FINAL TRANSCRIPT

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PRESENTATION

Operator

Welcome to the fourth quarter and year-end 2009 conference call for Graco, Inc. 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 303-590-3030. The conference ID is 420-0188. The replay will be available through January 31, 2010. 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 Provision 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 and Exhibit 99-2 to the Company's 2008 Annual Report on Form 10-K. This report is 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. I will now turn the conference over to Caroline Chambers, Vice President and Controller.

Caroline Chambers - *Graco - VP, Controller*

Good morning, and welcome to everyone. I'm here this morning with Pat McHale, President and CEO, and Jim Graner, our CFO. Today, I will focus mainly on our fourth quarter with a few additional comments on our full year and cash flow. Pat will follow with additional comments. PowerPoint slides are available to accompany the call and can be accessed on our website as well. Following these opening comments, we will open up the call for your questions.

Our net earnings were $17 million on sales of $146 million in the fourth quarter, including a favorable effect of currency translation of $5 million on sales and $3 million on net earnings. Sales were steady compared to the third quarter of 2009. By geography, sales in the Americas declined by 20% in the quarter as compared to the fourth quarter of 2008. Europe declined by 14%, or 21% at consistent exchange rates. Asia Pacific increased by 15% this quarter.

Gross profit margin as a percentage of sales was 53% in the fourth quarter. This was consistent with the third quarter of 2009 and an increase from 49% in the fourth quarter of 2008. The increase from 2008 was due to the favorable effects of currency translation in the 2008 fourth quarter workforce reduction cost. The favorable effects of pricing, product mix, lower material costs, and other cost reduction activities have helped offset the ongoing low production volume and increased pension costs this year.

Fourth quarter operating expenses were down 19% as compared to the fourth quarter of 2008. Product development spending was consistent with the third quarter of 2009. We also saw the effect of spending reductions including lower workforce reduction costs and lower volume-related expenses, though these were partially offset by higher pension expense. The tax rate was 24% in the quarter, due primarily to higher than expected benefit on filing of prior year tax returns.

For the full year, net earnings were $49 million on sales of $579 million, including an unfavorable currency translation effect of $10 million on sales and $4 million on net earnings. By geography, sales in the Americas declined by 28% as compared to 2008, and sales in Europe declined by 39%, or 35% at consistent exchange rates. Asia Pacific declined by 17%. Gross profit margin as a percentage of sales was 51%, down from 53% in the prior year. Lower production volumes accounted for approximately four percentage points of the reduction, and increased pension costs accounted for an additional one percentage point of the reduction. The favorable effects of pricing, product mix, lower material costs, and other cost reduction activities partially offset low production volumes and increased pension costs.

Operating expenses were down 11% for the full year. As in the quarter, this reflects spending reductions including lower workforce reduction costs and lower volume-related expenses that have been partially offset by higher pensions. The effective tax rate for the full year was 29% as compared to 32% in 2008. The effective federal business credits and the domestic production deduction was greater in 2009 as a percentage of pre-tax earnings as compared to the prior year. Additional information for each of the operating segments is also included in the PowerPoint slides that are available along with this webcast.

2009 cash flow from operations was $147 million as compared to $162 million in 2008. Primary uses of cash in 2009 included repayment of debt of $100 million, dividends of $45 million, capital expenditures of $11 million, and a contribution of $15 million into our pension plan. Throughout the year, we focused on managing working capital with a reduction of inventory of $33 million and reduction in accounts receivable of $28 million. We have adequate availability of credit. Our current long-term debt was $86 million at year-end, and available unused credit lines totaled $175 million.

Going forward, we will maintain our commitment to manage working capital. 2010 capital expenditures are planned at $15 million. Accounts receivable and inventory will vary with sales trends though maintaining service levels is a priority. No cash contributions to the funded pension plan will be required in 2010. Pension expense is expected to be approximately $4 million lower than in 2009. Volume-related items are expected to readjust going forward. For example, incentives and bonuses will add approximately $10 million in expense if performance targets are met. And we may have limited and opportunistic share repurchases during the year. With that, I will turn it over to Pat for additional comments.

Pat McHale - *Graco - CEO, Pres.*

Thanks, Caroline. Good morning. My comments on revenue will generally compare our Q4 results to run rate instead of prior year. Revenue in the fourth quarter was relatively flat compared to Q3 and Q2 which supports our view that the global economy has stabilized. Compared to Q3, increases in our industrial and lube segments were offset by the expected seasonal decline in our Americas Contractor segment. In Asia, we had double-digit increases in revenue across all segments compared to Q3. Most countries within Asia also showed signs of improvement from Q3 to Q4 with the developing countries leading the developed. Revenue in Europe was generally flat across our segments from Q3 to Q4 with Western Europe performing better than the East. In Contractor and the Americas, both Pro Paint and Home Center revenue were down double digits in the fourth quarter compared to both the prior quarter and prior year. Comparisons to the prior year for the Home Center business include the impact of additional stores added in the fourth quarter of 2008. In general, market conditions in Pro Paint and Home Center are similar, and we anticipate that residential is going to improve in 2010, but that commercial will remain difficult.

Our backlog from the end of Q3 to the end of Q4 increased by about $8 million, reflecting an overall low single-digit improvement in our incoming order run rate compared to Q3. Again, driven primarily by Asia. Return on sales for the quarter was 12%, and we were able to generate solid gross margins of 53% despite the ongoing challenge of significant unabsorbed manufacturing costs.

The impact of prior expense actions, currency translation, product cost reduction efforts, and a lower effective tax rate all contributed to our results. And again, I would refer you to the slides we have posted for our margin reconciliation details by segment. We continue to invest in our key growth strategies during the quarter. While product development spending was down compared to the fourth quarter of '08, the reduction in spend in Q4 was related to project timing and lower project spending, not to any change in our project plan. Our overall product development spend is up more than 20% compared to 2007. We made a strategic decision to ramp investment in new product development beginning in late '07 and implemented this decision during 2008. We anticipate spending for the full year 2010 will be in the $40 million range. 2010 is the first year we'll see the full benefit of spending increase we rolled in during 2008, and we'll have a nice increase in new products this year.

We also made good progress on expanding our global distribution channel during 2009 with nearly 1,400 new distribution outlets added, including approximately 350 in Europe and 200 in Asia. Commercial headcount was relatively flat in Europe and Asia in 2009 after the significant ramp-up in 2008. We do anticipate increasing selling headcount in both Europe and Asia again in 2010 as business conditions warrant.

Although the strength of the recovery is uncertain, and it's likely to be uneven. I do believe the economy has bottomed, and that we'll see gradual improvement in most of our markets through 2010. Order trends in Asia are encouraging. Europe appears to have stabilized. Inventories in our channel are low. We had many new products launching, and our global distribution channel continues to expand. Our decision to maintain our investment in long-term growth initiatives during the downturn has positioned us well to capitalize on the recovery, and our incremental operating margins will be healthy as revenue improves.

We have significantly reduced our debt, and our balance sheet and cash flow are strong. We continue to look for acquisition opportunities. As Caroline mentioned, we may also begin limited and opportunistic share repurchase activity going forward. That concludes my prepared remarks. I'll now ask the operator to open up the call to questions.

QUESTIONS AND ANSWERS

Operator

Thank you, sir. We will now begin the question-and-answer session. (Operator Instructions) Our first question is from the line of Kevin Maczka with BB&T Capital Markets. Please go ahead.

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

Good Morning.

Pat McHale - *Graco - CEO, Pres.*

Good morning, Kevin.

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

Pat, I guess my first question on these volume-related items that you expect to come back into the cost structure in 2010. You call out the $10 million item for incentives and bonuses. It was mentioned that that is tied to certain performance metrics or goals. Can you give a little more color on what those goals are? And what some of the timing is you would expect those costs to start to come back into the year? Are those heavily back-end loaded?

Pat McHale - *Graco - CEO, Pres.*

Those are going to depend on where we set the quarters. Which, of course, we're not going to share publicly. But as we perform throughout the year, we take accruals as appropriate. I would expect that those costs will match up pretty well with what's happening on our revenue side.

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

Okay. So you call out the $10 million in incentive comp.

Pat McHale - *Graco - CEO, Pres.*

That's sort of an on-plan -- if you assume that we set our performance targets, and we achieve them. That's sort of an on-plan number. Incremental number compared to our actual payout here in 2009 which is pretty low.

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

Yes. So as I look at 2010, and what's incremental relative to 2009, you call out a $4 million item for pension, a $10 million item for incentive. Are there any other items like that, that you can quantify for us?

Pat McHale - *Graco - CEO, Pres.*

Well, distributor rebates could have some influence there. And that really depends on individual account by account performance for those accounts where we do have some sort of rebate programs in place. Again, I don't expect that to be a huge number. And if we would have thought so, we would have called it out.

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

Okay. In terms of additional cost side actions, are there other things that are still ongoing that have not been completed yet? Or things that are completed now that you will get the full run rate in 2010?

Jim Graner - *Graco - CFO*

Kevin, this is Jim Graner. Most of our actions were completed mid-year. So the run rates that you're seeing on operating expenses, with the exception of the items that we've called out, should be fairly true to 2010. Again, with the exception as we're trying to highlight here, if volumes improve, incentives will return. If volumes improve, rebates will return. So the two things that we've called out -- the only thing we know so far is the favorable $4 million on pensions. The rest of it is predicated on volume increases off of 2009.

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

Okay. Got it. Thanks, Jim. Then finally on these product development costs. Pat, I think we've talked about some timing issues, not any kind of change in your plan for the last two quarters. Based on that, should we see a pretty big step-up in the first half of the year in those costs?

Pat McHale - *Graco - CEO, Pres.*

You know what, I don't think so. There could be some spillover from Q4 into Q1, but I don't think you are going to see anything that's going to raise your eyebrow too much. I think that $40 million range could be plus or minus $3 million, I suppose, as we go through the year. But I don't anticipate a big spike here in Q1.

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

Okay, thank you.

Operator

Thank you. Our next question is from the line of Charlie Brady with BMO Capital Markets. Please go ahead.

Charlie Brady - *BMO Capital Markets - Analyst*

Thanks. Good morning. With respect to the Contractor segment and your comments on your outlook -- resi versus commercial construction. Can you remind us, at least roughly, what the breakdown for that segment is on residential versus commercial construction? I know that's hard to do, but you must have some rough idea.

Pat McHale - *Graco - CEO, Pres.*

It is very difficult. Because when we sell our sprayer to a distributor, who sells them to a painter, who can use it for whatever job he happens to have in front of him. So we don't really get any feedback on that front. We really consider three big buckets to be important. New residential, new commercial, then the whole remodel-repaint market. And, of course, all three of those have been under a fair amount of pressure. We do think that res has probably bottomed, and we'll see some slight improvements this year. I think commercial has not. Those are three important buckets, but I can't give you a good split on that.

Charlie Brady - *BMO Capital Markets - Analyst*

Okay. With respect to the Lubrication segment, you're in the black here in Q4. Is that business at a level going into -- on a quarterly basis through 2010 that it would remain in the black?

Pat McHale - *Graco - CEO, Pres.*

Yes, I anticipate that at current volumes, it's going to be a challenge. But that we've got a reasonable chance to remain in the black there.

Charlie Brady - *BMO Capital Markets - Analyst*

Okay. One more, and I'll get back in the queue. Can you just give us the FX impact on the sales by the individual segments?

Jim Graner - *Graco - CFO*

Sure. Hang on a second. You want the quarter or the year?

Charlie Brady - *BMO Capital Markets - Analyst*

Quarter, please.

Jim Graner - *Graco - CFO*

So on the Industrial segment, it's about 3%. On the Contractor -- excuse me, that was for the year. For the quarter, it was 14%. This is talking just sales. This is not a reconciliation of margin. And on the Contractor, it was pretty much nonexistent. And on Lubrication, it impacted by roughly $500,000. So again, small percentage point.

Charlie Brady - *BMO Capital Markets - Analyst*

Great. Thanks very much.

Operator

Thank you. Our next question is from the line of Mike Schneider with Robert W. Baird. Please go ahead.

Mike Schneider - *Robert W. Baird - Analyst*

Good morning, everyone. Maybe first we could start with Industrial. I was focusing on the incremental margins because that's certainly the hope as we go into 2010-2011. When you back out currency out of industrial this quarter, there was a 10% revenue increase. But I guess the incremental margins weren't at the level of 50% plus as we've seen, and as I would have expected. Is there anything unusual running through the quarter within Industrial?

Pat McHale - *Graco - CEO, Pres.*

We had a couple -- it's mostly noise, Mike. We had some inventory charge-offs running against cogs. As we started bringing people back to work here, we ended up taking machinists that had been working in the warehouse and moving them back into machining and pulling people that hadn't been working for nine or 12 months and bringing them back in. We've had some performance as we've ramped up here that's been less than what our normal run rate performance will be. And then we had had a little bit of spending in sales and marketing buckets. But again, nothing really I'd call out as being a major impact.

Mike Schneider - *Robert W. Baird - Analyst*

So are my expectations still appropriate to look for 50% plus incrementals out of Industrial as the volumes come back, or is something different?

Pat McHale - *Graco - CEO, Pres.*

I think other than the things that we've called out on the bonus and the rebate programs, that's a reasonable expectation. Our margins are going to be in the lower 50%, and we're going to get some of our unabsorbed costs back. So I think that's still reasonable.

Mike Schneider - *Robert W. Baird - Analyst*

And the items during Q4, whether it was the additional personnel or the inventory -- can you ballpark it? Was it $1 million? $3 million?

Jim Graner - *Graco - CFO*

Roughly in the $1 million category for the quarter.

Mike Schneider - *Robert W. Baird - Analyst*

Okay. And then just taking a step back, if you look at Q1 earnings in the mid $0.20 range -- I'm sorry, Q4. As we get into Q1 seasonally, it is about the same for the total Company. You are going to have the higher pension expense, the higher incentive comp, accrual, presumably. Is there any reason to expect on flat sales, why earnings wouldn't actually be down sequentially?

Jim Graner - *Graco - CFO*

First of all, Mike, I need to correct. The pension expense is a $4 million reduction. It's not an increase.

Mike Schneider - *Robert W. Baird - Analyst*

Okay.

Jim Graner - *Graco - CFO*

So that's a positive. The incentives, of course, if we're running below 2009, we won't have any incentive accruals in the quarter. So those, again, will only impact if volumes increase. But with respect to your question, I need to jump a little bit to the gross margin. We've got a headwind of 4% for unabsorbed burden.

Mike Schneider - *Robert W. Baird - Analyst*

Right.

Jim Graner - *Graco - CFO*

In the fourth quarter, our hours -- our direct labor hours increased by 10%. We brought some more people back to work in the first quarter as well. So I would expect that we will have further improvement in our absorption in the first quarter. So I would say that, to answer your question on margins, we should see an incremental, small percentage point increase in margins in the first quarter with flat volumes to the fourth quarter.

Mike Schneider - *Robert W. Baird - Analyst*

Okay, and then the tax rate now. What should we be modeling Q1 and for 2010 as well?

Jim Graner - *Graco - CFO*

As Caroline mentioned, we've got two items that are bigger as a percentage of pre-tax earnings now with our earnings dropping from where they historically have been. Those are the research and development credit, and on a dollar basis, that's roughly $2.4 million. And the other one is a domestic production deduction that last year -- 2009 -- was $2 million. Excuse me, $1.2 million. On a normalized basis, when our production is higher, it's closer to $3 million. So that deduction increases as our factory production increases. So a long way to answer your question is, I think you can take the annual rate and model a slight improvement. Again, if our pre-tax earnings are roughly the same. Slight improvement is a slightly lower tax rate.

Mike Schneider - *Robert W. Baird - Analyst*

Okay. And then you mentioned you built backlog during the quarter. Just going back through the decade, it looks like Industrial sales are generally up about 10% sequentially during Q4, and that's what they were this quarter. So that was, at least, on pace with some normal years, middle of the decade. But you built backlog. Can you just give us some insight into Industrial orders by geography as they progress through the quarter?

Jim Graner - *Graco - CFO*

Sure. We mentioned that our ramp-up in orders that we saw in first quarter and is continuing into January are coming from Asia. Asia is predominantly an Industrial market for us, so that bodes well. We also have seen -- I'll call it a slight uptick in in orders in January with respect to our European region. Again, that's predominantly Industrial. So the backlog increase coming on the Industrial side. I'll complete the thought there and share that North American orders are not up as much as the other two regions in January.

Mike Schneider - *Robert W. Baird - Analyst*

Okay. And final question on pricing. Do you still expect -- well, what have you done with pricing thus far in terms of announcements in the channel? And then do you still expect 150 basis points to 200 basis points of positive pricing in 2010?

Pat McHale - *Graco - CEO, Pres.*

Yes, we've communicated our pricing increases. Still a few negotiations here or there, but for the most part those are implemented. And I think that 1.5% realized is still a good number for you to use.

Mike Schneider - *Robert W. Baird - Analyst*

Okay, thank you.

Jim Graner - *Graco - CFO*

I would like to go back and correct a response I gave to Charlie with respect to your questions on sales and the currency impact on the segments. It is 3% in every segment and 3% in the consolidated. So, in other words, the sales decline would have been 3% larger, and it's consistent with all three segments.

Operator

Our next question is from the line of Ned Borland with Next Generation Equity Research. Please go ahead.

Ned Borland - *Next Generation Equity Research - Analyst*

Good morning. Couple questions here. Other than seasonality in Contractor, were there any cost items sequentially that may have depressed the margin from 3Q to 4Q?

Jim Graner - *Graco - CFO*

Not other than in our response to Mike with respect to a little bit of noise in the Industrial segment, in that $1 million range. Again, the start-up of the people and moving people back in their jobs and a little bit of noise on the surplus and obsolete inventory.

Ned Borland - *Next Generation Equity Research - Analyst*

Okay. And then on raw materials, is there anything outside of price that you are doing to manage your exposure to raw materials as most of these commodities have increased?

Pat McHale - *Graco - CEO, Pres.*

We've got ongoing cost reduction programs at Graco, both in the factories and in our design engineering groups. We pretty much do that during good times and bad. So I would say that your expectation there would be that we would continue to do those kinds of things. We have have seen a run-up in some of the key commodities, especially since the early part of December. But with the exception of some of our materials that are tied to an index, a lot of what we buy has been converted by somebody else into another product. And so there's lots of negotiations that have to happen before we actually see those kinds of increases.

Ned Borland - *Next Generation Equity Research - Analyst*

Okay. And then finally, anything on the acquisition front? Are you still looking at that as a source -- a use of cash perhaps in 2010 outside of share repurchase?

Pat McHale - *Graco - CEO, Pres.*

We are, and we were as active or more active in terms of resources looking for M&A opportunities over the course of the last year. And we just weren't able to land any. Partly I think it's the market out there is dead. And partly, it's the typical deals that we're going to target are going to be businesses that are going to be privately held. Most of the attractive segments that we like that are owned by public companies, they want to keep them. So we're going to be look at $30 million to $50 million private companies. It just has not been a good environment for us to put any deals together. But we're as interested, and we're working as hard on it as we have in the past.

Ned Borland - *Next Generation Equity Research - Analyst*

Okay. Thank you.

Operator

Our next question is from the line of John Franzreb with Sidoti & Company. Please go ahead.

John Franzreb - *Sidoti & Company - Analyst*

Good morning. When we go to product development, can you give us a sense of how much of incremental revenue you expect from your 2008 actions, given that you've already invested roughly $14 million over the past two years? Or if not that, maybe which segment might be the biggest beneficiary in the timing of that benefit this year?

Pat McHale - *Graco - CEO, Pres.*

Well, we don't break out our estimates by product. Typically, you take a look at what we stated as an objective as an organization. That's to grow the top line 10% plus with two thirds of that being organic. And both new product development and channel expansion are the key drivers behind that. Our new product investment -- there's a substantial portion of that spend that we put back into maintaining our technology leadership and our quality leadership on our existing product, which of course, is driving our strong growth margins and our channel expansion. So it's not all incremental dollars that we put back in there. You can think of it over the long cycle as it being a 3% annual growth kind of a number.

John Franzreb - *Sidoti & Company - Analyst*

So Pat, there's not going to be any meaningful step-up this year from that early spend?

Pat McHale - *Graco - CEO, Pres.*

I think some of that is going to depend on what the market conditions are. Certainly in our Contractor business, we had a pretty good history of having new products that grabbed the market and generated some pretty nice growth numbers for us. Since the market downturn, the distribution channel has been less interested in the big spring product launches than they have been in the past so we have had had more trouble getting traction on the Contractor side. As that changes, we ought to see the opportunity for some more traction. Whether that's going to be this spring or not, I'm not sure at this point.

John Franzreb - *Sidoti & Company - Analyst*

Okay. And regarding your CapEx, $15 million. How does that compare to your maintenance level? It seems like it continues to be depressed versus some of your historical spend.

Jim Graner - *Graco - CFO*

That's correct. It's at least 50% lower than our replacement costs, and it consists really of -- for 2010, new product tooling and a few things where we can get opportunistic kinds of returns in production savings. Our bricks and mortar and for the most part our plant equipment is operated at about 60% of capacity. So at this time, we really have no need to get back to a higher level.

John Franzreb - *Sidoti & Company - Analyst*

And one last question. Can you talk a little bit about what you're hearing from your customer base, particularly in your Industrial jobber base? Looking at how weak the North American number was on the Industrial side, I just wondered what kind of feedback you're getting from them?

Pat McHale - *Graco - CEO, Pres.*

It's anecdotal. We've got thousands of industrial distributors around the world. But what we are seeing is -- we are seeing that our distributors are positioned from an inventory perspective that they are going to be buying from us pretty much anything that they sell through. And that the North America market, and in fact, significant chunks of the European market are still pretty soft. I think it's not dissimilar to the conversation we just had where Graco's CapEx spending is going to be down in the neighborhood of 50% for 2010. A lot of what we sell into factories is CapEx. So we need to see production volumes continue to improve in North America and Europe, and for customers to start loosening their CapEx wallet a little bit. We think we're seeing some signs of that, but it's probably going to be a little bit of a slow go here for a few quarters.

John Franzreb - *Sidoti & Company - Analyst*

Great, thanks a lot, Pat.

Operator

Our next question is from the line of Chris Glynn with Oppenheimer & Company. Please go ahead.

Chris Glynn - *Oppenheimer & Company - Analyst*

Thanks. Just a couple on Contractor to start. I know you have difficulty on the split between residential and commercial, but maybe you have a view own the mix of repaint-remodel?

Pat McHale - *Graco - CEO, Pres.*

No, I mean really it's the same issue. When we sell a sprayer, we don't know where it ends up. Of course, there were enough sprayers out in the marketplace in 2005 and 2006 to paint over two million homes. And then market started to contract pretty rapidly, and so where did all those sprayers go? Did they get eaten up by commercial guys that are buying them on the used market? It's extremely difficult for us to figure out where those sprayers go once we sell them, so I think it would be bad for us to start making guesses on that for you.

Chris Glynn - *Oppenheimer & Company - Analyst*

Okay, and then do you think that there's a difficult comparison issue on the middle quarters on '09 channel fill dynamics with the retail buildout?

Pat McHale - *Graco - CEO, Pres.*

There is a little bit in Q1. You are talking about Contractor in the Americas?

Chris Glynn - *Oppenheimer & Company - Analyst*

Yes.

Pat McHale - *Graco - CEO, Pres.*

For sure in Q1 of last year, we had added some stores, and I think some of those shipments spilled over into Q2. I don't see those as being insurmountable at this point.

Chris Glynn - *Oppenheimer & Company - Analyst*

Okay. And just last one then. Just a little record checking. Did you say 1,400 new distribution outlets added during '09?

Pat McHale - *Graco - CEO, Pres.*

That's correct.

Chris Glynn - *Oppenheimer & Company - Analyst*

Great, thanks a lot.

Pat McHale - *Graco - CEO, Pres.*

Yes.

Operator

Thank you. (Operator Instructions) And our next question is from the line of Matt Summerville with KeyBanc. Please go ahead.

Matt Summerville - *KeyBanc - Analyst*

The increase in distribution outlets that you mentioned at 1,400. How much in aggregate increase is that for Graco in percentage terms on a year-over-year basis?

Pat McHale - *Graco - CEO, Pres.*

We have in the neighborhood of 30,000, but all distribution outlets aren't created equal. And certainly, we like to see the ones that we're adding in Europe and Asia. Although their contribution to our revenue in the first year or two may be small, those are the seeds that we plant that are going to help us grow the business substantially as we go down the road. So it's been a consistent strategy at Graco for some period of time. We continue to find lots of opportunities, especially internationally, to either specialize our distribution or go into new markets. I think that you shouldn't start doing the math and start trying to figure out how the 1,400 outlets are going to drive revenue as much as it's an indication of the ability for us to continue to expand into markets that have good long-term potential for us.

Matt Summerville - *KeyBanc - Analyst*

With regards to the buildout and shelf space you've had in the home center and professional paint channels here in the US, are you essentially completed with that, or are there additional store sets that's will take place in 2010? How should we think about that?

Pat McHale - *Graco - CEO, Pres.*

In terms of any deals that we've got signed that we can talk about, you've seen it all. In terms of, do we have our product in every possible outlet? We don't. So it's an ongoing challenge for our group up there to try to get the product seated into more outlets. We've made progress the last couple years, and hopefully, we'll make more progress in 2010.

Matt Summerville - *KeyBanc - Analyst*

Two other quick questions. Is there any detail you can provide, Pat, just from what your guys or your customers are saying out in the field with regards to specific end-market trends across the three main geographies you serve. If there's anything to highlight? Maybe you have seen improvement, or maybe getting worse in that regard? And then, just how your mix of business is trending right now from -- with regards to new equipment sales versus after-market revenue?

Pat McHale - *Graco - CEO, Pres.*

We just went through a round of operating reviews with the divisions here within the last couple weeks. Where we have the data broken out, the trend of having part sales be down a lot less than the equipment sales continues. So, I think that that trend is likely to continue here at least for the first couple quarters of 2010. What we saw at the beginning of last year was -- we saw kind of everything was drying up pretty quickly, and distributors were reducing their stock. Of course, our distributors tend to carry stock of spare parts. So as the mix shifts back here in the second half of the year and going into next year where they start to replenish what they sell, that should be helpful to us. In terms of your comments on end-markets, really in North America and Europe, I would say there's not any dramatic change that we're seeing. Automotive in Europe and North America continues to be soft, although we're seeing continued investments in Asia Pacific. Although the overall market dynamics in wind and solar have cooled a bit. From an investment standpoint, we're still quoting a fair amount of projects in those spaces. Aerospace is still hanging in there okay. It's not great. Pharma is hanging in there okay. Not great. I would say it's -- we're looking to see a turn in Europe and North America in our end-market. We really haven't seen it yet.

Matt Summerville - *KeyBanc - Analyst*

Thanks, Pat.

Operator

Thank you. Our next question is from the line of Mark Zepf with Goldman Sachs.

Mark Zepf - *Goldman Sachs - Analyst*

Thank you. Good morning. I want to ask a quick follow-up on the January order trends. Is North America up sequentially in January thus far?

Jim Graner - *Graco - CFO*

Again, we've only got a few weeks here in January, and my comments earlier were with respect to the previous year. I'd prefer not to comment on it sequentially.

Mark Zepf - *Goldman Sachs - Analyst*

Okay. Is there any end-market color you can give just to -- in back of the January commentary that you did provide?

Jim Graner - *Graco - CFO*

Well, again, the majority of that is a geographic commentary. Economic conditions seem to be very positive in the developing countries in Asia. And Western Europe, for a few weeks, anyway, seems to be behaving better than the Americas. In the Americas, we're strong in Latin America and only modest kinds of growth numbers in North America.

Mark Zepf - *Goldman Sachs - Analyst*

Then on the capital allocation side, is the balance sheet currently at a level where you would be comfortable doing a deal in the first half of the year? Or would you like to bring the leverage ratios down for a couple more quarters before being more aggressive?

Jim Graner - *Graco - CFO*

We're currently comfortable doing a deal.

Mark Zepf - *Goldman Sachs - Analyst*

Okay. And is M&A a higher priority than the limited and opportunistic share repurchase? Or are they 1 and 1A?

Jim Graner - *Graco - CFO*

For sure M&A is a higher priority.

Mark Zepf - *Goldman Sachs - Analyst*

Thank you.

Operator

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

Pat McHale - *Graco - CEO, Pres.*

All right. Thanks for joining us this morning. And have a good day.

Operator

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