GRACO INC., #4502375
GRACO INC. FOURTH QUARTER 2011 EARNINGS
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Chairperson: Caroline Chambers (Mgmt.)

Operator: Good morning and welcome to the Fourth Quarter and Year-End 2011 Conference Call for Graco Inc. Please note, it is not Graco Incorporated. If you wish to access the replay for this call, you may do so by dialing 1-800-406-7325 within the United States or Canada. The dial-in number for international callers is 303-590-3030. The conference I.D. number is 4502375. The replay will be available through February 4, 2012.

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 as to 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 and Reform Act. Actual results may differ materially from those indicated as a result of various risk factors, including those identified in Item 1(a) of Exhibit 99 to the Company's 2010 Annual Report Form on 10-K, and in Item 1(a) 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 these statements in light of new information or future events.

Later on in today's presentation we will have a question and answer session, and at that time instructions will be given.

I will now hand the conference over to Caroline Chambers, Vice President and Controller. Please go ahead.

Caroline Chambers: Good morning everyone. I'm here this morning with Pat McHale, Jim Graner, and Christian Rothe. I will provide some comments on the financial highlights of our fourth quarter and Pat will follow with additional comments. Slides are available to accompany our call and can be accessed on our website. The slides include information about our consolidated financial results and each of the segments. After our opening comments, we will open up the call for your questions.

Sales for the quarter were 9% higher than the strong fourth quarter last year, which included 14 weeks as compared to 13 weeks in 2011.

Translation rates did not have a significant impact in the quarter. Sales for the year increased by 20%, or 18% at consistent translation rates, with strong growth in all the segments and regions. Although changes in currency translation rates had no effect in the fourth quarter, the full year effect increased earnings by 7 million after-tax. Additional information about effect of currency translation on sales for the segments and regions, as well as sales by currency are included on Page 5 in the slides that accompany this webcast.

Gross profit margins were 54% for the quarter, consistent with the prior year, and 56% for the year, an improvement of two percentage points from the prior year. Material cost increase in the second half of the year, largely offset by improved factory efficiencies. Operating expenses in the fourth quarter were flat compared to last year. For the year, the increase of 30 million from the prior year included additional product development spending, continued development of commercial and support capabilities in developing geographies, and increased general and administrative expenses. Operating expenses also include 8 million in 2011 related to the proposed acquisition of ITW's finishing businesses.

Interest expense was 4 million for the quarter and 9 million for the year. The effective tax rate for the quarter was 30%, compared to 26% for the quarter last year. In 2010, the effective rate for the quarter was low because the federal R&D tax credit was not renewed until the fourth quarter, and the full-year effect was included in that quarter. The lower 2011 fourth quarter rate compared to the 2011 annual rate is due to higher estimates for the domestic production deductions in R&D credits as compared to earlier in the year.

Year-to-date cash flow from operations was 162 million, compared to 101 million last year. Inventory and accounts receivable leveled off in the second half of 2011 after increases in the first half related to increased business volume. Capital expenditures were 24 million in 2011 and we also paid dividends of 51 million.

We repurchased 43 million of Company stock during the year. Cash of 300 million at year-end is held in deposit accounts and money market funds. Long-term debt is 300 million, with an additional 264 million of unused credit lines available at year-end. Our net liability for retirement benefits and deferred compensation increased to 120 million at the end of 2011, as compared to 76 million last year, primarily due to the very low discount rates at year-end.

A few other items of note – we expect to see material cost pressures continue into 2012. Even as some commodities moderate, other materials continue to see upward pressure. We have a robust plan for factory efficiencies that will be implemented during 2012. Factory production levels are expected to be in line with sales growth going forward. Although we expect costs overall to be consistent for the full year 2012, we do expect an increase of costs of 1 to 2% in the first quarter comparison.

Our annual price increase has been implemented and we expect to begin to see the impact in the first quarter with full-year expected price realization of 3%.

Expenses associated with the proposed acquisition are expected to be in the range of 4 to 6 million in the first quarter as we support the cost of litigation to gain approval for this transaction. We expect an increase of approximately 5 million in pension expense in 2012, and are considering an additional contribution of 10 to 20 million to our funded pension plan.

2012 capital expenditures are expected to be in the range of 30 million, and at this point an extension of the federal R&D tax credit has not yet been passed by Congress and we expect the annualized tax rate to be approximately 34%.

With that, I'll turn the call over to Pat.

Patrick McHale: Thank you, Caroline, and good morning everyone. As we start, I want to take a moment to thank our employees, our distributor partners and our end users for a great 2011. We achieved record sales for the year and our 2011 diluted EPS returned to the peak. Well done – I appreciate your efforts.

Before we get into the details of the quarter, I want to underscore for our investors there was one less week in the fourth quarter and full-year 2011 than there was in the same period in 2010. We called this out at the end of Q3, and I'm going to reference it several times today. You will hear in many of my comments figures that compare average weekly sales from Q4 2010 to Q4 2011. This removes the comparison issues with the additional week in 2010, and I believe is more insightful regarding our business tempo.

Even when adjusting for the extra week, there was a slowing of growth rate sequentially from the third quarter to the fourth quarter. This was not entirely surprising, given the strong double-digit figures we posted throughout 2011, as well as the headlines on the Eurozone sovereign debt crisis, the potentially slowing growth rates in China, and the ongoing overhang in worldwide construction. The fourth quarter was still strong; it's just that the growth moderated somewhat. But we posted our eighth consecutive quarter of double-digit growth in average weekly shipments, 18% year-over-year.

For the quarter, we had a few expense headwinds compared to the fourth quarter of 2010, including 2 million of acquisition-related costs, 3 million of additional interest costs on borrowings that will be used to fund the acquisition, and a tax rate that was four percentage points higher than last year. All told, these costs were a $5 million after-tax headwind on net income.

Material costs, which we were expecting to moderate in the fourth quarter, continued to put downward pressure on our margins throughout the quarter. While these costs are currently stable, we are actively working on cost reduction initiatives as part of our annual drive for zero cost change in our factories.

Now let's go through each of our divisions and regions, starting with the contractor segment. Worldwide, sales in this segment were up 1% in Q4 versus the prior year. On an average weekly sales business, the segment grew 8%. In North America, the pro paint channel was up 18% in average weekly sales for the quarter, reflecting the continued strength that we've seen in this channel throughout all of last year. This strength had been somewhat masked during the year due to the difficult 2010 costs that included the store launch of the handheld products. The fourth quarter didn't have that problem. Average weekly sales for the home center business in North America was up 14%.

In Europe, contractors struggled in the fourth quarter, with sales down 15%. While this is disappointing, the decline in the underlying business tempo is not as extreme as it appears. Europe had a later launch of the handheld product line in 2010, and the fourth quarter of 2010 included $4 million of handheld sales that were associated with store loads. When converted to average weekly sales and removing the handheld comp, the contractor segment in Europe actually grew modestly. That said, I'm generally cautious on my outlook for contractor Europe, particularly over the next couple of quarters where achieving growth over prior year will be challenging.

In Asia Pacific, contractor average weekly sales were up double digits in the fourth quarter. We've got some exciting new products that we're launching in contractor this year, including an extension of our handheld line that can apply protective coatings, innovations in our line striping category including a stand-up ride-on unit, and more products in development for a second half 2012 launch. We remain focused on converting end users from manual application methods to using spray equipment, particularly in the emerging markets, and we'll continue to invest as opportunities warrant.

While our North American contractor business will continue to be challenged by depressed new construction levels, we intend to stick to our strategies and investments. When the U.S. market tanked at the end of 2006, we made a decision not to right-size this business. Instead, we've continued to provide high levels of support to our distributor partners, innovate our product offering, and compete hard for new business. Operating margins in this segment have suffered, but we're confident that as base business volume returns, we will have good leverage. When construction markets normalize, I expect this business will return to the mid-20s operating margins and we will be a more able competitor as a result of our continued investment during the downturn.

Moving on to the industrial segment, the fourth quarter was another strong quarter for our industrial segment across all geographies and product lines. On an average weekly sales business, sales in Europe and North America grew in the mid-teens while Asia Pacific grew at 29% compared to the prior year. This was the highest quarterly revenue ever recorded in industrial for any fourth quarter in the Company's history.

From an end market perspective, we are seeing favorable growth trends with automotive, energy, mining, ag, and general industrial all generating above-trend activity levels. Operating margins were strong in this segment and we are positioned well for more growth in 2012.

Now for the lube segment. During Q4, sales continued to grow at a strong rate with solid double-digit increases in North America and Europe. On an average weekly sales basis, growth in Asia Pacific was outstanding at 71%. Operating margins continued to improve in lubrication as well. We exited the year at 19%, right on plan with our stated goal of the high teens. Looking to 2012, we expect that operating margins will expand into the low 20s. Ultimately, we believe that this business can perform in the mid-20s, although we are still a few years away from that goal.

We are seeing strong activity for vehicle services, both domestically and abroad, and we continue to gain traction in our industrial lubrication initiatives with recent wins in renewable energy applications as well as other traditional onboard lubrication systems. As you know, we've invested significantly in this business in the recent past, adding resources to grow our channels to market around the world and new product development initiatives. We made further investments into our plant in late 2011 and will continue those investments into 2012. As the equipment comes online, we will gain efficiencies in our plant, which should improve our operating margins.

We still see outstanding opportunities to grow our lubrication segment into 2012 and beyond. It's a big market and we're just scratching the surface. I am pleased with the great progress the entire LED team has made over the past two years.

Now for Europe. Q4 sales in Europe were flat to last year. Looking at it from an average weekly booking rate, however, the region grew 7% from the prior period, with growth in the mid-teens for industrial, 26% for lube, but down 9% for contractor. As stated in the contractor discussion earlier, there were $4 million of handheld sales in the fourth quarter of 2010 related to our launch of that line in Europe. Without that difficult comp, we would have posted a modest increase. That being said, there's no doubt that the overhang of the Eurozone sovereign debt crisis, as well as economic weakness in the developed countries of Western Europe is having an impact.

There are bright spots. Automotive has been strong of late with some nice wins with major European auto manufacturers. Our lubrication business is doing very well, plus renewable energy and Eastern Europe are contributing. On an average weekly sales business, Eastern Europe grew at a rate in the high teens during the fourth quarter.

Moving to Asia Pacific, our businesses in Asia Pacific all had a strong quarter, with each segment posting double-digit growth in average weekly sales, plus every segment also achieved new peak sales figures for any fourth quarter in the Company's history. The team in Asia Pacific has done a tremendous job. Since 2006, Graco's business in Asia Pacific has nearly doubled.

Before I get onto our outlook, I want to briefly discuss our litigation with the Federal Trade Commission, which is trying to block our acquisition of the finishing brands from ITW. We patently disagree with the FTC's position that this deal is anti-competitive, and we are fully prepared to lay out the facts in court. Beyond the facts of this case, which I believe support our position, I am personally disappointed to be fighting our own government on this transaction. Graco is a shining example of a U.S. manufacturing company competing successfully in a highly competitive global marketplace. While less than half of our sales are in the U.S., more than 90% of our manufacturing is here. We invest heavily in state-of-the-art technology and we provide a reliable and growing base of well-paying jobs and tax revenue. I see this transaction as consistent with the strategic goals outlined by President Obama on many occasions.

Approval of this transaction will expand our capabilities and allow us to more successfully compete against the many non-U.S. players we face here at home and around the globe. We will continue to press forward.

In terms of outlook, we are planning for growth in 2012. Certainly there are a number of headwinds that we will be facing, including continued economic uncertainty in Europe and a construction market that will remain challenging. As is always the case with Graco, we don't just take what the market gives us. Each of our segments has a plan of attack for 2012 that has us taking share, entering new market segments, increasing our presence in emerging markets, growing our distribution in both developed and emerging markets, converting end users from manual paint application methods to using spray equipment, and launching new products to keep us ahead of the competition.

While we have a strong history of executing against these strategies, we do have difficult comps from our record year in 2011. This is particularly true in the first quarter, where we had very strong results in all of our segments in 2011. Nonetheless, we are expecting growth and we're off to a good start. Incoming orders for the first four weeks of this year have been solid in all segments and geographies.

From the margin perspective, I'm expecting that we will grow margins sequentially from the fourth quarter. New pricing took effect on January 1 in both the Americas and Europe and will take effect February 1 in Asia Pacific. We have new equipment coming online that should improve factory efficiencies this year and the cost reduction projects, as I mentioned earlier. We have the right strategy and the right team. I am pleased with their performance in 2011 and I'm excited about the opportunities we have for 2012.

Operator, we're ready for questions.

Operator: Thank you. The question and answer session will begin at this time. If you do have a question, please press the star, followed by the one on your touchtone phone. To withdraw your question, please press the star, followed by the two; and if using speaker equipment, please lift the handset before making your selection. Your question will be taken in the order that it is received.

Our first question comes from the line of Charlie Brady. Please state your question.

Charlie Brady: Hey, thanks. Good morning, guys.

Patrick McHale: Morning.

James Graner: Charlie.

Charlie Brady: Hey, could we just get a little more granular on some of the growth expectations and the incoming order rate? When you talk about slowing growth, are you referring to comparing that to Q4 growth rate, or all of '11 or something else?

James Graner: Charlie, this is Jim. As Pat said, we're looking forward to a good year in 2012. The first quarter comparison will give us some difficulty, especially in the contractor area. If you can recall last year, we had an initial store load that we're estimating about $6 million with one major U.S. chain. That store load will give us a tough comp for the quarter, as well as the comments that Pat made about contactor in Europe.

With that, we're looking for a flattish revenue number to slightly positive in the first quarter worldwide, but we should see an improvement in our operating margins as the approximately 3 million in store load costs we incurred last year first quarter won't recur in 2012.

Regarding Europe, we're looking at single-digit growth, again quarter-to-quarter, first-to-first, as Europe struggles in the construction; and we're expecting very little help from Southern Europe. Northern Europe looks okay, the incoming order rate there is in the double digit; so again, we're confident at this point in forecasting growth there in Europe in the low single digits.

Given that, we're still expecting Asia Pacific and Latin America to grow in double digits, as well as our worldwide industrial and lube segments.

Charlie Brady: So just so I'm clear, are you—for industrial and lube for the year, would you expect those both to grow double digits?

James Graner: Yes, that's our current plans.

Charlie Brady: Okay. And—okay, that's fine. With regard to the acquisition expense, the 4 to 6 million in Q1, can you help us out beyond Q1 what your expectation is for expense beyond that, for the full year, maybe?

James Graner: We haven't gotten there. Currently, our expectation is that the litigation will start and complete in the first quarter, and in that range that Caroline threw out of 4 to 6 million that expects the start and completion in the first quarter. And of course, if we win, we should start to execute on the acquisition.

Charlie Brady: Okay, one more and then I'll hop back into the queue, here. On your commentary on material cost headwinds, can you give us a sense just on that piece of it how much of a headwind to margin that was in the quarter?

James Graner: It's less than one full percentage point. What we did see—I think we called out in the third quarter that we did expect a moderation in the cost of metals. We did see that. We had some surprises, though, on some other material costs that offset the reduction in the metal kind of area. But in total, it was less than one full percentage point – closer to three-quarters of one percent.

Charlie Brady: Great, thank you.

Operator: Thank you. And our next question comes from the line of Kevin Maczka with BB&T Capital Markets. Please go ahead.

Kevin Maczka: Good morning.

James Graner: Hey Kevin.

Patrick McHale: Morning.

Kevin Maczka: Pat, you're back to record revenue now. You're increasing capex a bit in 2012. Can you just talk about utilization by segment? Are you capacity constrained anywhere, and where do you need to spend the money to expand that capacity?

Patrick McHale: Well, we have two major processes that we do internal to our factories, and one is machining where we take the raw material – the bar stock and the castings – and we turn that into precision parts, and then the other is our assembly area. From a machining standpoint, generally we're fairly well utilized on our machining equipment. It's hard to justify new equipment unless you've got a fair amount of load to put on it, so I would say that going forward in 2012, we're in, I would say, sort of a fairly normal position from the machine utilization; and as we grow, we'll continue to add machines like we do every year.

From an assembly and from brick and mortar standpoint, the evaluation gets a little bit more complex. We can take a lot of growth in our existing product line within the assembly lines and the space that we have. As we get new products that launch that have to have their own assembly lines is where we start to push the boundaries a bit on brick and mortar. I'd say our factories are pretty full right now, in the $30 million number. We do not—in that $30 million, there's not an expectation that we'll do a brick and mortar project.

Kevin Maczka: Okay. Incremental margins – I wanted to ask a question there. You broke that out nicely, 44%, even higher if we back out the ITW acquisition. Generally, should we be expecting something similar next year, and can we just talk about this pension expense a little bit more because that looks like that will be quite a drag potentially.

James Graner: Yes, there's no reason, Kevin, that we shouldn't achieve the 44% incremental margin if we get the kind of growth rates we talked about a few minutes ago. The pension cost, you know, is an incremental 5 million, so if you compare that to a 900 million revenue number, it's less than 1% of sales, so it's an impact. You know, I think all corporations are feeling the pain of the ever-decreasing long-term interest rates and the lower discount rate that Caroline talked about. So we're fully allocated to equities. We're at about 80% of our assets in equities, so we're fully leveraged to what I expect to be a more positive equity market in 2012. And if that happens, that will diminish the need to put more funds into the plan.

Kevin Maczka: Right, Jim. The 5 million is relatively minor, but in your slide it may be as much as 25 million. I guess what would be the bell there? What would trigger that?

James Graner: Caroline, would you—

Caroline Chambers: Yes, sure. The 5 million is what we expect to see running through the P&L. What we might see is the needs, as Jim referenced, to contribute some additional cash into the plan. Part of that will really depend on what we see for asset growth during the coming year, so there's a difference between the cash contribution expectations, the possible expectation there, as compared to what will run through the P&L.

Kevin Maczka: Okay, got it. Two more quick ones from me – are you ramping product developing spending again in 2012, and was that 3% price increase across the board?

Patrick McHale: On the product development side, we may do a little bit, but it's not going to be a dramatic step function increase. In terms of pricing, you know, we do our pricing by product line and by region and by category, so that's an aggregate number of all the different areas.

Kevin Maczka: Got it. Okay, thank you.

Operator: Thank you. And our next question comes from the line of John Franzreb with Sidoti & Company. Please state your question.

John Franzreb: Good morning, guys.

Patrick McHale: Morning.

John Franzreb: Could you talk a little bit about the roadmap to growth in Europe? It sounds like you're allowing for some slowing growth in contractor Europe, with growth coming out of lube and industrial. Is that the case, and is there more needed for you to have year-over-year growth in that business over there?

Patrick McHale: Well, of course there's been a lot of uncertainty in the headlines since kind of the summertime period, but what we're trying to communicate really is that through the fourth quarter and even off to the beginning of this year, we continue to see pretty good demand on the industrial and lube side of the business, and where we're having the most impact is on contractor. Certainly even within industrial, there are areas that stronger and weaker, and I think Jim pointed those out to you where the north is doing better and the south is not doing very well, but for Graco, it's EMEA, so it includes eastern Europe, Russia, the Middle East and parts of Africa. And so we believe that despite the fact that there is going to be challenges in our contractor business in '12, that there are ample opportunities for us to continue to grow other segments of our business within that reporting region.

John Franzreb: Great. That was helpful. And the margin profile, it's improving incredibly in the lube business and you've kind of laid out a formula that will go to the low 20s next year and mid-20s sometime thereafter. You've talked about investments. Can you provide a little color as to what kind of investments we're talking about here? Is there some sort of end markets that are outperforming others, or some sort of process improvements that are more important to get you that kind of margin profile? A little color would be helpful.

Patrick McHale: So you know we were there back before we did all the acquisitions and moved all the factories, so we do have a history. We also have a view that the businesses that we acquired, the underlying nature of those businesses is not less attractive from a margin standpoint than the historical business that we had. It's been a challenge for that group; shutting down three factories associated with the acquisitions and moving the Minneapolis business all into a new factory and then trying to get those product lines reengineered to, I'll say, Graco's standards and get some product differentiation. So we've been confident during this, I guess what you'd call swoon in our lubrication operating margins that we were going to return to our kind of historical place in the mid-20s, and for the last couple of years they've really been doing that on schedule.

The opportunity in lube for Graco isn't necessarily just a particular end market. The way I really view is that we're going to make investments in our distribution channel and our sales coverage outside the U.S. where we have small share and there's a lot going on, and in the U.S. is where our major project development is – not all of it, we have some in China, but in U.S. is the big chunk of it – and we're going to continue to invest in making sure our product is differentiated.

From an operating margin standpoint, the factory is still not performing up to what we believe it can do. They justified a lot of new capital. They showed up beginning in the second half and particularly in the fourth quarter of 2011, and so we think we've got some nice improvements that we're going to have flowing through that factory in 2012 that will also contribute to the operating earnings. So we expect to see leverage on the top line, and we expect to see better factory performance and investments related to people, channel and new product.

John Franzreb: Perfect. And lastly, should the IT deal go against you, have you guys thought about or articulated a Plan B for us to think about out there?

James Graner: We have not articulated anything else other than that at this time, John. We're still focused on this transaction, and all our efforts are on completing this transaction.

Patrick McHale: I'd also remind everybody that we made the decision to put the long-term debt in place of the 300 million before we actually had the ITW deal, and we believe from a strategy standpoint that interest rates were historically low and locking in some long-term debt at those low rates would be beneficial to our shareholders. And so we're confident that outside of the ITW acquisition, we've got enough opportunities to invest and to grow that we can put that money to good use.

John Franzreb: Okay, thanks Pat and Jim.

Operator: Thank you. And our next question comes from the line of Matt Summerville with Keybanc. Please state your question.

Matt Summerville: Good morning, a couple questions. First, are you able to provide an update as to the performance of the ITW finishing businesses, given that those guys are out reporting today as well, versus kind of the expectations that you had laid out for those businesses back in March or April, whenever this transaction was originally announced? Are there any updates you can provide us to those numbers?

James Graner: Yes, Matt, I don't want to get back into specifics, but I would say that their business is performing like our industrial business and they're close to their peak that they had that we announced back at the time.

Matt Summerville: Okay. And then with regards to the handheld products in contractor, you've added around that product line a little bit already with fine finishing. Now you're moving more into—I think you indicated other types of materials that you're looking to put through those devices. How big is that handheld business for Graco now, and I guess what can these new products add incrementally to that platform?

James Graner: So, you know, it's been a little volatile with the store load, so it's about—this year we ended about 20 million, down from the 28 million we had last year. We do have some products scheduled to launch in 2012, but at the present we're still thinking in the 20 million range on an annual basis, down from where we were a couple years ago, which at that time we were forecasting much higher volumes than we are today.

Matt Summerville: And then with regards to corporate expense, and bearing in mind pensions, what sort of numbers should we be using for 2012? And just for the purposes of this discussion, let's exclude the transaction costs which, I mean, you really can't predict beyond the first quarter anyway, so let's exclude that. What should the ongoing rate of Graco's corporate expense look like, Jim?

James Graner: I would expect that pension expense would grow by the 5 million referenced earlier, and if you exclude the ITW numbers, it should stay fairly consistent – 2011 plus the 5 million in 2012.

Matt Summerville: So that pension does hit the corporate expense line?

James Graner: Correct.

Matt Summerville: Okay. And then with regards to the fourth quarter, if you back out the ITW transaction costs, it looks like your corporate expense run rate, it'd come down a bit. Was there some adjustment there, or is that kind of the right run rate to think about?

James Graner: The only thing that we didn't do in the fourth quarter, Matt, was make a contribution to the Graco Foundation. So the full year, the Foundation contribution was 3 million, all of which was made in the first three quarters. Other than that, there was nothing significant in the fourth quarter.

Matt Summerville: Got it. Thank you.

Operator: Thank you. And our next question comes from the line of Terry Darling with Goldman Sachs. Please state your question.

Terry Darling: Thanks. Good morning everybody.

Patrick McHale: Good morning, Terry.

Terry Darling: You know, I guess a couple follow-ups on a number of items. First, on a—maybe a finer point on first quarter organic growth. You know, Pat, given your comment about solid double-digit weekly orders here through the first four weeks, and if you go back and adjust for the weeks issue in the fourth quarter and then sprinkle in Jim's more precise commentary on contractor, does organic for the entire company get into the low double digits for the first quarter? Is that the translation?

Patrick McHale: So I'll make a couple comments for you, Terry. First of all, I didn't give any specific order run rates for the first four weeks of the year. My comments were that we had double digit run rate through the fourth quarter, and I said the first four weeks of the year we were off to a good start. I really don't want to get into trying to make fine estimates in terms of what our organic growth rate is going to be in the first quarter, primarily because, as you know, we have a short cycle business and it's pretty spread geographically.

Terry Darling: Thank you. Can we perhaps, though, put maybe a finer point on the full-year commentary of double digit organic for the company? You know, on the segment side, is it fair to put lube in, call it the strong double digits and industrial in the low double digits at least? Is that fair?

Patrick McHale: I think you're going to have to do your own numbers.

Terry Darling: Okay. And then maybe we'll follow up on your comments, Pat, on contractor margins getting back to the mid-20s. Revenue for this year just under 300 million, I think if you go back to the period when you last had mid-20 margins in contractor, you were just over 300 million. I guess the question is, what level of volume do you need to see in order to get back to that level, or is it a more complicated equation based on mix and those sorts of things?

Patrick McHale: Yes, let me take a stab at it and then Jim can jump in if he wants. When you take a look at the current revenue that we have in contractor by product family, it looks a lot different than it did back in 2006. It's been a really terrible environment for that division to try to grow, and yet they've been eking out some pretty consistent double digit gains. That's primarily been with new products and with new initiatives, so the underlying base business, particularly in North America, but to some extent in southern Europe, on our—I'll say our core everyday bread-and-butter product is down by tens of millions of dollars from where it was back in 2004 to 2006 timeframe.

From my standpoint, we really need to see that base business continue to rebound. Again, we did see it starting to come back in 2011 for the first time, which was nice, but we really need to get that revenue back in order to drive our profitability up. Assembly lines are sitting there; the machines are there. We know how to make the product. It tends to be our higher volume pro product—excuse me, higher margin pro product, and that's going to be really important in driving that improvement in operating margins. If we get our growth through new products or primarily get our growth through new products in the course of the next year, the I would expect that we would see operating margin leverage that is more in line with what you've seen in the last couple of years and not the snapback that I expect to get when we see the end markets get better.

From my perspective, a normal housing market in the U.S. is somewhere around 1.5 million units; and if we get back to 1.5 million housing starts, I think that the operating margins in our contractor North America business are going to start to look pretty nice again.

Jim, you can jump in if you want.

James Graner: Just—Terry, just echo Pat's comments. It does take that mix change to come into the equation. We're geared to do that. Our market position is as strong as it's ever been. We have a few new products that are being launched in the second quarter, so we see an incremental march back to the mid-20s. It won't happen in 2012, but maybe by '14, hopefully, if we see some improvement here and in Western Europe with respect to construction.

Terry Darling: Okay, and just to be clear, Pat – so if the growth is coming from new products, you have growth and profit in line with what we've seen in recent years, or margins are about where they are now?

Patrick McHale: I think we'd see incremental operating margins in line with what the incremental operating margins have been—

Terry Darling: Okay, okay.

Patrick McHale: --when it's coming from new product.

Terry Darling: Okay. And then maybe it'd be helpful for folks if we could get a little bit of a breakout within your European business. You've called out emerging market Europe. What is that as a percentage of total Europe at this point?

James Graner: Emerging markets is about one-third of what we report under the Europe heading—

Terry Darling: Okay, yes.

James Graner: --and two-thirds is what we refer to as Western Europe.

Terry Darling: Okay, and can you tell us what that emerging Europe piece grew in the fourth quarter, as we calibrate the pieces of the puzzle here?

James Graner: In the high teens.

Terry Darling: Okay. And then lastly on Asia, Pat, I wonder if you could provide a little more color there. We saw pretty good deceleration at the company level overall – still very healthy, above 20%, with a lot of that reflected in the results of a number of other companies in the China area in particular. I think most people are looking for kind of a similar slow type environment in Q1 and then a rebound; but I wonder if you might add some color from what you guys are seeing.

Patrick McHale: You've got to remember, too, when you look at our fourth quarter, we had the same 13 versus 14 issue in Asia that we had everywhere else, which would act on some more growth there. You know, in general I'm feeling pretty good about what's happening over there. There are some areas of watch-out, I guess, from an economic perspective, but we've been investing a lot. We put a nice, new training center in place in June. We've got new products launching over there. The team is getting better every month, so I think the building blocks for Graco in Asia Pacific look pretty solid and I think that as long as something dramatic doesn't happen over there, our ability to get nice growth in 2012 stays intact. You know, they have been putting up some really big numbers. It's hard to predict whether those kinds of big numbers are going to continue, but we definitely feel confident that they can do double-digit kind of numbers in '12.

Terry Darling: Okay, sorry, just trying to squeak one more in here. Jim, I think I heard the tax rate guidance, 34%. That does not include an assumption of a R&D tax credit re-up. Would you be in a similar zone in '12 versus '11 if that did come through at the end of the year?

James Graner: We would. You know, for your equations, R&D credit for Graco represents about a 3 million in tax savings; so yes, again, it depends on where you're modeling there, but it's $3 million in cash and lower tax rate.

Terry Darling: Okay, thanks very much.

Operator: Thank you. And our next question comes from the line of Mike Halloran with Robert Baird. Please state your question.

Mike Halloran: Morning, everyone.

Patrick McHale: Morning, Mike.

Mike Halloran: So just a point of clarification on Jim's more granular comments – when you were referring to kind of flattish revenue and up and a little bit better on the margin line, were you specifically referring to the contractor piece?

James Graner: Yes, only the contractor.

Mike Halloran: The contractor piece – okay. That makes sense. And then on the industrial margins, specifically, still great margins. Just wondering at the revenue level you saw third—fourth quarter versus third quarter, lower margins sequentially off of that. Is that just a function of some of the commodity costs you mentioned, maybe some incentive comp differences and things like that, or maybe just a little more granularity there?

James Graner: Yes, it's mainly—one point of that is the cost pressures in the equation, and as we talked about before, we have pricing in 2012 that should offset those cost pressures. And then the other piece is a little bit on the exchange rate.

Mike Halloran: Okay. And so when I think about margins on a sequential basis as you work through the year this year, your high water mark was the first quarter, trended down through the year. Is there anything structural about the business that that would be the case, or is it just the confluence of a lot of those one-off environmental-oriented—maybe not one-off, but environment-oriented costs that eke through through the year, that cause that trend line?

James Graner: Yes, I would say that, one, the cost pressures—you know, our pricing happened in the first quarter. Our cost pressures got a little bit more extreme as the quarters went by, and then the exchange moved against us, is really the cause in that quarter-over-quarter sequential decline.

Mike Halloran: Okay, that makes sense. I appreciate it.

Operator: Thank you. And our next question comes from the line of Liam Burke with Janney Capital Markets. Please state your question.

Liam Burke: Thank you. Pat, you talked earlier about kind of a consistent concern about the construction market in the U.S. and how if housing starts got back to the 1.5 million, you'd be having impressive operating margins. North American contractor was up 18% in the fourth quarter. Are those end markets doing any better or worse than you'd anticipated from the beginning of the year?

Patrick McHale: You know, I've quit trying to guess what the market is going to do because I was wrong for so many years, but I would say the pro paint business, in the first quarter of 2011 we really started to see some improvement in the underlying base business and the mix on some of the units that are used in larger construction projects, like our large gas sprayers and our large electric sprayers. And it had really been three or four years when those product lines hadn't done hardly anything, and so in the first quarter we saw that underlying base business get better, and that really stuck throughout the year. So the optimistic part of me wants to say, look, we saw a nice trend improvement in our pro paint business, particularly in what I would call standard bread-and-butter units throughout 2011, and potentially that bodes well for 2012. Of course, the negative part of me says I was wrong for so many years about when the recovery was going to happen, I should just shut up. So I'm not really sure, but I would say currently I feel—I'm pretty decent about what we saw in '11 and I'm thoroughly optimistic that we're going to see some sort of a continued slight improvements in construction markets quarter-over-quarter going forward.

Liam Burke: Okay. And I know you talked about it on one of the earlier questions, but your capex gaps from about 24 to 30. Are there any one-off large projects in that, or is it just capacity increases?

James Graner: It's really a combination of capacity and productivity, so—and new products.

Liam Burke: All right, thank you.

Operator: Thank you. And our next question comes from the line of Matt Summerville with Keybanc. Please state your question.

Matt Summerville: I just had a couple of follow-ups. Maybe if you guys can comment, with our without the ITW businesses, how you're thinking about share buybacks here as you start off 2012.

James Graner: Well, our long-term goal is to have no net increase in our shares outstanding, so our cash flows, as you can see, are solid. We generated 160 million last year. Our cash balances are greater than our outstanding debt, so we feel good about the position we're in and we will continue to make opportunistic share buybacks.

Matt Summerville: Hey Jim, how much of that cash is in the U.S. versus outside?

James Graner: It's all in the U.S.

Matt Summerville: Okay. And then just one follow up on the contractor business – are you guys able to give out sort of a breakdown in terms of how much of your business now is being derived from the pro paint channel versus the home center channel, without getting into individual customers?

James Graner: We'd prefer not to.

Matt Summerville: Okay. All right, that's all I had. Thanks.

Operator: Thank you. Ladies and gentlemen, if there are any additional questions, please press the star, followed by the one at this time. And our next question comes from the line of Charlie Brady with BMO Capital Markets. Please state your question.

Charlie Brady: Thanks. Hey guys, a follow-up here, and I don't mean to beat a dead horse on the revenue growth rate, but you're giving some—broad guidance as to what you expect the growth rate to be for the full year, and on the first quarter across the three business segments, not so much. And particularly given your visibility that you have in the business, I'm trying to square that up with the enthusiastic, I guess, growth rates for—you know, if we're talking double digit industrial and lube for the year, just to get a sense of what that means in Q1 and what the ramp might be through the year because second quarter is a tough comp as well.

James Graner: So just to clarify, Charlie, I'll call it the flattish call is really just contractor in Europe – contractor globally, and then Europe in the, I'll call it the low single digits. We are looking at—we are looking at in Q1 as well to have double digit growth in Asia, Latin America, North American markets outside of contractor. So it's really the contractor market in total that has a tough comp in North America in Q1. That comp will get easier in the next quarters, and then we're seeing sort of a bottoming impact in Europe, so again, we're looking further on in the year to having some rebound in the contractor market there, as well as continuing strength in the industrial and lubrication.

Charlie Brady: Okay, thanks.

Operator: Thank you. I'm showing no further audio questions at this time.

Patrick McHale: All right. Thank you everyone for attending the call this morning and have a good day.

Operator: This concludes our conference call for today. Thank you all for your participation and have a nice day. All parties may now disconnect.

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