blasting surface prep product offering.

The second business is Multimaq, a very small manufacturer and distributor of industrial fluid handling products in Brazil. This is our first operational footprint in Brazil, and our intent is to use it as a platform to enhance our long-term competitive position in Brazil.

The third businesses White Knight Fluid Handling, a manufacturer of specialized air-operated double-bellows pumps, air-operated double-diaphragm pumps, and metering pumps. The White Knight product line expands Graco's current process pump offering into niche high and ultrahigh purity applications where Graco previously had no presence.

The fourth acquisition is High Pressure Equipment, a manufacturer of valves, fittings, and other flow control equipment engineered to perform in ultrahigh pressure environments. About half the revenue is in oil and gas applications with the other half in attractive niche process segments. This business will complement the Alco Valves offering. We have a slide in our conference call deck on High Pressure Equipment.

We expect these transactions to add approximately 5 percentage points of growth to our 2015 sales, $26 million of EBITDA, and $0.13 to $0.15 of earnings accretion in 2015 before purchase accounting and transaction cost.

Regarding the sale of the liquid finishing brands to Carlisle Companies, our current estimate is that the transaction will close either late in Q1 or early Q2. As reminder, the sales price is $590 million dollars. After paying cash taxes, transaction costs, and harvesting the remaining cash, we expect to receive $570 million in net cash proceeds.

When all is said and done, including the proceeds from divestiture and the cash we have spent on recent acquisitions, we currently expect to be in a net debt position of approximately $200 million. That would consist of $300 million of our existing private placement debt, which has a pretax interest rate of about 4.8% offset by a little over $100 million in cash.

For 2015 we are planning to achieve organic growth in every reportable segment in every region of the world. In the Americas we are expecting industrial organic growth in the mid-single digits. We expect the US construction environment will continue to improve and that our contractor Americas business can grow at a double-digit pace again in 2015. The lubrication businesses expected to have mid-single-digit growth. All in, the Americas should grow in the mid-to high single digits organically.

On a constant currency basis, we expect EMEA and Asia-Pacific will grow organically in the low single digits for the first quarter and the full year 2015.

Overall, we believe Graco can achieve mid-single digit organic sales growth in the first quarter and full year. As noted in the press release, if currency rates stay about where they are today, there will be a sales headwind of about 4% for the full year 2015 with the impact skewed somewhat to the first three quarters. FX headwinds should be more than offset on the top line by growth from acquisitions of around 5%.

Our 2015 plan relies on a continued focus on strategic growth initiatives, new products, new markets, expanded distribution, and end-user conversion. Our slate of new products in the market this year looks solid and we have most of the resources already in place to execute our market and distribution initiatives.

In short, we had a good all-around performance in 2014 and look forward to maintaining our momentum as we head into 2015. Operator, we are ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) John Franzreb with Sidoti & Company.

John Franzreb - *Sidoti & Company - Analyst*

I'd like to start, actually, on the acquisitions of High Pressure and, I guess, also Alco. But first, on High Pressure, how much of that business is in distribution versus OEM sales? And can you talk a little bit about distributor inventories, what they are saying out there, especially in oil and gas sector?

Pat McHale - *Graco Inc. - President and CEO*

So the High Pressure has got a direct sales model, and it has got a fairly diverse business or list of customers, I should say. The business, of course, is half in the process and half in the oil and gas world, and that's split between different segments of the oil and gas marketplace. I don't have an exact breakdown for you in terms of the detailed sales split, but we are talking pretty small numbers. That's $38 million in revenue and we're talking less than half in oil and gas and it's split up into quite a few different segments.

John Franzreb - *Sidoti & Company - Analyst*

And when you add Alco and the rest of the existing business, how much is your total exposure into the oil and gas sector?

Pat McHale - *Graco Inc. - President and CEO*

So the new initiative that we have is really focused on at the well site and between those two acquisitions we're talking about 3% of Graco sales, approximately. And you think about the rest of Graco's business, of course, we do have pluses and minuses. There's going to be winners and losers in other markets that are important to Graco, regardless of what's happening with oil and gas, our protective coatings businesses and others have exposure to either tangential markets or markets that are going to do better or worse because of what's happening with our prices. So it will have an impact plus or minus in other areas of our business as well.

John Franzreb - *Sidoti & Company - Analyst*

Just sticking with acquisitions in total, can you talk about potential margin improvement opportunity at the core businesses?

Pat McHale - *Graco Inc. - President and CEO*

One of the things that we look for when we decided to go into this space is we looked for businesses where we felt like our core competencies fit both from an engineering and from a manufacturing standpoint. So we do see opportunities here. We are not going to realize those overnight, but certainly we see opportunities to invest our manufacturing capability into those organizations to help on the cost and quality side, and also I think there's more that we could do to fund new product development and engineering projects for both those businesses that will help drive organic growth over the longer term.

John Franzreb - *Sidoti & Company - Analyst*

And one last question and I'll get back into queue -- regarding liquid finishing you pushed back to timing a little bit. I wonder if there's any specific reason why. And also, will you be collecting the dividend in the first quarter? And if so, what should we budget for that number?

Pat McHale - *Graco Inc. - President and CEO*

Timing being pushed back, it's just because it's taking a long time. There's nothing specific going on, so I think we just have to work through the process, the whole process, nothing has been so fast. I'll let Caroline or Jim here jump in on the other part of your question.

Jim Graner - *Graco Inc. - CFO*

We are, of course, waiting for some word out of Washington on the agreement that we submitted to them for approval. But if it looks like we can close that early in the second quarter, we will not take a dividend in the first quarter.

John Franzreb - *Sidoti & Company - Analyst*

Okay, thank you very much, guys. I'll get back into queue.

Operator

Kevin Mackza with BB&T Capital Markets.

Kevin Mackza - *BB&T Capital Markets - Analyst*

Good morning. So kind of to follow up on that and expand on it in terms of some of the big moving parts here for 2015, so if you don't take a dividend in Q1 or Q2 and then the business is sold on schedule -- so the dividends were about $0.45, I think, in 2014, and now you are calling out the large currency headwind and the elevated pension expense. So there's some nice offsets here in terms of your M&A and organic growth and buyback, but it still seems like you are suggesting that earnings will be down quite a bit in 2015. Is that -- without quantifying that, is that --?

Pat McHale - *Graco Inc. - President and CEO*

I'm not ready sitting here in January to say that I'm expecting earnings to be down quite a bit in 2015. We've got 3,000 people are going to work hard to have a good year. We've got a lot of new product and other things going on. I can't argue with the math that you've laid out there on pension and currency and liquid dividend. So we have got our sites clearly set on that and we're going to have to do some things to try to have a good year.

Kevin Mackza - *BB&T Capital Markets - Analyst*

Got it.

Jim Graner - *Graco Inc. - CFO*

Kevin, on the $0.45 -- we are about two-thirds of the way to recovering that $0.45 with acquisitions and share buybacks. We, of course, are planning for the growth numbers that Pat talked about. So I think if you do the math you should get some accretion.

Kevin Mackza - *BB&T Capital Markets - Analyst*

Jim, on that point of acquisitions, five deals in the past few months -- did you just take out your entire pipeline that you were looking at, or is it still fairly healthy and we ought to expect more to come in the new year?

Jim Graner - *Graco Inc. - CFO*

Yes, I would say it's fairly healthy. They tend to skew to the smaller side, so they will be along the lines of the smaller deals that we've got done, at least those that are closed. You could see three or four but, again, nothing as significant as the High Pressure or Alco Valves transactions.

Kevin Mackza - *BB&T Capital Markets - Analyst*

On the corporate line that you called out and the elevated pension expense are you suggesting that total corporate line ought to be about $10 million higher, or it's up about $10 million on pension and other things and maybe there's some other offsets like some other, I don't know, acquisition and divestiture cost that maybe don't recur?

Caroline Chambers - *Graco Inc. - VP, Corporate Controller and Information Systems*

Yes, for sure you need to take into account those acquisition costs because those deals are past and will just see what comes with the future on those items. What we do see is some headwind with the pension as well as we only have about half a year of our new central warehouse in 2014 so we will have the additional incremental half-year of that. And that's also included in that number.

Jim Graner - *Graco Inc. - CFO*

So yes, Kevin, the total will go up less than the $10 million.

Kevin Mackza - *BB&T Capital Markets - Analyst*

Okay. Less than the $10 million with, I guess, $5 million of acquisition costs in the quarter that go away but some additional full-year effect of the other cost that were just mentioned?

Caroline Chambers - *Graco Inc. - VP, Corporate Controller and Information Systems*

Plus the pension, yes.

Kevin Mackza - *BB&T Capital Markets - Analyst*

Okay. That's it for me. I'll get back in line. Thank you.

Operator

Michael Halloran with Robert W. Baird.

Michael Halloran - *Robert W. Baird & Compnay, Inc. - Analyst*

On that same train of thought, what's the estimated purchase accounting hit in the first quarter coming up here.

Caroline Chambers - *Graco Inc. - VP, Corporate Controller and Information Systems*

We're thinking it's about $2 million. We are finalizing some of that purchase accounting work as we speak here for some of these deals that closed now in the new year. But with inventory step-up and the finalization of the acquisition costs, we are thinking it's about $2 million.

Michael Halloran - *Robert W. Baird & Compnay, Inc. - Analyst*

That makes sense. And on the European side of things what did you see through the quarter? Are you at the point now where the swings in currency are starting to help some of the demand, hurt some of the demand over there? What is the core underlying trends feel like in your perspective?

Jim Graner - *Graco Inc. - CFO*

It's too early to say what the currency is going to do with respect to demand. Again, we are optimistic on the West. We talked about the growth in the fourth quarter in the West. Russia is going to get worse on a comp basis, especially in the first quarter. But overall, we expect EMEA to grow, again on a constant currency basis on the underlying demand in that single-digit number.

Michael Halloran - *Robert W. Baird & Compnay, Inc. - Analyst*

Makes sense. And then anything different on the mix in North America contractor?

Pat McHale - *Graco Inc. - President and CEO*

No, there shouldn't be anything too dramatic on the mix. We don't have any major channel shifts. We do have some new product that we are launching on kind of on both ends of the spectrum, although when I take a look at what we've got launching we could be in a situation where the stuff that is most popular again could be towards the lower half of the Pro line this year. But generally I would expect mix to be more stable.

Michael Halloran - *Robert W. Baird & Compnay, Inc. - Analyst*

Appreciate the time.

Operator

Charles Brady with BMO Capital Markets.

Charles Brady - *BMO Capital Markets - Analyst*

Just a quick question on, number one, raw material costs. Are you guys seeing any positive uplift from lower raw material costs, and is that budgeted into the forecast in 2015?

Caroline Chambers - *Graco Inc. - VP, Corporate Controller and Information Systems*

I took a look at our commodity current chart yesterday. Obviously, they are favorable as to where they were three months, six months ago. It will take a little bit of time for that to work its way through, so maybe just a slight favorable compared to Q4. And depending on what happens, maybe we'll see more into Q2.

Charles Brady - *BMO Capital Markets - Analyst*

Great. And just on the contractor side, I'm wondering just from a competitive standpoint, given what and where the euro has gone, has that had any impact on your primary competitor as far as getting more aggressive on pricing or trying to use that as leverage against you guys? Or is it not having any impact at all?

Pat McHale - *Graco Inc. - President and CEO*

So far I would say we haven't seen anything that's a significantly different in terms of competitive strategy on pricing or otherwise out there. One of our main competitors, a significant portion of their cost of goods sold is driven out of Asia, not driven out of Europe, although of course they do have corporate costs and people in Europe.

Charles Brady - *BMO Capital Markets - Analyst*

That's helpful. Thanks, appreciate it.

Operator

Liam Burke with Wunderlich Securities.

Liam Burke - *Wunderlich Securities, Inc. - Analyst*

Pat, you mentioned you've got a whole slew of new products coming out. Is there any particular business segment that you are emphasizing this year? Last year you had a pretty big slew of contractor related products.

Pat McHale - *Graco Inc. - President and CEO*

Yes, contractor looks good again this year. Really, all the businesses have been active and have been investing, and the product pipeline it doesn't really have any what I'll call slug to air in it. It looks like all of our divisions are going to be launching at a pretty good cadence this year, the new products that we've been working on. So generally I feel like we are in a decent position on new products across the front and probably nobody is going to be dramatically stronger than anybody else.

Liam Burke - *Wunderlich Securities, Inc. - Analyst*

Okay. And I know on the contractor side you don't know exactly who the end buyer is, but are you seeing any more weighting towards the higher end systems as we look into a stronger commercial construction market in 2015?

Pat McHale - *Graco Inc. - President and CEO*

We've seen growth in the large end of the product category, but we are also seeing really strong growth in the small end of the product category. I just got back from a sales meeting and show at one of our vendors were all of our sales guys were from around the country yesterday and I got a chance to talk to quite a few of them. Frankly, my read on that is that, while there is a decent level of activity in general, the big resurgence in non-res is not actually being seen right on the ground today and we are still grasping for it. So is it going to be soon? We hope, but I would say most of my guys weren't seeing a big spike right now today.

Liam Burke - *Wunderlich Securities, Inc. - Analyst*

Great, thank you.

Operator

Jim Krapfel with MorningStar.

Jim Krapfel - *Morningstar - Analyst*

So you know that the industrial segment in America has exceeded your expectations. I'm just wondering -- looking to hear some sort of color on that and how sustainable you think that pickup in growth was.

Pat McHale - *Graco Inc. - President and CEO*

Yes, when you take a look at our performance across product categories it has been pretty good. It hasn't really all been concentrated in one particular end market here, in industrial Americas. And while the economy is, I wouldn't say, smoking hot, it's pretty decent. And of course compared to the rest of the world it still looks pretty darn good. So I'd say we're going into the year with a feeling that the North American industrial economy is going to give us a good chance to be successful. And that's going to be fairly broad based.

Jim Krapfel - *Morningstar - Analyst*

Okay. And I know it's difficult to forecast acquisitions, but do you expect a similar breakdown between share repurchases and acquisitions in 2015 as what you did in 2014?

Pat McHale - *Graco Inc. - President and CEO*

If you count the High Pressure deal that we just got done, it was a pretty active last three months for us. And if you are going to put me on the hot seat and ask me to guess, I would say that it might be less likely that we will get as many deals done in the next 12 months as we have the last 12 months. But we certainly have an active team and we are looking for opportunities. The share repurchase -- we've got a cadence that we are executing to. And, of course, should the market give us a reason to be more aggressive, I'm certain that we would be.

Jim Krapfel - *Morningstar - Analyst*

Right, thank you.

Operator

Walter Liptak with Global Hunter.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

I wanted to follow on to that last question about acquisitions. You've had the last three months being more active. I wonder if it's because of the finishing business getting closer to getting divested. Or is it just that those deals came in and the timing is the timing?

Pat McHale - *Graco Inc. - President and CEO*

I think it's more the deals just came in. We really started to put more resources on building an M&A pipeline way back in end of 2008. And it took us quite a while to get traction. I can tell you here a couple years ago I was somewhat frustrated by the fact that we had done as much work as we did and we weren't bringing anything to the table, and it just seems like the last six months or so some things started to fall out. So I think it's more random than anything else.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Okay. And the deals that you are finding -- I don't know if I've seen anything on multiples, but can you give us an idea of what kind of multiples you are looking at?

Pat McHale - *Graco Inc. - President and CEO*

Yes. Up until recently the multiples have been pretty healthy in the marketplace. And so we've had multiples -- and Jim, you can jump in probably -- but probably between, what, high single and low double?

Jim Graner - *Graco Inc. - CFO*

Correct.

Pat McHale - *Graco Inc. - President and CEO*

Digit kind of multiples. I would anticipate for some of the product categories and assets that we are interested in, if things continue the way they are we might see some better buying opportunities in the next 12 months than we did in the last 12 months. So having a little bit of patience here could be good for us as well.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Okay. And I realize your comment about ONG is a very small percentage of Graco's overall mix. It just seems like the valuations are high for industrial, low for oil and gas, and that's maybe where you could look for capital allocations. I guess I'm wondering, if you look at it that way, as you are looking for acquisitions, trying to get the right valuation at the right time, or if there's a something about oil and gas where you wouldn't want to increase your sales mix above a certain level?

Pat McHale - *Graco Inc. - President and CEO*

You know, it's interesting because six month ago oil and gas deals were hot and everybody was paying up big time for oil and gas. And you were a hero if you were buying oil and gas deals. And now you are dog. So things can change rather quickly. We are early on trying to, I'll say, learn that market space. We have identified some things that we think for the next 20-30 years that are going to be attractive and we believe that we can leverage our core competencies. But we've got a lot to learn.

And actually the timing may turn out to be good for us because if the oil prices stay down and maybe some assets that would have been expensive six months ago that in a year from now or 18 months from now become available at a better price. Of course, we take a long-term view of things. So I will be watching that closely. Certainly, our appetite to purchase an oil and gas asset at the prices we were willing to pay six months ago has been dampened. And we will take that into consideration as we take a look at opportunities that might come up here throughout the course of the year.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Okay, great, thank you.

Operator

Joe Ritchie with Goldman Sachs.

Evelyn Chow - *Goldman Sachs - Analyst*

This is actually Evelyn Chow for Joe. I appreciate you taking my question. I appreciate the color you provided on FX for sales and EPS. Given how much of your COGS is denominated in USD, would you consider implementing more natural hedging in your portfolio or do you remain fairly committed to your low-volume/high-mix model?

Pat McHale - *Graco Inc. - President and CEO*

Yes. No, we remain committed to our model. This is one of those deals that it's always moving around and we decided long ago that we're going to perform better over the long-term if we sink roots and work on process improvement and training our employees rather than trying to chase around to wherever the exchange rates happen to be more favorable out a given point in time. I would view the long-term natural hedging to happen as we want to produce more product close to the end markets so that we can get better service to the customers, not because we are necessarily chasing any kind of a hedging strategy. But I think it could happen over time as we move production closer to the customer but not specifically for the reason of expense management.

Evelyn Chow - *Goldman Sachs - Analyst*

Okay, understood. And as a quick follow-up, do you have any hedging contracts in place? Or if not, would you consider starting some hedging quarter to quarter?

Jim Graner - *Graco Inc. - CFO*

We don't do any hedging with our revenue stream and our cost stream. I've been through the cycles quite a few times, and we always get this question when we are at the bottom. But hedging moves your problem out 12 months or 24 months, it doesn't fix the problem. And hedging has a cost. So our model is not to do it, and we have no contemplation of doing it in the future.

Evelyn Chow - *Goldman Sachs - Analyst*

Thanks, guys. I'll get back in queue.

Operator

Jim Giannakouros with Oppenheimer & Co.

Jim Giannakouros - *Oppenheimer & Co. - Analyst*

Sorry if I missed this, but can you break down the core margin profile of your acquired sales in 2015? I know you talked about the top-line effect, but I was just trying to see from a gross margin, SG&A, or even just on the industrial segment, how should we be thinking about their margin contribution this year and next?

Christian Rothe - *Graco Inc. - VP and Treasurer*

Jim, this is Christian. So I'm just going to make sure that I answer your question properly. We do have a slide in our slide deck that does call out the effect of the acquired businesses on operating earnings leverage. So for the full year 2014 it was $6 million increase. [Net] excludes the inventory step up and acquisition cost, which were $5 million for the full year. So again, I think your question was just around if you were to take out those one-time costs, what exactly would that improvement to the operating earnings be? And again, it's that $6 million. And that is an EBIT number, so if you are looking for an EBITDA number, I don't have depreciation and amortization in front of me, but that would of course be added.

Jim Graner - *Graco Inc. - CFO*

So I'll try it a little bit different response, Jim. In the core margins I would say the acquired businesses in aggregate are running in the low 40s from a gross margin perspective and in the low double digits from an operating margin. Of course, as with most of the things we acquire, we focus a lot on the manufacturing opportunity. And we view these opportunities to not be dissimilar from what we have been able to do in the past, which is generally around 1,000 basis points improvement on the gross margin side. Again, it takes time and it takes some capital to get there. But nothing we've seen in the acquired businesses prevent us from taking our core industrial manufacturing technology IP to get those kinds of returns in the future.

Jim Giannakouros - *Oppenheimer & Co. - Analyst*

That's helpful because I was looking for some guidance on 2015. And also the pension expense -- everybody is going to be hit with a higher year-over-year in 2015. But help me understand. Should I think that your corporate unallocated should stay at a relatively elevated level in 2016, or does that come down again and we should be treating that pension expense as one-time issue?

Jim Graner - *Graco Inc. - CFO*

You know the function of the discount rates on pension expense, so we really can't answer that question. The long-term bond rates dropped by, I think, 80 basis points between 2013 and 2014 end of the year. So if that was to go back up, that 80 basis points, we would be back where we were in 2013. If it goes higher, of course, we would be even lower expense in 2016 than we were in 2013. So it's a function of the discount rates, the rate at which you discount the future liabilities that are really driving those costs.

Caroline Chambers - *Graco Inc. - VP, Corporate Controller and Information Systems*

We saw some favorable in 2014, kind of puts us back not so different as to 2013, although there are various other assumptions that go into play as well as the discount rate.

Jim Giannakouros - *Oppenheimer & Co. - Analyst*

Okay, fair enough. Thank you.

Operator

(Operator Instructions) Joe Radigan with KeyBanc.

Joe Radigan - *KeyBanc Capital Markets - Analyst*

A question on contractor in Asia -- Pat, I know you have been disappointed in the growth rates there. It looks like they rebounded a little bit in the fourth quarter off of a relatively easy comp. But in the past you have mentioned more local competitors, perhaps distribution gaps in smaller cities. Is that still the case, or have you changed your strategy at all in an attempt to reaccelerate growth there?

Pat McHale - *Graco Inc. - President and CEO*

Despite the good performance in the fourth quarter, my view on contractor Asia hasn't changed. I'm still not satisfied with how we are executing over there, particularly in China. We have made some adjustments to our channel strategy over there. We had been selling through, I'll say, more of a traditional paint dealer distribution model and had been avoiding, I'll call it, the hardware market, where we see a lot of these competitors springing up. But the division has been working hard and region has been working hard on initiative to establish a presence in these hardware markets around the country. We have made some pretty decent progress and we're seeing some sales performance there. But certainly, I don't think we should take Q4 and say, geez, we've got that fixed and we're taking off in China. We've got a lot of work there from a leadership standpoint as well as from a channel and product standpoint to get to where I'm satisfied.

Joe Radigan - *KeyBanc Capital Markets - Analyst*

Okay. And then for the contractor segment overall, you have had a pretty good string of double-digit organic growth there. Obviously, you had a nice run with new products. But it sounds like you think double-digit organic growth is sustainable based on your prepared comments. Is that primarily an Americas comment, or is that for the segment overall?

Pat McHale - *Graco Inc. - President and CEO*

It's primarily an Americas comment. I don't know about sustainable, but, certainly, the housing market has got some significant recovery left in front of it. And the non-res -- that should be a plus to us going forward here the next couple, three years as well. And it's an aggressive group up there from a product standpoint, so in addition to having a good market environment in terms of year-over-year activity growth here in the Americas, they continue to do a great job launching products that convince contractors that they ought to buy. So organic growth double-digit year over year. They have had a nice run, but I think that we can keep that going at least here through 2015.

Joe Radigan - *KeyBanc Capital Markets - Analyst*

Great, thanks, Pat.

Operator

If there are no further questions, I will now turn the conference over to Mr. Pat McHale.

Pat McHale - *Graco Inc. - President and CEO*

All right. Well, again, thank all of our employees and partners for a good fourth quarter. While we have some challenges here that we have discussed going into 2015, we also have done a lot of work to set the table for pursuit of opportunities. And I'm not anything but excited about the next 11 months ahead of us. So thanks for your time today, and we will talk to you again in a few months.

Operator

This concludes our conference for today. Thank you all for participating, and have a nice day. All parties may now disconnect.