

annual report **20**  
**03**



**focused**

ON GROWTH



# focused

## corporate mission

Graco's mission is to generate sustained profitable growth to benefit its customers, employees, shareholders and communities.

We will be the world's leading supplier of fluid management products and packages in the markets we target.

## corporate vision

We will grow revenues by 10% and net earnings by 12% per year. We will grow our sales more significantly outside North America and in new markets, and with new products and improved business processes. Graco's goal is to have at least 30% of each year's revenues from new products introduced in the last three years and to have at least 5% of each year's revenues from sales in markets entered in the last three years. We will actively pursue focused strategic acquisitions where we can add significant value.

## corporate profile

Founded in 1926, Graco is a world leader in fluid handling systems and components.

Graco products move, measure, control, dispense and spray a wide range of fluids and viscous materials used in vehicle lubrication, commercial and industrial settings. The Company's success is based on its unwavering commitment to technical excellence, world-class manufacturing and superior customer service. Working closely with specialized distributors, Graco offers products which set the quality standards in a wide range of fluid handling applications, including spray finishing and paint circulation, lubrication, sealants and adhesives and power application equipment for contractors. Graco's ongoing investment in fluid management and controls will continue to provide innovative solutions to a diverse global market. The Company has its corporate headquarters in Minneapolis, Minnesota, and employs approximately 1,700 people worldwide. Graco common stock (ticker symbol: GGG) is listed on the New York Stock Exchange.

# focused



focused on long term growth, Graco is investing in new markets and technologies, providing maximum value to our shareholders, customers and employees.

## David A. Roberts

*President and Chief Executive Officer*

*Focusing on sustained growth requires a sound strategic plan. We look for new markets that leverage Graco's strengths. The diversity of our products provides balance across many industries and buffers economic swings. We have a proven track record of achievement, exceptional employees and strong leaders. Our initiatives are aimed at serving new customers and adding value to our existing customers and industries. Together we are more than 1,700 people worldwide working toward growing our business in 2004 and beyond.*

## to our shareholders

For Graco, 2003 was a year of record accomplishments. While global economic conditions were challenging, we remained focused on growth by implementing our strategies of developing new products, expanding distribution, entering new markets and making strategic acquisitions.

## 2003 results

We took a number of steps in 2003:

- We achieved record results in a challenging economic environment
- We acquired Sharpe Manufacturing operations, which gave us access to a new market and new customers
- We successfully reorganized our Industrial/Automotive sales and marketing organizations by application area, aligning these groups to better serve the changing needs of our customers
- New products represented 34 percent of annual sales
- We consolidated our manufacturing in Minneapolis from two buildings to one
- We broke ground in 2003 and completed a new office building in February 2004 on our Minneapolis campus
- We repurchased 2.2 million shares of our stock for \$55 million
- We announced a 70 percent increase in the regular common dividend
- We announced a special one-time dividend of \$2.25 per share payable in March of 2004

Net earnings totaled \$86.7 million, or \$1.85 per diluted share, up from \$75.6 million, or \$1.57 per diluted share in 2002. Net sales were \$535.1 million, up 10% from \$487 million in 2002. We generated \$94.3 million of free cash flow, which we define as cash provided by operating activities less capital expenditures, after making a \$20 million voluntary contribution to our pension fund. Our balance sheet remains strong with no debt and plenty of capacity to pursue all of our strategic options. We achieved these results by relentless pursuit of operational excellence, while not sacrificing critical investments in our core growth strategies.



ocused on strengthening our position as a global leader, retaining skilled management is vital to our success. These business leaders are experienced and united in achieving solid results and meeting corporate objectives.

## new products

We have always recognized that efficiency alone cannot generate sustained profitable growth, so we remain focused on organic growth through new products. In 2003, we invested \$18.1 million in product development. We believe that new product introductions and delivering innovative solutions to our customers are critical to our success. In each of the last three years, we have exceeded our objective of generating at least 30 percent of annual sales from products introduced in the prior three years. In order to build on this momentum, we are increasing our investments in product development to accelerate the number of innovative products and improve our speed and efficiency in delivering the products our customers need. I am convinced that by making these investments we will accelerate our organic growth beyond what we have achieved in the past.

## expanding distribution

Our growth will come not only from accelerated new product development, but also from adding distributors around the world. Today we have distributors in more than 100 countries and our footprint is constantly expanding. Identifying, training and developing distributors takes time and money, but it is absolutely critical to our long-term prospects for sustained profitable growth. Our largest and most exciting opportunities are in the world's emerging economies, where our products are being well-received by those making fluid handling infrastructure decisions. We are growing by making investments in places like China, Korea, India, the Middle East and Eastern Europe. We will continue to drive investments in these regions, as well as in more developed geographies, where our businesses will continue to get the resources they need to be successful.

## solid results

*"Graco Ranked #1 in Advanced Industrial Equipment 3-Year, 5-Year, and 10-Year Average Return."  
- The Wall Street Journal (March 2003)*

*100 Best Corporate Citizens,  
"Graco has highest customer satisfaction rating of 3.0."  
- Business Ethics Magazine (March 2003)*

*"Graco ranks in the Top 10 on Return on Assets, Return on Equity & Return on Revenue."  
- Minneapolis Star Tribune (April 2003)*

*"America's 100 Best Companies"  
Achievement of operating performance within the top 3% of all major U.S. corporations, categorized by industry.  
- DeMarche Associates (May 2003)*

## highlights

- Record sales of \$535.1 million, up 10%
- Record earnings per share of \$1.85, up 18%
- Sharpe acquisition
- 34% of sales from new products
- Significant dividends and stock repurchases

## new markets

While adding distribution is critical to our success, we also recognize the need to expand our footprint by serving new markets. In 2003, we entered the automobile refinish market by acquiring Sharpe Manufacturing operations. We also made further inroads in the foam and polyurea markets with the introduction of our Reactor™ product and its related accessories.

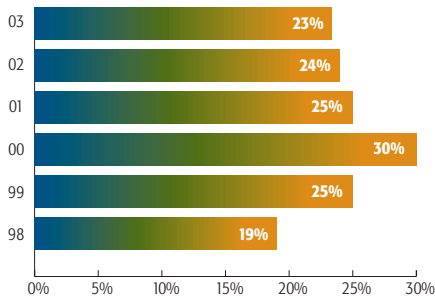
It is our goal that at least 5 percent of each year's sales come from markets that were entered during the last three years. We are looking for markets where we can add value to the users of fluid handling equipment. Since new markets offer the potential for truly incremental growth, we will drive our organization to select and enter new markets either through the development of new products, acquisitions, licensing or acquiring attractive technologies.

## strategic acquisitions

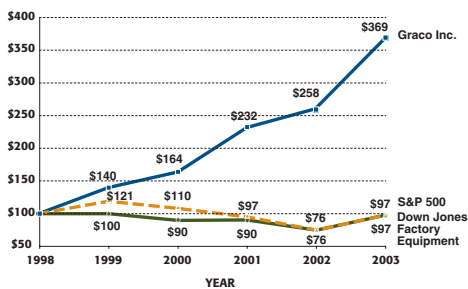
As a complement to our organic growth initiatives, we believe that strategic acquisitions are an important part of our overall growth. We are focused on acquisition opportunities that are within our sphere of knowledge and where we can leverage our core strengths. Our strong balance sheet provides us with the financial flexibility to move quickly and aggressively for the appropriate strategic opportunity.

While the desire for growth is strong within our organization, we have not lost sight of the reality that many acquisitions do not increase shareholder value. The challenge is to find the right balance between growth and an acceptable return for our shareholders. At Graco, we have a rigorous capital investment process, based on discounted cash flow, which helps us minimize the downside risks of poor investment decisions. In many cases this has meant that we have not purchased businesses where the final price was too high in relation to the risk of not achieving the potential synergies. Our processes have withstood the test of time, as evidenced by our high returns on invested capital, and we will continue to challenge all of the investments that we make.

Return on Assets



Value of \$100 invested in 1998



## summary

When I look at Graco today I see a company with tremendous opportunities that will be realized with the proper focus. Our management team and all of Graco's employees are committed to accelerating sales while not sacrificing bottom-line results. We are very proud of our past accomplishments, but we are also confident that our best years are yet to come. In 2004, we have a lot to be excited about and we are confident that, through our initiatives, we will achieve another record year.

I want to acknowledge the retirement of David Koch from our Board of Directors this past year. Dave was formerly Chairman of the Board and Chief Executive Officer of Graco and his contributions to the company are far too many for me to mention in this letter. On behalf of the past and present employees of Graco, I want to thank Dave for his many years of service and tremendous accomplishments. Undoubtedly, he will always be one of the most important figures in this Company's history. Finally, I want to thank all of our employees for an outstanding year in 2003. We have a tremendous global team that is committed to achieving even greater results in the years ahead.

*David A. Roberts*

David A. Roberts  
President and Chief Executive Officer

focused on a relentless pursuit of operational excellence while maintaining critical investment in our core growth strategies.

## at-a-glance

### industrial/automotive equipment

Graco focuses its product design and marketing efforts on five major application areas: sealants and adhesives, process, finishing, protective coatings and automotive refinish. Currently the Industrial/Automotive Equipment segment generates 43 percent of our sales, serving firms that manufacture, assemble and repair: automobiles and components, wood products, railcars, ships and other marine equipment, aircraft and other aerospace equipment, farm and construction equipment, truck, bus and recreational vehicles, and approximately thirty other industries.

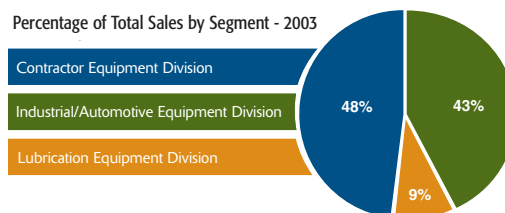
### contractor equipment

Graco designs and markets sprayers for the application of paint and other architectural coatings, and for the high-pressure cleaning of equipment and structures. Currently 48 percent of our sales, the Contractor Equipment segment supplies products to distributors who sell to contractors and tradesmen in the painting, roofing, texture, corrosion control and line striping markets. This equipment delivers high quality finishes at rapid production rates, and is known in the marketplace for durability and ease of use.

### lubrication equipment

Graco has been a leading manufacturer of lubrication equipment in North America for over 77 years. We design and market products for the lubrication and maintenance of vehicles and other equipment. Currently 9 percent of our sales, the markets served include fast oil change facilities, service garages, fleet service centers, automobile dealerships and industrial lubrication. These products are the industry standard, and the first choice for the most demanding applications.

Percentage of Total Sales by Segment - 2003



## products

### Pumps and Sprayers

Air, electric, gas and hydraulic  
–Transfer fluids to dispense & spray

### Controls

Electronic and mechanical fluid control  
–Manage flow, pressure & mixing

### Applicators

Automatic and manual dispense valves and spray guns  
–Spray or dispense fluids

### Accessories

Fittings, regulators, hoses, etc.  
–Auxiliary components for complete product solutions

## markets served

### Industrial /Automotive Equipment Division

Aerospace  
Automotive/Truck Assembly  
Automobile Repair Shops  
Chemical Process Industry  
Farm and Construction Equipment  
General Industrial Assembly  
Marine  
Mining  
Rail  
Wood

### Contractor Equipment Division

Painting and Specialty Contractors  
Ceiling and Wall Texture  
Remodeling  
Line Striping

### Lubrication Equipment Division

Automobile Dealerships  
Fast Oil Change Facilities  
Fleet Service Centers  
Industrial Lubrication

focused on introducing new products, enhancing our research, strengthening our team, addressing challenges and meeting our financial objectives.

## new products

There is a driving force behind the way we approach our jobs and the results we have achieved for our customers and shareholders. It is our desire to tap into the new technologies that are being introduced every day and to create new products that match our fluid handling expertise to our customers' needs.

We are working hard to develop new products that are innovative and reliable. Our quality equipment stands the test of time and is the foundation of Graco. We are striving to improve our leadership role in product technology by

keeping our research and development pipeline robust. In 2003 alone, we invested \$18.1 million in product development.

Graco has introduced a number of innovative products, including Xtreme Mix™, GH 200™ Hydraulic Airless Sprayer, Ultra® 395 & 495 electric sprayers, ST™ & STX™ electric airless sprayers, Reactor™ E-XP, TexSpray RTX™ and RAC® X.

These new products provide solutions to customers' needs today by improving productivity, eliminating waste and refining work processes.

In the past year, we successfully expanded our global business by introducing new products, strengthening our team and addressing customer challenges.

Our goal is to generate 30 percent of our annual revenue from products that have been introduced during the past three years. In 2003, we exceeded this objective with 34 percent of our sales coming from new products.



*dedicated employees are on the front lines of every new Graco product – providing valuable expertise and innovative solutions*







## the industry standard

With over 35 years of experience designing and manufacturing airless spray guns, Graco is the industry standard for high quality and performance. The Contractor™ II and Contractor FTx™ II are two of our professional spray guns used in new construction, residential, repainting/remodeling, light commercial and property maintenance. When paired with a Graco airless sprayer, jobs are easier than ever. With a variety of models to choose from, the Ultra Max is leading the way in the airless sprayer marketplace.

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*the Starcorp Furniture Company, located in Shanghai, China, uses Graco equipment to spray coatings on furniture*

## expanding distribution

Graco continues to add coverage and improve the effectiveness of its global distribution network. Our work is not simply about producing products and generating sales.

Important as those things are, they are part of a more complex equation – the process of building deep and lasting relationships with our customers. Those relationships, maintained by an industry-leading distribution network, create loyalty. And loyal customers drive our success.

Our knowledgeable worldwide distribution network provides fluid management equipment and expertise to Industrial/Automotive, Lubrication and Contractor customers. They are motivated, energetic and adept at meeting the challenges of the industry.

Graco provides ongoing support to these distributors through superior customer service, sales support, technical assistance, training and marketing programs.

To better serve international customers' needs, Graco expanded its distribution network by adding distributors in Europe, Japan, Australia, Malaysia, the Philippines, China, India and Korea.

our growth will come not only from accelerated new product development, but also from adding distributors around the world.



## the critical connection

Our largest and most exciting opportunities are in the world's emerging economies, where our products are well-received by those who are making fluid handling infrastructure decisions. We are growing by making investments in places like China, Korea, India and Eastern Europe.

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## new markets and strategic acquisitions

Acquisitions are driven by the desire to create a rate of return that exceeds the cost of capital. As these opportunities arise, Graco evaluates them against a set of strict criteria. We are looking for candidates that will allow us to add value by leveraging our strengths, plus provide a positive contribution to our future earnings.

Focused on being the leader in the finishing market, on April 1, 2003, Graco purchased the operations of Sharpe Manufacturing located in Santa Fe Springs, California. Sharpe supplies paint spray guns, infrared paint curing systems,

air controls and related parts and accessories to automotive refinish professionals.

Established in 1921, the Sharpe brand is well respected in the automotive refinishing industry. Sharpe sells its products through a network of warehouse distributors, automotive refinish jobbers and tool retailers.

We are excited about this opportunity to expand into a new market that leverages our skills in manufacturing, marketing and selling paint spraying equipment and related accessories.

We see a good fit between Sharpe and Graco, and are excited about the prospects for future revenue and earnings growth.

Sharpe's manufacturing operations are being relocated from Santa Fe Springs, California, to our Sioux Falls, South Dakota, plant. This transfer will be completed in April 2004.

it is our focus to make strategic acquisitions that contribute to our overall growth. The more we develop and acquire innovative products, the greater value we bring to the marketplace and to our shareholders.

*maintaining the Sharpe brand is critical, as it is highly recognized in the automotive refinishing industry*



An aerial photograph of a large industrial facility, possibly a water treatment plant, featuring a complex network of concrete structures and pipes. Several workers are visible on scaffolding, and bright spray guns are being used to apply coatings to the surfaces. The scene is brightly lit, casting long shadows.

## state-of-the-art spray guns and proportioners

In 2003, Graco made further inroads into the new markets of foam and polyurea coatings. The Reactor™ Proportioner and Fusion™ guns are designed for less maintenance and downtime, longer life and a better mix – making Fusion the best plural-component spray gun available in the marketplace. Combined with the state-of-the-art Reactor proportioning system, customers get superior performance, control and accuracy. In addition to proportioning, the Reactor's electronics provide diagnostic, data reporting, pressure readout, temperature and pressure controls, as well as auto shutdown capabilities to assure the system performs to the customer's specific requirements.

## Board of Directors

Lee R. Mitau  
*Executive Vice President  
and General Counsel, U.S. Bancorp  
Chairman of the Board, Graco Inc.*

Robert G. Bohn  
*Chairman, President and  
Chief Executive Officer,  
Oshkosh Truck Corporation*

William J. Carroll  
*Acting President and Chief Operating  
Officer, Dana Corporation*

Jack W. Eugster  
*Non-Executive Chairman,  
ShopKo Stores, Inc.*

J. Kevin Gilligan  
*Former President and Chief Executive  
Officer, Automation and Control  
Solutions, Honeywell International*

James H. Moar  
*Chief Operating Officer, Identix Inc.*

Martha A.M. Morfitt  
*President and Chief Executive Officer,  
CNS, Inc.*

Mark H. Rauenhorst  
*President and Chief Executive Officer,  
Opus Corporation*

David A. Roberts  
*President and Chief Executive Officer,  
Graco Inc.*

R. William Van Sant  
*Operating Partner,  
Northwest Equity Partners*

William G. Van Dyke  
*Chairman, President and Chief  
Executive Officer, Donaldson  
Company, Inc.*

## Management

David A. Roberts  
*President and Chief Executive Officer*

Karen Park Gallivan  
*Vice President, Human Resources*

James A. Graner  
*Vice President and Controller*

Dale D. Johnson  
*Vice President, Contractor  
Equipment Division*

D. Christian Koch  
*Vice President, Asia Pacific*

David M. Lowe  
*Vice President and General  
Manager, European Operations*

Robert M. Mattison  
*Vice President, General  
Counsel and Secretary*

Patrick J. McHale  
*Vice President, Lubrication  
Equipment Division*

Charles L. Rescorla  
*Vice President, Manufacturing/  
Distribution Operations and  
Information Systems*

Mark W. Sheahan  
*Vice President and Treasurer*

Fred A. Sutter  
*Vice President, Industrial/Automotive  
Equipment Division*

## General Information

### Annual Meeting

Shareholders are cordially invited to attend the Annual Meeting, which will be held at 1:00 p.m., April 23, 2004, at Graco's George Aristides Riverside Center, 1150 Sibley Street Northeast, Minneapolis, Minnesota 55413.

### Corporate Inquiries

Investors may obtain the Graco Inc. annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports by visiting the Graco website at [www.graco.com](http://www.graco.com). Requests for financial publications can also be addressed to: Graco Inc. Attn: Treasurer, P.O. Box 1441, Minneapolis, Minnesota 55440-1441 or placed by phone by calling (612)623-6659.

### Shareholder Inquiries

Questions regarding dividend checks, dividend reinvestment, lost stock certificates, change of address or consolidation of accounts, should be directed to the Company's Transfer Agent and Registrar: Wells Fargo Bank, N.A., Shareowner Services, 161 North Concord Exchange Street, So. St. Paul, Minnesota 55075-1139. Or call: (800) 468-9716. In Minnesota: (651) 450-4064. Monday-Friday, 7 a.m.-7 p.m. CT.

Graco is an equal opportunity employer. Graco's EEO policy is on the Company's website at [www.graco.com](http://www.graco.com)

## Corporate Directory

### Americas

**Corporate Headquarters**  
Graco Inc.  
Russell J. Gray Technical Center  
88 – 11th Avenue Northeast  
Minneapolis, Minnesota 55413  
(612) 623-6000

**Mailing Address**  
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Minneapolis, Minnesota 55440-1441

**Graco Minnesota Inc.**  
Riverside Office Complex  
65 – 11th Avenue Northeast  
Minneapolis, Minnesota 55413-1894

George Aristides Riverside Center  
1112 - 1150 Sibley Street Northeast  
Minneapolis, MN 55413

David A. Koch Center  
20500 David Koch Avenue  
Rogers, Minnesota 55374

**Graco South Dakota Inc.**  
3501 North 4th Avenue  
Sioux Falls, South Dakota 57104

### Europe

**Belgium**  
European Headquarters  
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3630 Maasmechelen, Belgium

### Asia Pacific

**China**  
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Pudong New Area  
Shanghai, P.R.C.

**Hong Kong**  
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Flat B, 14th Floor  
Hang Seng Causeway Bay Building  
28-34 Yee Wo Street, Causeway Bay  
Hong Kong Special Admin. Region, P.R.C.

**Japan**  
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1-27-12 Hayabuchi  
Tsuzuki-ku, Yokohama 224, Japan

**Korea**  
Graco Korea Inc.  
4th Floor, Choheung Bank Building,  
1599, Gwanyang-Dong, Dongan-Ku  
Anyang-City, Kyongki-Province, Korea,  
431-060

## Graco Common Stock

Graco common stock is traded on the New York Stock Exchange under the ticker symbol "GGG." On December 26, 2003, there were 46,040,134 shares outstanding and 2,280 common shareholders of record, with another estimated 13,500 shareholders whose stock is held by nominees or broker dealers.

QUARTERLY FINANCIAL INFORMATION												
(In thousands, except per share amounts)												
Quarter	2003				2002				2001			
	1	2	3	4	1	2	3	4	1	2	3	4
Net sales	\$119,660	\$146,364	\$133,788	\$135,286	\$107,857	\$132,796	\$125,832	\$120,563	\$109,814	\$130,873	\$118,651	\$113,481
Gross profit	63,003	75,932	71,403	72,464	55,163	67,141	65,414	62,440	55,138	64,253	59,156	56,215
Net earnings	18,194	24,463	22,711	21,345	15,546	21,516	20,494	18,069	13,120	18,248	16,760	17,138
Diluted net earnings												
Per common share <sup>1</sup>	.38	.53	.49	.46	0.32	0.44	0.42	0.37	0.28	0.39	0.35	0.36
Stock price												
High	\$29.80	\$32.00	\$40.10	\$40.49	\$28.09	\$30.49	\$26.99	\$30.16	\$19.50	\$22.00	\$23.51	\$26.03
Low	25.68	28.27	32.93	36.01	24.50	25.14	22.90	23.35	16.23	17.48	18.67	19.26
Close <sup>2</sup>	28.10	32.00	37.55	40.10	27.23	25.14	24.80	28.65	18.67	22.00	20.13	26.03
Volume (# of shares)	7,124	8,766	12,440	8,137	6,645	8,077	8,891	7,922	4,436	6,215	4,584	6,672

<sup>1</sup> All share and per share data has been restated for the three-for-two stock split declared on May 7, 2002 and distributed on June 6, 2002.

<sup>2</sup> As of last trading day of the calendar quarter.



**for financial information, please refer  
to Graco Inc.'s 2003 Form 10-K.**







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[www.graco.com](http://www.graco.com)