



# **2<sup>nd</sup> Quarter 2014 Earnings Conference Call**

*July 24, 2014*

# 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 1 p.m. CT, July 24, 2014. The replay by telephone will be available through July 28, 2014

- 888-203-1112 – Conference ID #1832522
- 719-457-0820 – Conference ID #1832522, for International participants

# Financial Results



\$ millions except EPS	Second Quarter			Year-to-Date		
	2014	2013	Change	2014	2013	Change
Sales	\$ 322.5	\$ 286.0	13 %	\$ 612.5	\$ 555.1	10 %
Gross Profit	176.9	158.7	11 %	336.2	309.4	9 %
% of Sales	54.8 %	55.5 %	(0.7) pts	54.9 %	55.7 %	(0.8) pts
Operating Earnings	85.8	75.2	14 %	160.6	146.7	9 %
% of Sales	26.6 %	26.3 %	0.3 pts	26.2 %	26.4 %	(0.2) pts
Net Earnings	\$ 66.2	\$ 57.8	15 %	\$ 117.0	\$ 110.0	6 %
% of Sales	20.5 %	20.2 %	0.3 pts	19.1 %	19.8 %	(0.7) pts
Diluted Earnings Per Share	\$ 1.07	\$ 0.92	16 %	\$ 1.88	\$ 1.76	7 %
<i>Diluted Shares in Millions</i>	62.0	62.8		62.2	62.6	

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

Dividends	\$ 11	\$ 11	\$ 15	\$ 15
EPS Impact	\$ 0.18	\$ 0.18	\$ 0.24	\$ 0.24

Dividend income will cease when investment is sold

# Financial Results



## Components of Net Sales Change

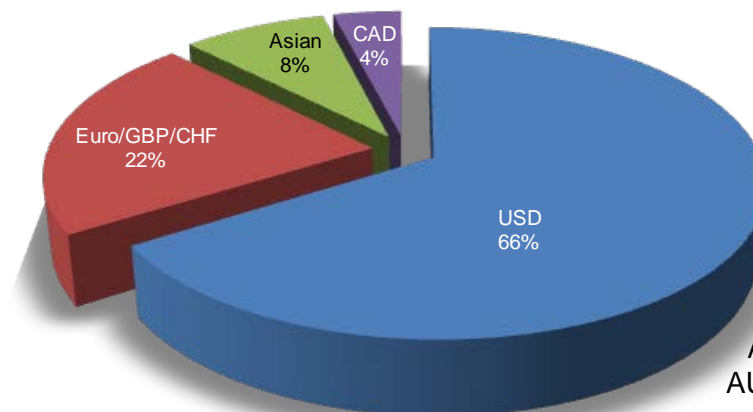
Second Quarter 2014

	Segment			Region			Consolidated
	Industrial	Contractor	Lubrication	Americas	EMEA	Asia Pacific	
Volume and Price	6 %	12 %	7 %	10 %	7 %	4 %	8 %
Acquisitions	6 %	—	—	6 %	1 %	2 %	4 %
Currency	2 %	1 %	—	(1)%	4 %	1 %	1 %
<b>Total</b>	<b>14 %</b>	<b>13 %</b>	<b>7 %</b>	<b>15 %</b>	<b>12 %</b>	<b>7 %</b>	<b>13 %</b>

Year-to-Date June 2014

	Segment			Region			Consolidated
	Industrial	Contractor	Lubrication	Americas	EMEA	Asia Pacific	
Volume and Price	5 %	11 %	7 %	11 %	5 %	(2)%	7 %
Acquisitions	5 %	—	—	5 %	1 %	1 %	3 %
Currency	1 %	—	(1)%	(1)%	4 %	—	—
<b>Total</b>	<b>11 %</b>	<b>11 %</b>	<b>6 %</b>	<b>15 %</b>	<b>10 %</b>	<b>(1)%</b>	<b>10 %</b>

Sales by Currency YTD June 2014

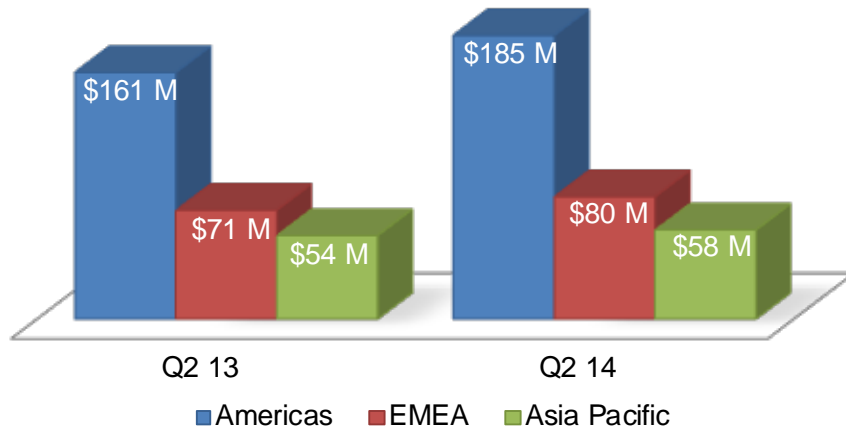


Asian currencies include:  
AUD, CNY/RMB, KRW, JPY

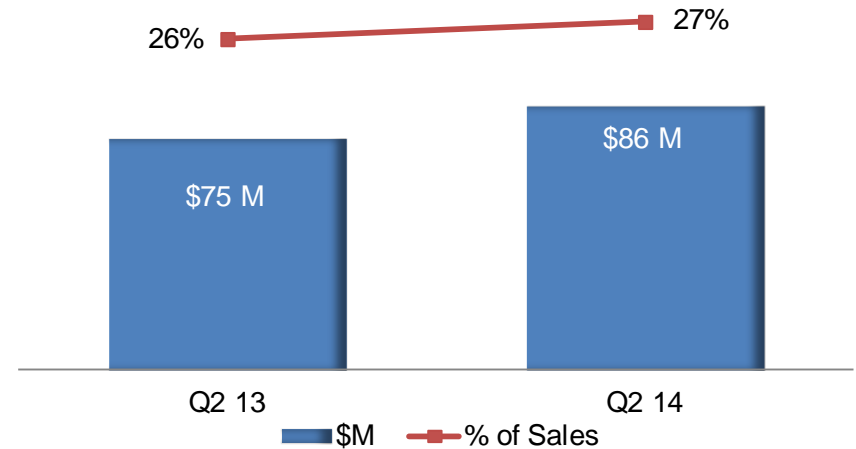
# Second Quarter 2014 Results



## Sales



## Operating Earnings

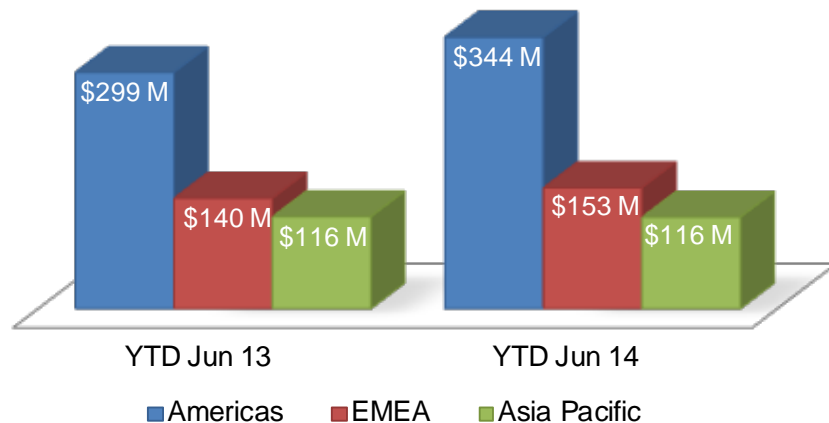


- Sales increase of 13%
  - Currency translation added 1 percentage point
  - Acquired businesses sales of \$10 million account for 4 percentage points of growth
- Gross margin rate down slightly from second quarter 2013
  - Changes in product mix, including effect of entry level unit sales in Contractor segment
- Operating earnings up \$11 million; as a percentage of sales, up slightly from second quarter 2013
  - Acquired businesses contributed \$2 million to operating earnings
  - Operating expenses, as percentage of sales, down 1 percentage point compared to Q2 2013
  - Incremental expense investment in region and product expansion \$2 million
- Interest expense \$5 million consistent with second quarter 2013
- Liquid Finishing dividend \$11 million (post-tax), the same as second quarter 2013
- Tax rate of 28% is lower than second quarter 2013 rate of 29%
  - Higher foreign earnings taxed at a lower rate partially offset by R&D credit not reinstated for 2014

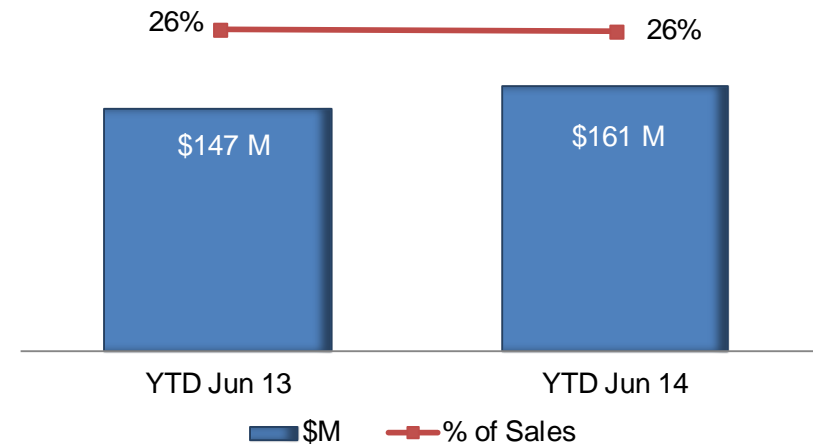
# June 2014 Year-to-Date Results



## Sales



## Operating Earnings



- Sales increase of 10%
  - Acquired businesses sales of \$17 million account for 3 percentage points of growth
- Gross margin rate down slightly from 2013
  - Changes in product mix, including effect of entry level unit sales in Contractor segment
  - Purchase accounting and lower margin for acquisitions impacted consolidated margin by .4 percentage point
- Operating earnings up \$14 million; as a percentage of sales, consistent with 2013
  - Acquired businesses contributed \$2 million to operating earnings
  - Operating expenses, as percentage of sales, down ½ percentage point from 2013
  - Incremental expense investment in region and product expansion \$3 million
- Interest expense \$9 million consistent with 2013
- Liquid Finishing dividend \$15 million (post-tax), the same as 2013
- Tax rate of 29% is higher than 2013 rate of 28%
  - 2013 reduced by effect of R&D tax credit reinstated retroactive to the beginning of 2012
  - R&D credit not reinstated for 2014, increase in the effective rate partially offset by higher foreign earnings taxed at a lower rate

# Operating Earnings



## Change in Operating Earnings

2013 Q2 Operating Earnings (\$M and % of sales)

Translation effect

Volume, mix, cost, price

Effect of acquired businesses on operating earnings leverage

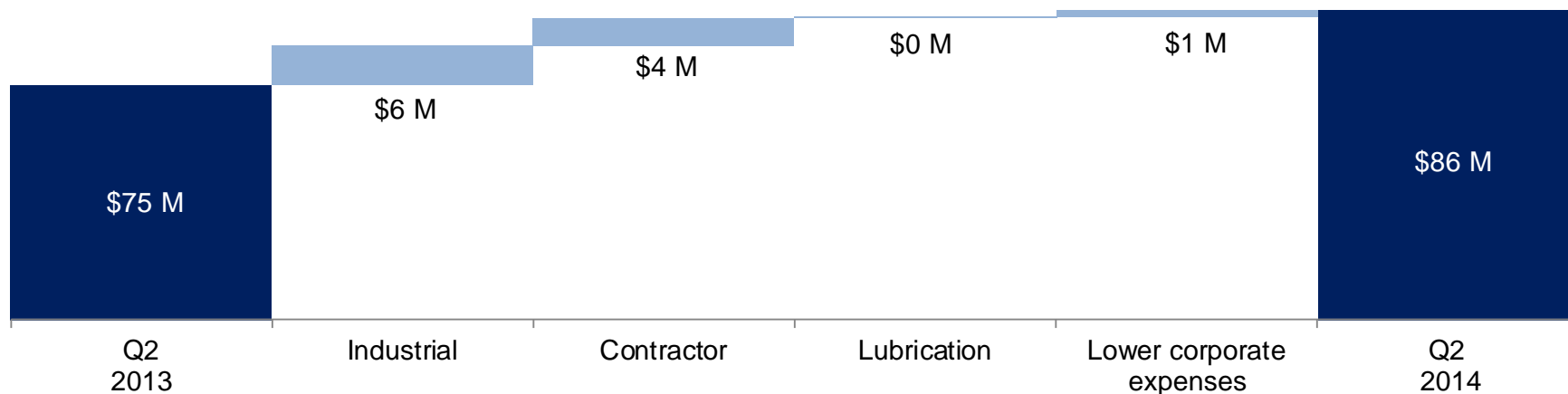
Incremental investment in regional and product expansion

Expense leverage

2014 Q2 Operating Earnings (\$M and % of sales)

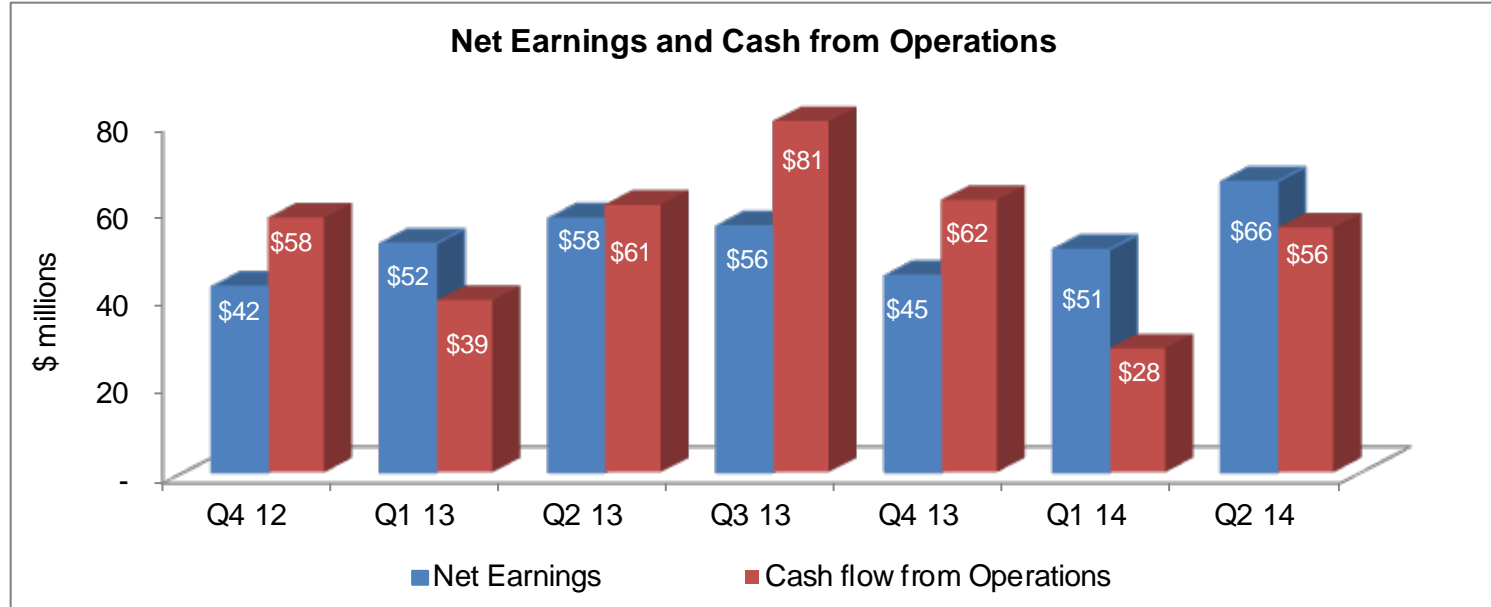
	Second Quarter		Year-to-Date	
2013 Q2 Operating Earnings (\$M and % of sales)	\$ 75	26 %	\$ 147	26 %
Translation effect	1	—	—	—
Volume, mix, cost, price	12	(1)	18	—
Effect of acquired businesses on operating earnings leverage	2	—	2	—
Incremental investment in regional and product expansion	(2)	—	(3)	(1)
Expense leverage	(2)	2	(3)	1
2014 Q2 Operating Earnings (\$M and % of sales)	<u>\$ 86</u>	<u>27 %</u>	<u>\$ 161</u>	<u>26 %</u>

## Quarter Over Quarter Operating Earnings Walk





# Cash Flow and Liquidity



2014 year-to-date cash flow from operations \$84 million versus \$100 million in 2013

- First half increase in accounts receivable \$15 million higher in 2014 than 2013, in line with volume growth; days sales outstanding consistent with 2013

Liquid Finishing dividends (post-tax) \$15 million, the same as 2013

Long-term debt \$523 million; up \$114 million from year-end

- Interest expense \$9 million

Cash uses year-to-date:

- Capital expenditures \$17 million
- Dividends paid \$33 million
- Share repurchases \$94 million
- Business acquired \$65 million

# Acquisition of Finishing Businesses



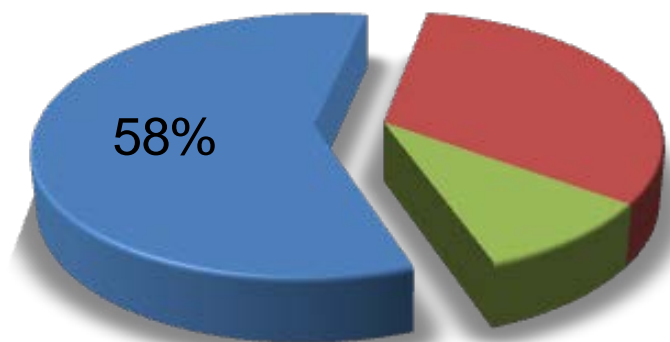
- The purchase of the finishing businesses of Illinois Tool Works Inc. was completed in April 2012 and included Powder Finishing and Liquid Finishing equipment operations, technologies and brands. Results of the Powder Finishing business have been included in the Industrial segment since the acquisition
- 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
  - Income is recognized based on dividends from current earnings of the Liquid Finishing businesses; \$15 million (post-tax) year-to-date through June 2014
- The FTC issued a proposed decision and order (the “Decision and Order”) in May 2012, and continues to work to resolve issues related to a proposed final Decision and Order
- Graco has retained an investment bank to help market the Liquid Finishing businesses and identify potential buyers
- Once the FTC issues its final decision and order, and the Company completes the sale of its investment, there will be no further dividends from Liquid Finishing

## Other Discussion Items



- Capital expenditures expected to be in the range of \$25-\$30 million in 2014; \$17 million through June
- Operating expenses related to the new leased warehouse are expected to be approximately \$2 million in the second half
- The tax rate for the third quarter and the year is expected to be approximately 29-30%, excluding any impact from sale of Liquid Finishing businesses
  - Assumes \$9 million and \$4 million (post-tax) dividends from Liquid Finishing in third and fourth quarter, respectively, the same as 2013
  - Assumes the Federal R&D tax credit will not be reinstated in 2014. If renewed, the annual benefit is expected to be approximately \$3 million or 1 percentage point on the tax rate
- Share repurchases have continued with a goal of less than 60 million shares outstanding by the end of the year

# Industrial Equipment Results



June 2014 YTD Industrial Segment Sales as % of Consolidated



Sales (\$M)	Second Quarter			Year-to-Date		
	2014*	2013	Change	2014*	2013	Change
Americas	\$ 83	\$ 70	18 %	\$ 162	\$ 137	18 %
EMEA	56	50	12	110	100	10
Asia Pacific	43	40	8	86	87	(1)
<b>Total</b>	<b>\$ 182</b>	<b>\$ 160</b>	<b>14 %</b>	<b>\$ 358</b>	<b>\$ 324</b>	<b>11 %</b>
Operating Earnings	\$ 58	\$ 52	12 %	\$ 113	\$ 107	6 %
% of sales	32 %	32 %		31 %	33 %	

\* Includes sales from acquired businesses of \$10M QTD and \$17M YTD 12

# Industrial Equipment Results



## Change in % of sales

2013 Q2 Operating Earnings (percentage of sales)

Translation effect

Mix, product cost and pricing

Effect of acquired businesses on operating earnings leverage

Incremental investment in regional and product expansion

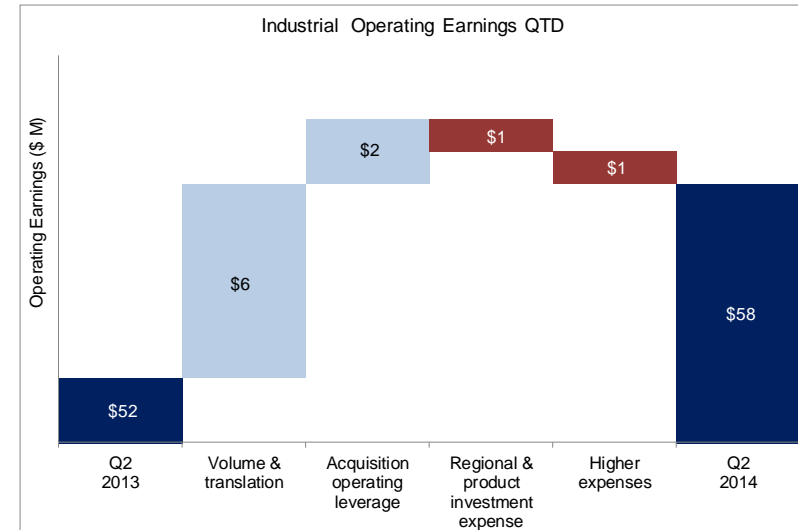
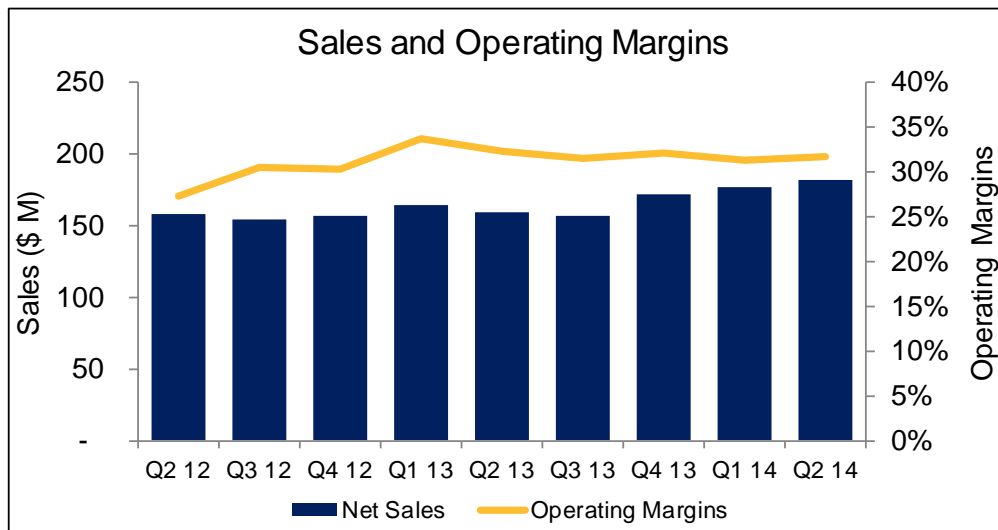
Expense leverage

2014 Q2 Operating Earnings (percentage of sales)

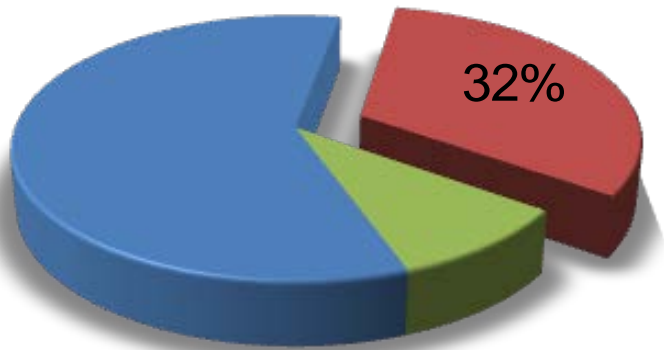
## Second Quarter

## Year-to-Date

32 %	33 %
—	—
—	—
—	(1)
(1)	(1)
1	—
<b>32 %</b>	<b>31 %</b>



# Contractor Equipment Results



June 2014 YTD Contractor Sales as % of Consolidated

Sales (\$ M)	Second Quarter			Year-to-Date		
	2014	2013	Change	2014	2013	Change
Americas	\$ 79	\$ 70	13 %	\$ 138	\$ 121	13 %
EMEA	21	18	18	38	34	10
Asia Pacific	11	10	1	20	21	—
<b>Total</b>	<b>\$ 111</b>	<b>\$ 98</b>	<b>13 %</b>	<b>\$ 196</b>	<b>\$ 176</b>	<b>11 %</b>
Operating Earnings	\$ 28	\$ 24	16 %	\$ 47	\$ 41	14 %
% of sales	25 %	25 %		24 %	23 %	

# Contractor Equipment Results



## Change in % of sales

2013 Q2 Operating Earnings (percentage of sales)

Translation effect

Product mix; including effect of entry level unit sales

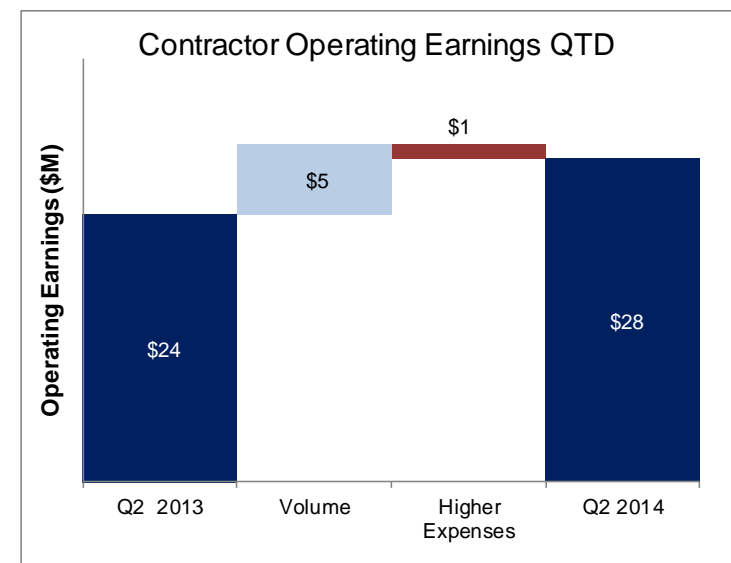
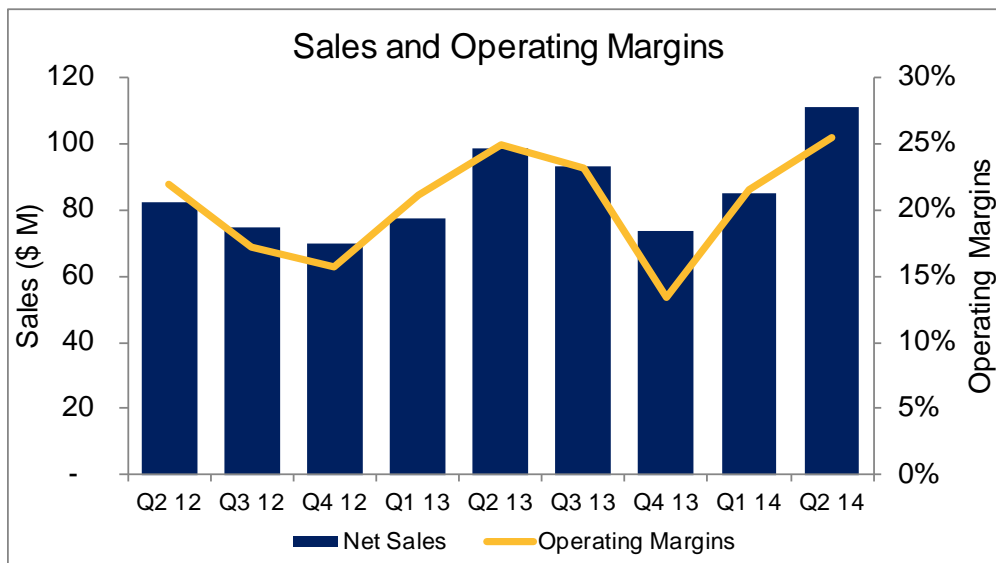
Expense leverage

2014 Q2 Operating Earnings (percentage of sales)

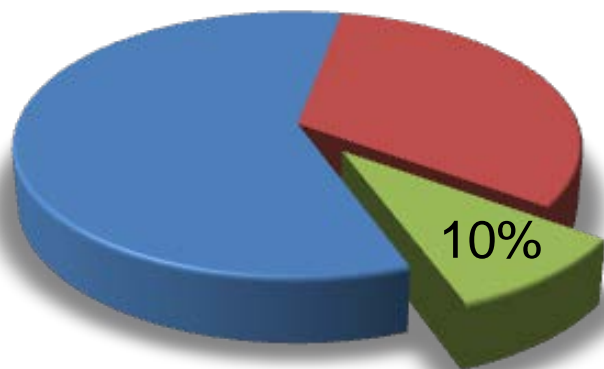
## Second Quarter

## Year-to-Date

25 %	23 %
—	—
(1)	(1)
1	2
<u>25 %</u>	<u>24 %</u>



# Lubrication Equipment Results



June 2014 YTD Lubrication Sales as % of Consolidated

Sales (\$ M)	Second Quarter			Year-to-Date		
	2014	2013	Change	2014	2013	Change
Americas	\$ 23	\$ 21	11 %	\$ 44	\$ 41	8 %
EMEA	3	3	(17)	5	6	(8)
Asia Pacific	4	4	4	9	8	3
<b>Total</b>	<b>\$ 30</b>	<b>\$ 28</b>	<b>7 %</b>	<b>\$ 58</b>	<b>\$ 55</b>	<b>6 %</b>
Operating Earnings	\$ 7	\$ 7	4 %	\$ 13	\$ 12	14 %
% of sales	23 %	24 %		23 %	21 %	



# Lubrication Equipment Results



## Change in % of sales

2013 Q2 Operating Earnings (percentage of sales)

Translation effect

Pricing, product cost and mix

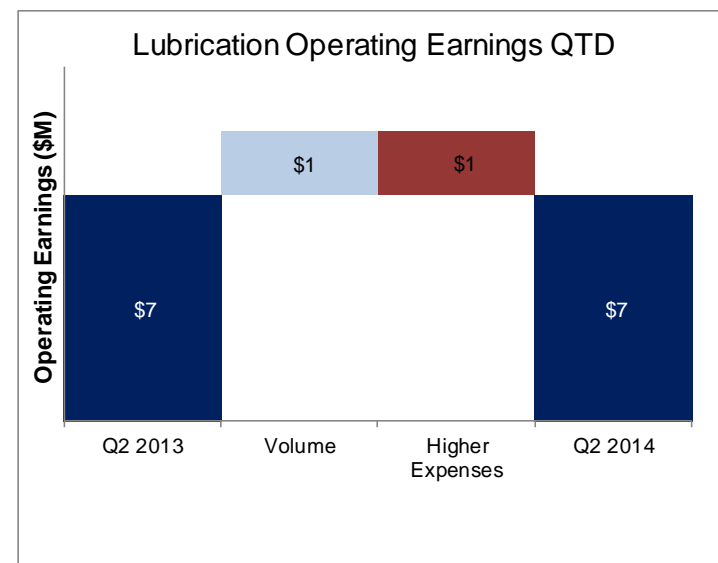
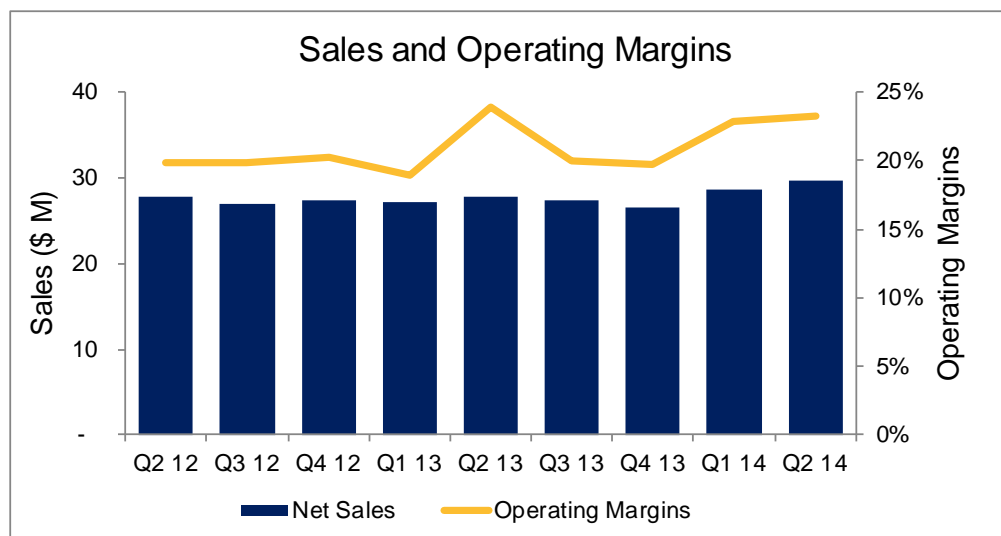
Expense leverage

2014 Q2 Operating Earnings (percentage of sales)

## Second Quarter

## Year-to-Date

24 %	21 %
(1)	(1)
(1)	1
1	2
<u>23 %</u>	<u>23 %</u>





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