

# 4<sup>th</sup> Quarter 2013 Earnings Conference Call

## Tuesday January 28, 2014 – 10 am CT



MANUFACTURING  
EXCELLENCE

# Safe Harbor



Today's presentation includes forward-looking statements that reflect management's current expectations about the Company's future business and financial performance.

These statements are subject to certain risks and uncertainties that could cause actual results to differ from anticipated results.

Factors that could cause actual results to differ from anticipated results are identified in Part 1, Item 1A of the Company's Form 10-K, and the current Quarterly Report on Form 10-Q.

# Conference Call Logistics



The release, accompanying slides and replay web cast are available online at [www.graco.com/ir](http://www.graco.com/ir)

Telephone replay will be available after 2 p.m. ET, January 28, 2014. The replay by telephone will be available through January 31, 2014

- 800-406-7325 – Conference ID #4659630
- 303-590-3030 – Conference ID #4659630, for International participants

# Financial Results



\$ millions except EPS	Fourth Quarter			Year-to-Date		
	2013	2012	Change	2013	2012	Change
Sales	\$ 271.9	\$ 253.7	7 %	\$ 1,104.0	\$ 1,012.5	9 %
Gross Profit	147.2	138.9	6 %	607.5	550.5	10 %
% of Sales	54.1 %	54.7 %	(0.6) pts	55.0 %	54.4 %	0.6 pts
Operating Earnings	63.3	57.9	9 %	279.8	224.7	25 %
% of Sales	23.3 %	22.8 %	0.5 pts	25.3 %	22.2 %	3.1 pts
Net Earnings	\$ 44.7	\$ 42.3	6 %	\$ 210.8	\$ 149.1	41 %
% of Sales	16.5 %	16.7 %	(0.2) pts	19.1 %	14.7 %	4.4 pts
Diluted Earnings Per Share	\$ 0.71	\$ 0.68	4 %	\$ 3.36	\$ 2.42	39 %
<i>Diluted Shares in Millions</i>	62.9	61.9		62.8	61.7	

Includes dividends (post-tax) from Liquid Finishing businesses held separate:

Dividends	\$ 4	\$ 4		\$ 28	\$ 12	
EPS Impact	\$ 0.07	\$ 0.07		\$ 0.45	\$ 0.19	

# Financial Results – Net Sales



## Components of Net Sales Change

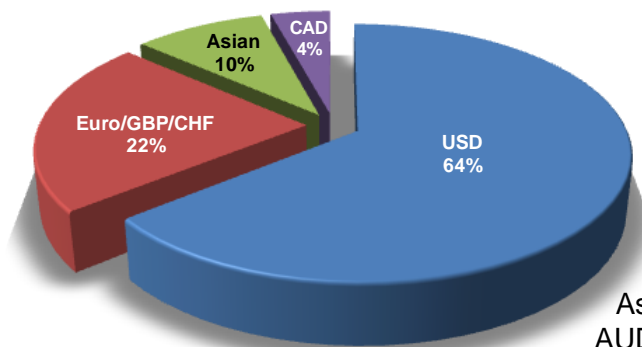
Fourth Quarter 2013

	Segment			Region			Consolidated
	Industrial	Contractor	Lubrication	Americas	EMEA	Asia Pacific	
Volume and Price	9 %	5 %	(2)%	5 %	4 %	16 %	7 %
Acquisitions	—	—	—	—	—	—	—
Currency	1 %	—	(1)%	(1)%	4 %	(2)%	—
<b>Total</b>	<b>10 %</b>	<b>5 %</b>	<b>(3)%</b>	<b>4 %</b>	<b>8 %</b>	<b>14 %</b>	<b>7 %</b>

Year-to-Date December 2013

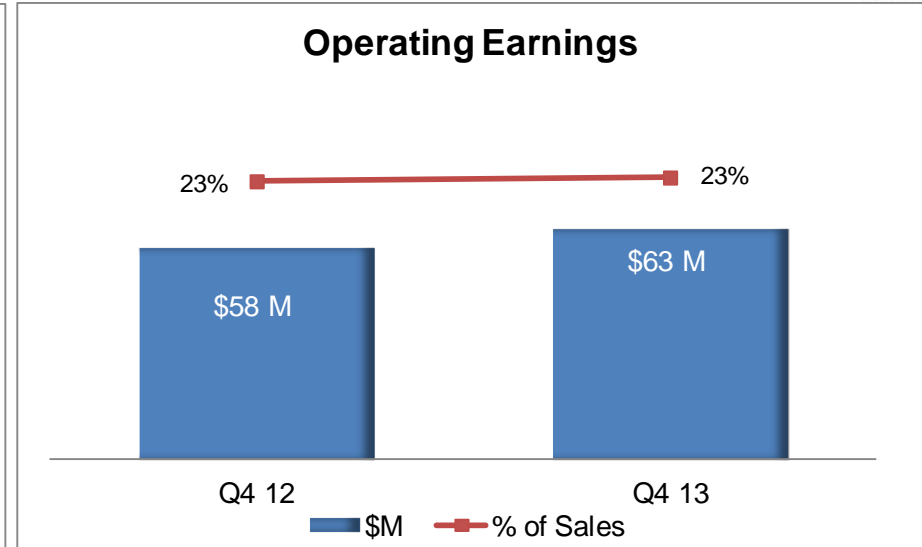
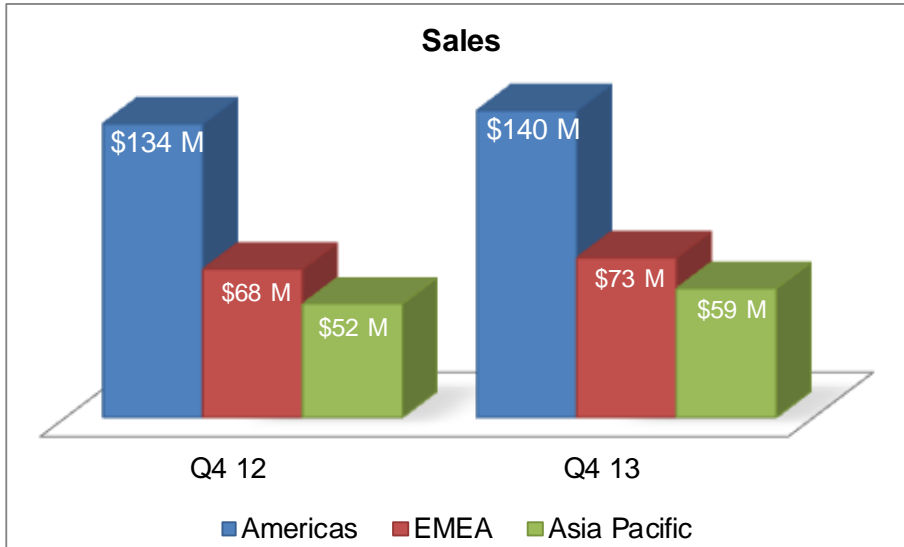
	Segment			Region			Consolidated
	Industrial	Contractor	Lubrication	Americas	EMEA	Asia Pacific	
Volume and Price	3 %	14 %	—	10 %	2 %	1 %	6 %
Acquisitions	5 %	—	—	1 %	6 %	4 %	3 %
Currency	—	1 %	(1)%	—	2 %	(2)%	—
<b>Total</b>	<b>8 %</b>	<b>15 %</b>	<b>(1)%</b>	<b>11 %</b>	<b>10 %</b>	<b>3 %</b>	<b>9 %</b>

2013 Sales by Currency



Asian currencies include:  
AUD, CNY/RMB, KRW, JPY

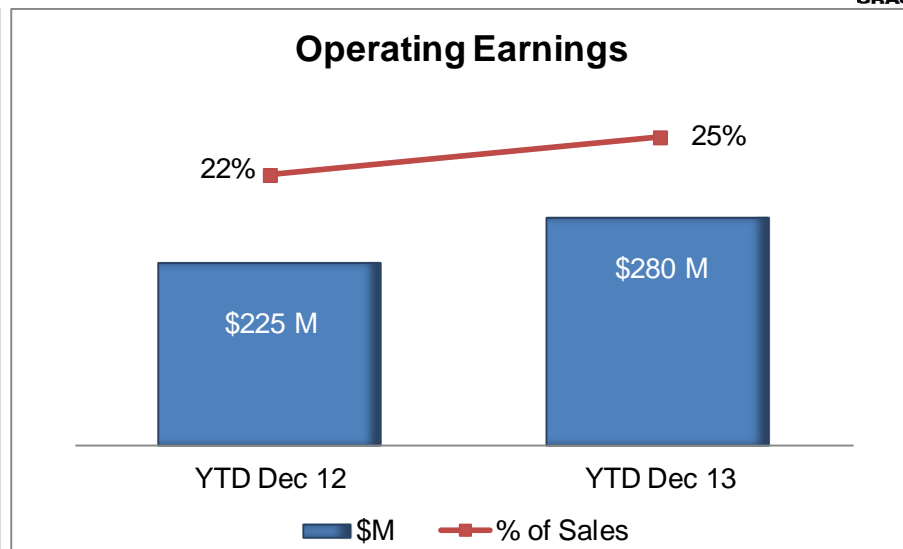
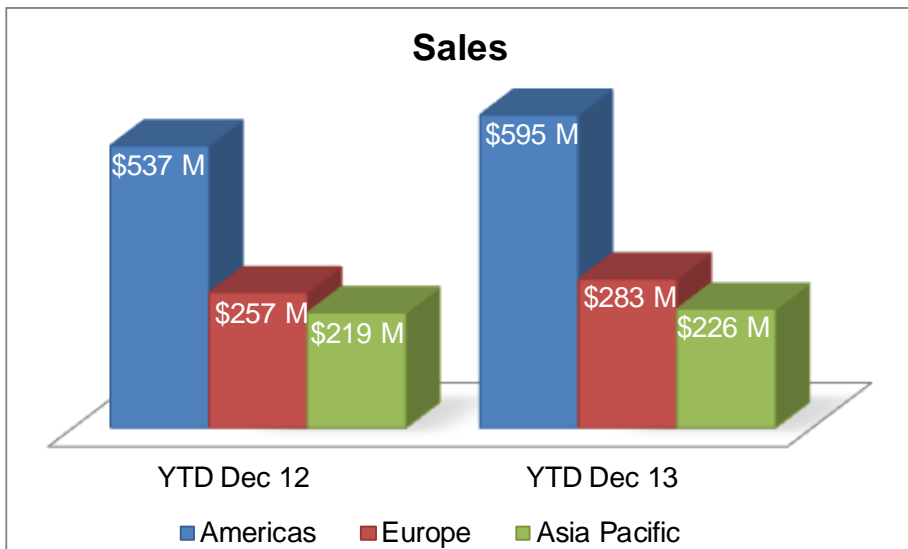
# Fourth Quarter 2013 Results



- Sales increase of 7% (no net impact from currency translation)
- Gross margin rate down ½ percentage point from fourth quarter 2012
  - Manufacturing spending increases and changes in mix, including effect of increased sales of powder finishing equipment, offset the favorable effect of realized pricing
- Operating earnings up ½ percentage point from fourth quarter 2012
  - Contractor segment expenses increased \$3 million primarily due to product development and pre-launch activities for new products expected to be released in Q1 2014
  - No acquisition/divestiture expenses in the quarter, down \$1 million from fourth quarter 2012

- Interest expense \$4 million down \$0.5 million from fourth quarter 2012
- Liquid Finishing dividend \$4 million (post-tax), the same as fourth quarter 2012
- Tax rate of 28½% is comparable to fourth quarter 2012 rate of 28%
  - Fourth quarter dividend income (post-tax) from Liquid Finishing was the same in 2013 and 2012
  - R&D credit in 2013, not available in 2012
  - Tax holiday in a foreign jurisdiction decreased the tax rate in the fourth quarter 2012

# Full Year 2013 Results



- Sales increase of 9%; with the first quarter impact of the Powder Finishing operations contributing approximately 3 percentage points
  - No net impact from currency translation
- Gross margin rate up ½ percentage point from prior year
  - Realized pricing and higher production volumes offset by change in product mix, including effect of increased sales of powder finishing equipment and Contractor
  - Purchase accounting had a negative impact on 2012 gross margin
- Operating earnings up 3 percentage points from 2012
  - Acquisition/divestiture expenses \$2 million year-to-date, down \$14 million from 2012

- Interest expense of \$18 million, down \$1 million compared to 2012
- Liquid Finishing dividend \$28 million (post -tax) compared to \$12 million in 2012
  - 2013 quarterly dividends of \$4 million in Q1, \$11 million in Q2 and \$9 million in Q3 and \$4 million in Q4 vs. \$4 million in Q2, Q3 and Q4 2012
- Tax rate of 27% is lower than 2012 rate of 31½%
  - 2013 reduced by effect of additional \$16 million dividend income (post-tax) from Liquid Finishing
  - R&D tax credit reinstated; full year 2012 effect (\$3 million) and 2013 credit recognized in 2013

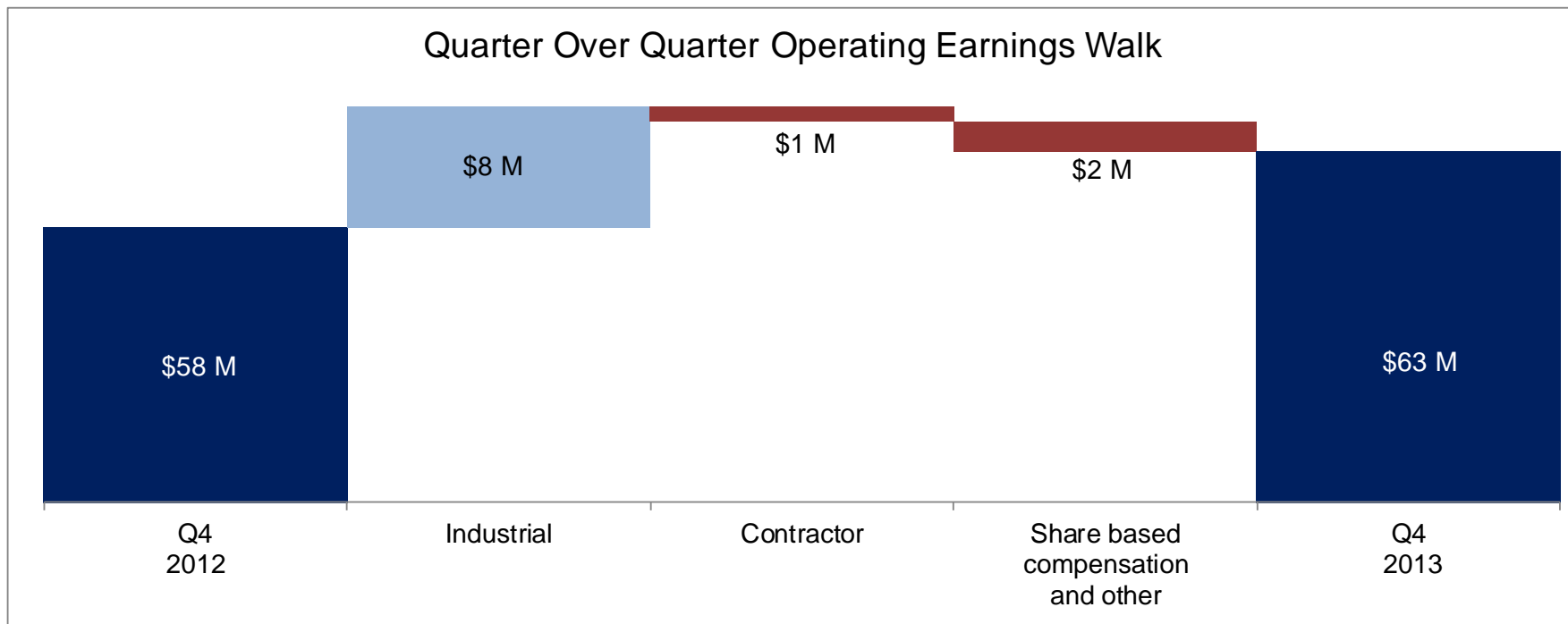
# Operating Earnings



## Change in Operating Earnings

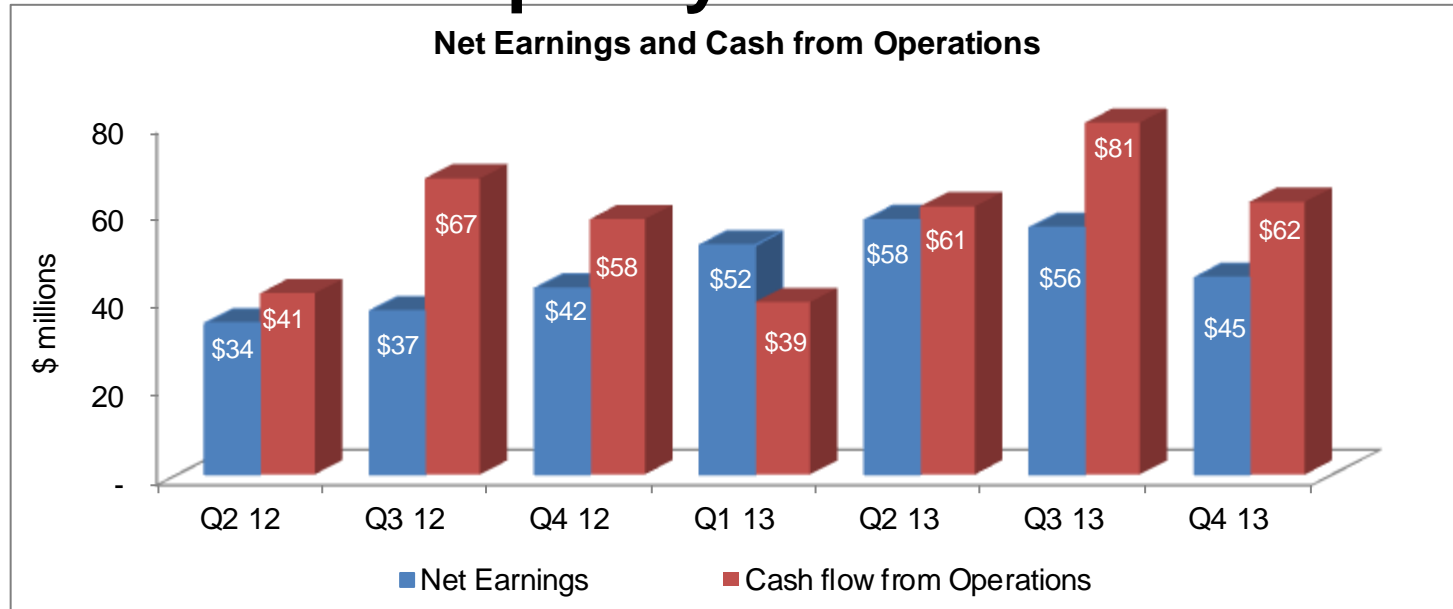
	Fourth Quarter		Year-to-Date	
2012 Operating Earnings (\$M and % of sales)	\$ 58	23 %	\$ 225	22 %
Translation effect	—	—	(2)	—
Volume, pricing, product cost and mix	9	—	52	—
Effect of 2012 purchase accounting	—	—	7	1
Acquisition/divestiture costs reduction	—	—	14	1
Employee share based compensation	(3)	(1)	(3)	—
Volume effect on expense leverage	(1)	1	(13)	1
2013 Operating Earnings (\$M and % of sales)	<u>\$ 63</u>	<u>23 %</u>	<u>\$ 280</u>	<u>25 %</u>

## Quarter Over Quarter Operating Earnings Walk





# Cash Flow and Liquidity



2013 year-to-date cash flow from operations \$243 million versus \$190 million in 2012

- Cash uses year-to-date
  - Net payments on long-term line of credit \$148 million
  - Capital expenditures \$23 million
  - Dividends paid \$61 million
  - Share repurchases \$68 million
  - Business acquired \$12 million
- Working capital
  - Increases in accounts receivable \$12 million and in inventories \$10 million, in line with volume growth

Long-term debt \$408 million; down \$148 million from year-end

- Interest expense \$18 million

Retirement benefits liability declined by \$43 million, primarily due to an increase in the discount rate, asset performance and funding contributions

- Voluntary contribution to U.S. funded pension of \$9 million in fourth quarter

Liquid Finishing dividend (post-tax) \$28 million for the year

# Acquisition of Finishing Businesses



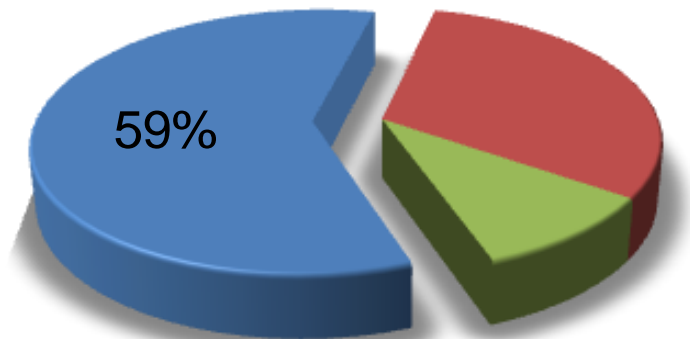
- The purchase of the finishing businesses of Illinois Tool Works Inc. was completed in April 2012 and included Powder Finishing and Liquid Finishing equipment operations, technologies and brands. Results of the Powder Finishing business have been included in the Industrial segment since the acquisition
- The Federal Trade Commission (FTC) issued a Hold Separate Order for Graco to hold the Liquid Finishing assets separate and these businesses are reflected as a cost-method investment, and its financial results have not been consolidated with those of the Company
  - Income is recognized based on dividends from current earnings of the Liquid Finishing businesses; \$28 million (post-tax) in 2013
- The FTC issued a proposed decision and order (the “Decision and Order”) in May 2012, which requires Graco to sell the Liquid Finishing business assets, no later than 180 days from the date the order becomes final. The FTC has not yet issued its final Decision and Order
- Graco has retained an investment bank to help market the Liquid Finishing businesses and identify potential buyers

# Other Discussion Items



- Capital expenditures expected to be in the range of \$25-\$30 million in 2014
  - Includes \$5 to \$8 million for initial fit-out and warehousing equipment for a leased warehouse in the Twin Cities area
  - The facility is expected to be ready mid-year. Move costs of approximately \$1-2 million are expected during the second half of the year and annual operating costs expected to be approximately \$3 million
- Non-allocated corporate expense, excluding acquisition / divestiture transaction costs, is expected to range between \$5 and \$6 million per quarter in 2014, with a decrease in pension expense offsetting an increase in share-based compensation expense
- The 2014 annualized tax rate is projected to be approximately 29-30%
  - Assumes \$28 million (post-tax) dividends in 2014 from Liquid Finishing, equivalent to 2013
  - The Federal R&D tax credit has not been extended into 2014. If approved, the 2014 annualized tax rate is expected to be approximately 28-29%
- Share repurchases have continued into 2014
- The EcoQuip Inc. and QED Environmental Systems businesses were acquired in December, with combined revenues of approximately \$30 million
  - Both are in the Industrial Segment
  - The QED Environmental Systems acquisition closed subsequent to Graco's year-end
- Total future divestiture costs for the Liquid Finishing business are expected to be approximately \$10 million, though the timing and final amount may be affected by the sales and regulatory review process

# Industrial Equipment Results



**2013 Industrial Segment Sales as % of Consolidated**



Sales (\$M)	Fourth Quarter			Year-to-Date		
	2013	2012	Change	2013	2012	Change
Americas	\$ 71	\$ 69	3 %	\$ 276	\$ 261	6 %
EMEA	55	50	8	206	184	12
Asia Pacific	46	37	25	170	158	7
<b>Total</b>	<b>\$ 172</b>	<b>\$ 156</b>	<b>10 %</b>	<b>\$ 652</b>	<b>\$ 603</b>	<b>8 %</b>
Operating Earnings	\$ 55	\$ 47	16 %	\$ 211	\$ 186	14 %
% of sales	32 %	30 %		32 %	31 %	

# Industrial Equipment Results



## Change in % of sales

2012 Operating Earnings (percentage of sales)

Translation effect

Volume, pricing, product cost and mix

Effect of 2012 purchase accounting

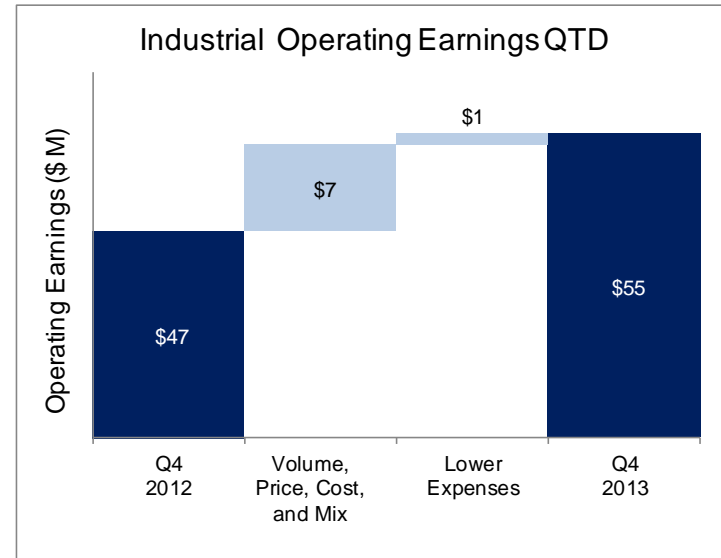
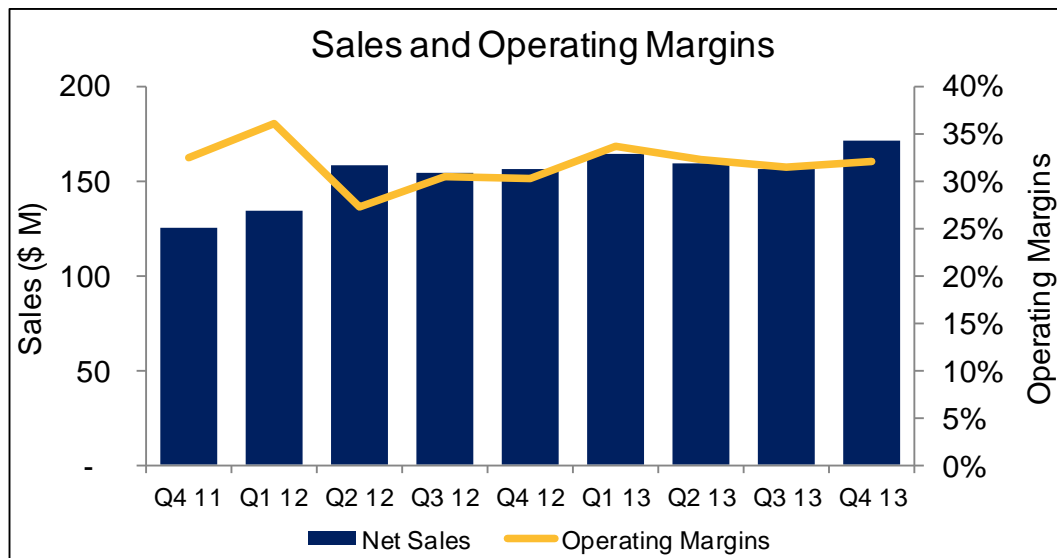
Volume effect on expense leverage

2013 Operating Earnings (percentage of sales)

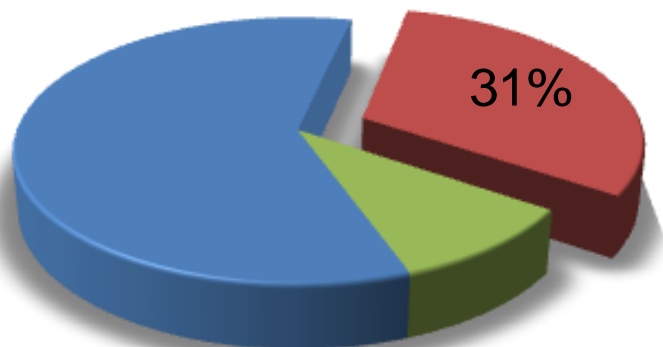
## Fourth Quarter

## Year-to-Date

30 %	31 %
—	—
(1)	—
—	1
3	—
<u>32 %</u>	<u>32 %</u>



# Contractor Equipment Results



2013 Contractor Sales as % of Consolidated



Sales (\$ M)	Fourth Quarter			Year-to-Date		
	2013	2012	Change	2013	2012	Change
Americas	\$ 48	\$ 45	8 %	\$ 237	\$ 194	22 %
EMEA	16	15	8	67	64	4
Asia Pacific	9	10	(12)	39	41	(4)
<b>Total</b>	<b>\$ 73</b>	<b>\$ 70</b>	<b>5 %</b>	<b>\$ 343</b>	<b>\$ 299</b>	<b>15 %</b>
Operating Earnings	\$ 10	\$ 11	(10)%	\$ 72	\$ 54	33 %
% of sales	13 %	16 %		21 %	18 %	

# Contractor Equipment Results



## Change in % of sales

2012 Operating Earnings (percentage of sales)

Translation effect

Volume, pricing, product cost and mix

Increased product development spending

Increased selling and marketing expenses

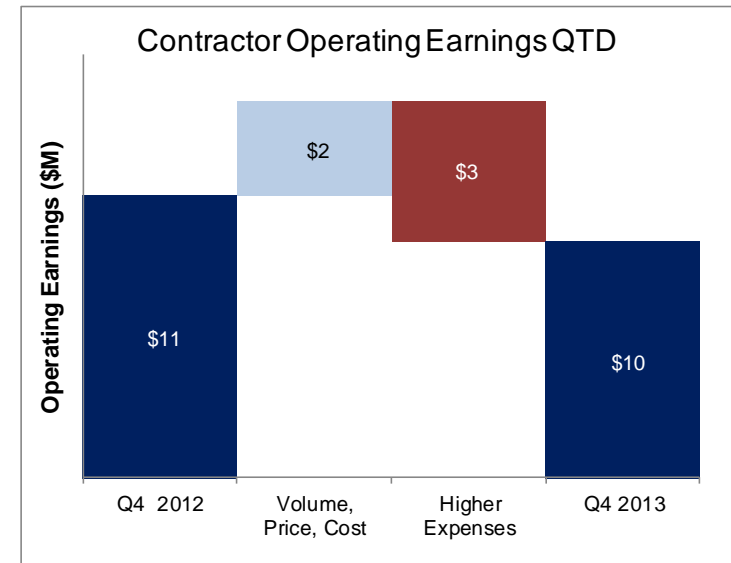
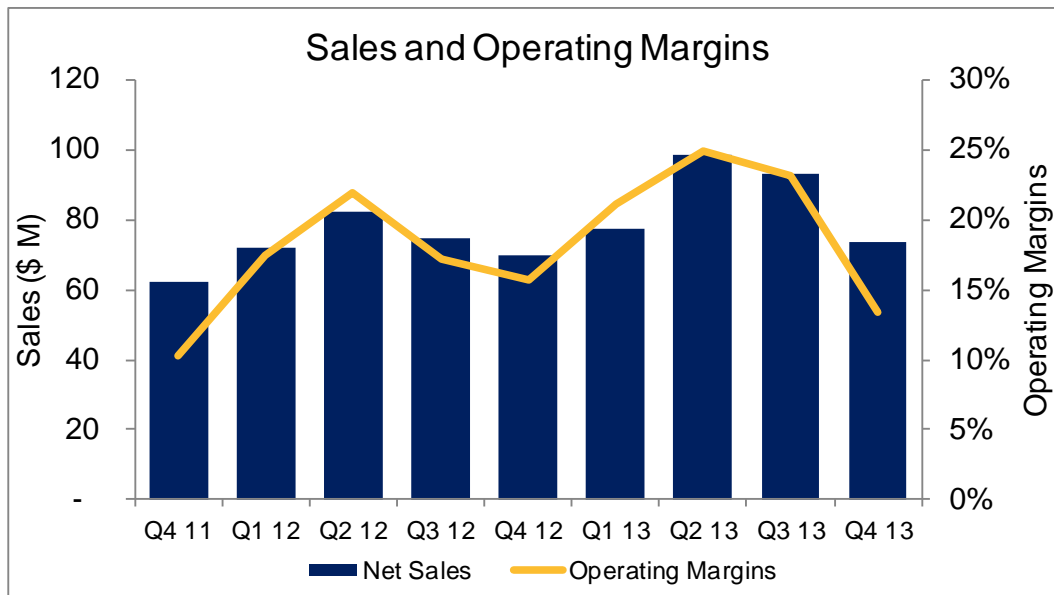
Expense/volume leverage

2013 Operating Earnings (percentage of sales)

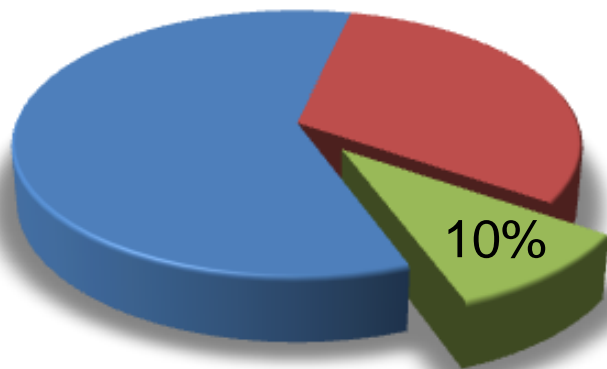
## Fourth Quarter

## Year-to-Date

16 %	18 %
—	—
—	1
(2)	—
(2)	—
1	2
<b>13 %</b>	<b>21 %</b>



# Lubrication Equipment Results



2013 Lubrication Sales as % of Consolidated



Sales (\$ M)	Fourth Quarter			Year-to-Date		
	2013	2012	Change	2013	2012	Change
Americas	\$ 21	\$ 21	—	\$ 82	\$ 81	—
EMEA	3	2	—	10	9	14 %
Asia Pacific	3	4	(19)%	17	20	(13)
<b>Total</b>	<b>\$ 27</b>	<b>\$ 27</b>	<b>(3)%</b>	<b>\$ 109</b>	<b>\$ 110</b>	<b>(1)%</b>
Operating Earnings	\$ 5	\$ 6	(6)%	\$ 23	\$ 23	—
% of sales	20 %	20 %		21 %	20 %	



# Lubrication Equipment Results



## Change in % of sales

2012 Operating Earnings (percentage of sales)

Translation effect

Pricing, product cost, mix

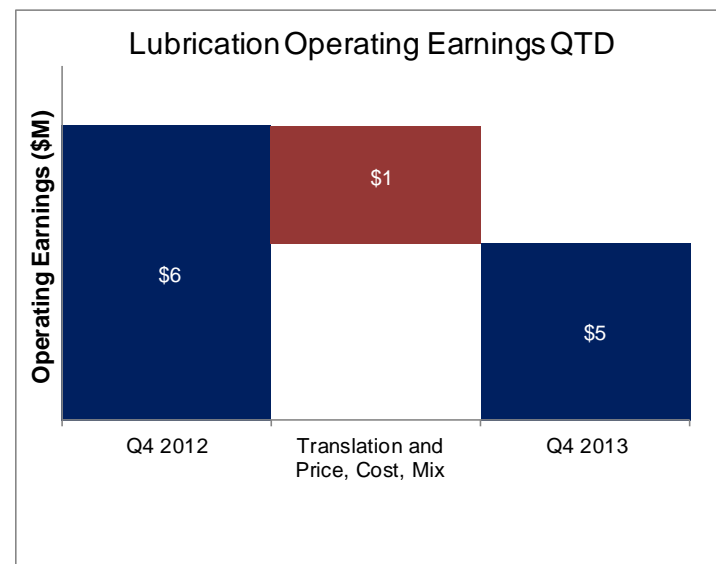
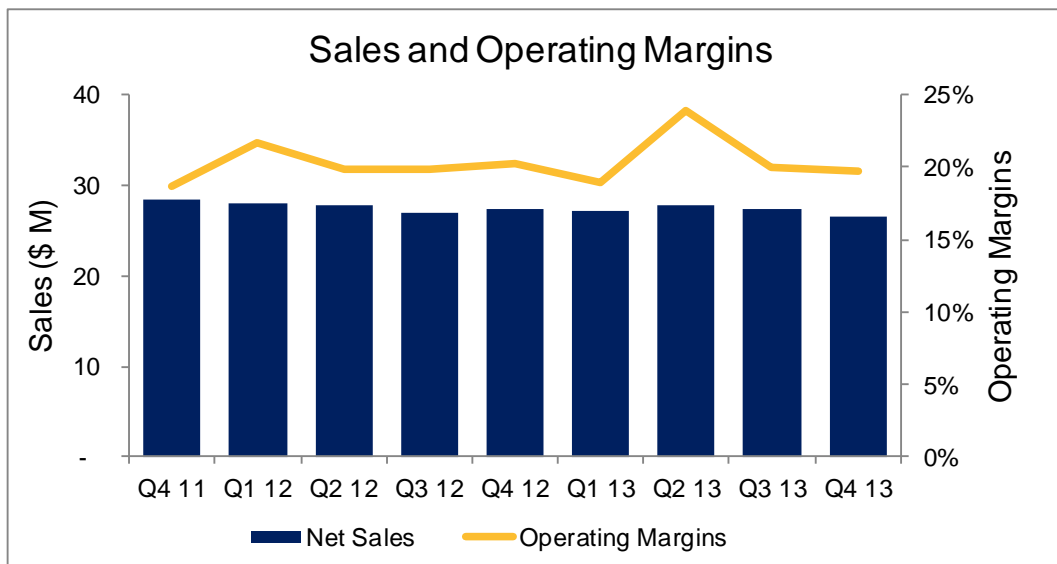
Volume effect on expense leverage

2013 Operating Earnings (percentage of sales)

## Fourth Quarter

## Year-to-Date

20 %	20 %
(1)	—
1	1
—	—
<b>20 %</b>	<b>21 %</b>



# INNOVATION IN FLUID HANDLING



move

measure

mix

control

dispense

spray

# MANUFACTURING EXCELLENCE