GRACO INC., #4399746
GRACO INC. FOURTH QUARTER 2010 EARNINGS
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Chairperson: Patrick McHale (Mgmt.)

Operator: Good morning and welcome to the Fourth Quarter Year 2010 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 is 303-590-3030. The conference I.D. is 4399746. The replay will be available through February 4, 2011.

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 provisions 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 1(a) of Exhibit 99 to the Company's 2009 Annual Report Form on 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.

If any participant has difficulty hearing the presentation, please press the star followed by the zero on your telephone for operator assistance.

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 and Jim Graner. I'll provide some comments on the financial highlights of our fourth quarter, and Pat will follow with additional comments. Slides are available to accompany this call and can be accessed on our website. The slides include information about our consolidated financial results in each of the segments. After our opening comments, we will open up the call for your questions.

Net sales of 197 million, up 35% for the quarter as compared to the prior year. Annual sales were 744 million, up 28% from the prior year. Sales increased in all divisions and regions with strong growth continuing in the Asia Pacific region and in the fourth quarter, and solid growth in both the Americas and Europe.

There were 53 weeks in our fiscal 2010, including 14 weeks in the fourth quarter. There were 52 weeks in 2009 with 13 weeks in the fourth quarter. Currency translation did not have a significant effect for the quarter or the year. Changes in

Asian currencies and the Canadian dollar continue to largely offset changes in the Euro.

Operating earnings for the quarter as a percentage of sales were 19%, up from 16% a year ago with net earnings totaling 27 million for the quarter. Gross profit margin in the quarter as a percentage of sales was 55% as compared to 53% in the fourth quarter last year. Higher production volume in 2010 has been the primary driver of improvement in both the quarter and annual rates.

Unabsorbed fixed manufacturing costs were approximately 12 million in 2010 as compared to approximately 26 million in the prior year. Although material costs were slightly favorable through the first three quarters of 2010, cost pressures became more significant in the fourth quarter. Material costs were slightly unfavorable in the fourth quarter as compared to the same quarter in the prior year.

Operating expenses increased by 16 million for the quarter and 32 million for the year. Continued strong operating results drove higher incentive and bonus provisions in all regions and sales territories in the fourth quarter, accounting for approximately half of the increase in operating expense for the quarter and two-thirds of the increase for the year. For the full year, costs and expenses related to incentive and bonus were 21 million higher than last year.

Our effective tax rate was 26% for the fourth quarter and 31% for the full year compared to 23.5% and 29% for the comparable periods last year. In both 2010 and 2009, the federal R&D tax credit was renewed in December with an impact of 2.5 million in 2010 and 2 million in the fourth quarter of 2009. Overall, the effective business credits and domestic production deductions in 2010 was lower as a percentage of pretax earnings as compared to last year.

A brief comment on each of the segments – sales in the industrial segment increased 31% for both the quarter and the year. The higher sales and resulting increases in production volume led to improvement in operating earnings as a percentage of sales. Contractor segment sales increased 36% for the quarter and 23% for the year. Costs related to consumer advertising, displays, and other costs and expenses held down operating margin in the quarter. Lubrication segment sales increased 52% for the quarter and 35% for the year, with increased sales of industrial lubrication products contributing significantly to strong growth in the segment.

In 2010, cash flow from operations was 101 million as compared to 147 million last year. Our working capital investment increased in line with our increasing volumes. Year-to-date inventories have increased by 33 million with an improvement in terms from the prior year and include build-up of certain Contractor products to support first quarter 2011 activities. Accounts receivable have increased by 23 million year-to-date with consistent days to sales outstanding.

Other primary uses of cash in 2010 included capital expenditures of 17 million, a voluntary contribution of 10 million to a funded pension plan, dividends of 48 million, and share repurchases of 24 million. Long-term debt totaled 70 million at the end of the year with unused credit lines of 194 million. Finally, backlog continues to be strong, up 6 million from prior quarter and up 12 million from last year, and reflects strong sales growth in each segment and region.

Going forward, we will continue to manage our working capital and cash flows. Accounts receivable will vary with sales trends. Inventory will be in line with sales trends, although stocking for new product introductions and maintenance of service levels is a priority. Our 2011 capital expenditures are expected to be about 30 million. No cash contributions to our funded pension plan is required in 2011.

Volume-related items such as incentive and bonuses will reset based on 2010 results. For example, with a 10% growth in sales, we would expect to incur incentive and bonuses at a level of approximately two-thirds of 2010 expense. Individual growth in regions, sales territories, and product lines will affect the actual expense, and change through the year may not be linear.

The Contractor segment in North America plans to further expand the number of outlets and product mix within individual outlets in the first half of 2011 with 2 to 3 million in expense expected in the first half of the year weighted towards the first quarter.

Rising commodity cost are an area of focus and we will continue to look for opportunities to work with our supply chain to minimize the impact. We expect that 2011 pricing will offset the impact that we have seen to date.

We expect our tax rate to be approximately 34.5% going forward, less the impact of the federal R&D credit. The amount of the R&D credit is expected to be consistent in 2011 as compared to 2010.

We have also reviewed our long-term financing requirements, taking into consideration the favorable interest rates currently available. We have reached an agreement in principle with a major lender to provide private placement debt up to 300 million with maturities extending up to 15 years; and in January we entered into a letter of credit to begin this funding. We are planning to use the favorable rate long-term debt for general corporate purposes, working capital needs, share repurchases, and acquisitions. We expect a higher rate of share repurchases in 2011 as compared to 2010.

With that, I'll turn it over to Pat for additional comments.

Patrick McHale: Good morning. I'll start off by giving some color to our revenue performance during the quarter. I'll begin with Europe. Sales were strong across all product segments. Revenue increased 42% at consistent exchange rates versus the fourth quarter of 2009. Sales increased at solid double-digit rates in Western Europe, Eastern Europe, the Middle East, and Africa.

Contractor equipment sales in Europe increased 52% at consistent exchange rates compared to the fourth quarter of 2009. The new handheld product was a significant contributor to growth; however, revenue grew in excess of 20% in Contractor Europe, excluding the impact of handheld.

We continue to be positive regarding our growth prospects in Europe in 2011. We expect the recovery will continue and that new products launched in 2010 and 2011 will be successful.

Switching to Asia Pacific, Asia Pacific finished strong with double-digit increases in both developed and developing countries and across most product lines. On a percentage basis, our highest growth was in our industrial lubrication segment. We're seeing good traction in this targeted new market with an energetic new sales team and effective new products.

In 2010, Asia Pacific significantly exceeded our pre-recession peak. We've invested heavily in people and channels during the past few years, and our 2011 plans reflect significant additional incremental investment for commercial people, customer support and training. We're very positive about our growth prospects in Asia Pacific going into 2011 as most of our key end markets are healthy and we have a strong team in place.

Now on to the Americas, where we also saw good growth. For the year, revenue in Latin America also exceeded our pre-recession peak. In addition, we had nice growth quarter-over-quarter throughout the year, and Q4 was our biggest quarter ever in that region. In North America, all segments were up double digits compared to last year. Our industrial segment continued to perform extremely well with solid growth compared to Q4 of 2009 and compared to the third quarter of 2010. Most end markets continue to strengthen, although we do see ongoing weakness in select industries such as recreational vehicles, boating, wood, and commercial construction.

The lubrication segment finished the year very strong, continuing a pattern of revenue expansion we experienced throughout 2010. The car dealership, mining, and federal, state and municipal markets continue to be quite active. In Contractor North America, revenue was up significantly compared to the Q4 of 2009 but was down seasonally and nearly equal to 2010, even with the new product.

The propane channel was a primary driver of the increase for both the quarter and the year. For the year, sales in 9449Contractor North America increased by 21% with more than half of this increase coming from the new handheld product line.

A little discussion on margins – gross margins were solid at 54.6%, up 1.5 points from last year's fourth quarter. We are experiencing material cost pressures but we anticipate pricing measures will be sufficient to offset those. Operating margins in industrial and lubrication are significantly improved compared to last year's fourth quarter. Industrial margins were flat compared to Q3 on increased sales, partially impacted by the effect of higher sales incentive and distributor rebate levels on stronger than expected volume to close the year.

Lubrication margins declined from Q3 for similar reasons; however, we anticipate lubrication margins will improve significantly in 2011 as they did for the full year 2010. Operating margins in Contractor were weak for the quarter, negatively impacted by spending on new product, spending associated with the planned roll out of a full entry level product line into 1,700 home center outlets, and due to incentives and rebates.

For 2011, we're expecting continued solid operating margins in industrial and improving margins in lubrication. We expect base business revenue in North American Contractor to improve only modestly in 2011, but we're striving to drive growth with new products and new selling initiatives. These initiatives will require significant up-front investments which will weigh on segment operating margins. A return to more historical margin norms in North American Contractor will require normalization of residential and commercial construction markets and Contractor buying patterns.

In terms of outlook, we believe we're well positioned for another year of solid growth in sales and earnings for 2011, and we expect the global industrial economy will continue to recover. Our investments in new products, new markets, and new distribution should drive continued growth in our industrial and lubrication segments in all regions. Outlook in developing markets is particularly positive and we'll continue to press forward aggressively with investments in those areas.

We remain cautious about our base business prospects in the U.S. Contractor equipment market; however, our investments in new product, end user conversion, and channel expansion give us an opportunity for success in 2011 even with lackluster end market growth in North America. We expect the European/Asian Contractor businesses will perform well.

In summary, we believe overall market conditions will be favorable for us in 2011. We expect the investments we made in new product and international expansion during the downturn will continue to pay dividends to our shareholders, and we're looking forward to a good year.

This concludes my prepared remarks, and I now ask the operator to open the session to Q&A.

Operator: Thank you. The question and answer session will begin at this time. If any participant would like to ask a question, please press the star followed by the one on your telephone. If you wish to cancel this request, please press the star followed by the two. Your question will be taken in order that it is received. Please stand by for your first question.

The first question comes from Mike Halloran from Robert W. Baird. Please go ahead.

Michael Halloran: Good morning, everyone.

Patrick McHale: Good morning.

Michael Halloran: So first on the cost side, could you just maybe go into—I think it's the kind of three areas we saw some cost pressures in the quarter – the incentive comp side, the new product side, and then the litigation side. If I understand you correctly, you guys are saying that the incentive and bonus-related should trend down, given the growth rate—should trend down against the comparisons. And then on the new price—is that correct, first off?

James Graner: Well Mike – this is Jim – our message is maybe for you to calculate the incentive comp depending upon where the sales growth is; so as Caroline mentioned, we had 25 million of incentive and bonus compensation expense in 2010. If sales growth was even across our businesses in 2011, at 10% we're projecting that that 25 million would become 15 million. If you would say that it's going to grow in excess of 20%, you again model a 25 million kind of number.

Michael Halloran: Makes sense. And then on the new product side, just to be clear, the cost that she was talking about in excess of 2 million for the first half of the year, front-end loaded in the first quarter, those are incremental year-over-year costs that should taper that down, then, in the back half of next year; or is there the expectation that you'll have some other new product type costs coming on from other new product launches mid-year next year?

James Graner: Well, those costs will be incremental to what you saw in the first half of 2010, but more in line with what you saw in the last half of 2010. They really relate to store sets where we're having expanded offerings in about 3,400—or different offerings in about 3,400 stores, which I think is a positive for the volume side. So we're really addressing here just the expense side of the equation.

Michael Halloran: And then on the litigation side, was that more one-time in nature this quarter, or is that more the run rate?

James Graner: It's, I will say, one-time in nature for this quarter with significant activity.

Michael Halloran: Thanks. I appreciate the time.

Operator: Thank you. The next question comes from Kevin Maczka from BB&T Capital Markets. Please state your question.

Kevin Maczka: Good morning.

Patrick McHale: Good morning.

Kevin Maczka: Jim and Pat, I guess I want to be clear here in terms of—we're always going to be in the business of initiating new products, having new product roll-out expense, paying incentives to our sales people, expanding distribution. How much of these additional costs would you say are unusual this year and in Q4, because we had such a big handheld launch, for example, versus just normal ongoing business?

Patrick McHale: Hey, this is Pat. On the incentive and the rebate side, you know, unless we can get ourselves on a roll where we're growing the business 30% a year, these numbers would be larger than what you would normally expect. And you know, we set incentive and rebate targets late '09 for 2010, and we had no idea that we would blow the top off the revenue, really across every product line in every region. And our—although the management bonuses are capped, the sales force bonuses aren't capped, and in fact we encourage our sales people to beat the number by having an accelerator once they get over a quarter that lasts for a while. So we had a lot of people that blew right through the accelerator this year.

So in terms of thinking about what those numbers could be in the future, you know, we probably did a maximum sort of year from an incentive plan that we could get based upon a growth rate that was near 30%; and will the number normalize? Actually, I hope not. I hope we blow the top off again in 2011, but I think Jim gave you some color on what would happen on incentives if we had more of a normal, lower double-digit top line growth rate.

In terms of the new products, you know, you're right – we're going to have new product launches every year. The handheld opportunity has really taken us into a new product segment, getting us down more to the consumer range than we've ever been before; and costs for us to go and rework a lot of the store—existing store sets is substantial so that we can get this product family properly displayed. In addition to that, the team has done some nice jobs, getting some wins at the channel level that we're going to harvest here going into 2011; and of course any time you add a bunch of stores, you're going to get a bunch of costs.

So are they one-time? Maybe not. Are they unusual? I'd say yes, they are; and barring a more expanded product offering into brand new segments, I think you'll probably lean these more to being one time.

Kevin Maczka: Okay. And Pat, along the line of product development, your product development line item, do you expect that to take another fairly significant leg up in 2011 as you push new products out the door?

Patrick McHale: I'd use a $40 million number for next year. We are doing some selective increases in resources in product development, particularly in one of our industrial—or maybe both of our industrial segments. But 40 million is probably a good number to use.

Kevin Maczka: Okay. And then just finally a kind of high level question – I think ever since we bottomed, investors have kind of had their eye on returning to peak revenues, returning to peak margins, you know, beating prior peak earnings. You know, if you grow 10% or so in 2011, you'll start to get back into that prior '06, '07 revenue run rate, and I know everything on the cost side is not apples to apples here, but is there some reason that we should not be thinking that at that kind of revenue run rate, we get back towards those prior peak margins?

Patrick McHale: Yes, I think you will see that continued drive towards the peak in industrial business, for sure; and of course lube is healing up. We feel pretty good about how they're doing. On the Contractor side, you know, the business looks a lot different than it did in '05 and '06 when we had a strong North America propane; and so I believe that performance in Europe and Asia is going to continue to be strong from a margin standpoint. But until we see some recovery here in end markets in North America, we're going to be digging hard for growth, and it's going to come probably primarily through new products, which are going to have a lot more expenses and a lot less incremental margin associated with them.

So if you take a look at the Contractor segment and you're looking for return to operating margins there, we've got to back to a more normal environment. That's certainly not going to happen this year.

Kevin Maczka: Okay, that's all I had. Thank you.

Operator: Thank you. The next question comes from Christopher Wiggins from Oppenheimer & Co. Please state your question.

Christopher Wiggins: Hi, good morning.

Patrick McHale: Good morning.

Christopher Wiggins: Just a little bit more detail, if I could, on the pricing for 2011. I think last quarter you said you were looking for something in the 2% range. With the kind of run in commodity costs we've had, I'm just curious as to kind of what you went out with and what you expect it to be in 2011.

James Graner: Yes, Chris. We have implemented in Europe and in North America price increases in the neighborhood of 2%.

Christopher Wiggins: Okay.

James Graner: We still feel that they're adequate to cover our commodity cost increases. Again, 2% on, I'll say, 800 million in revenue, and whatever commodity cost increases you're projecting on about 50 million in purchases in the commodity area which, I think, still works favorable for us; but we are watching it and if it became extreme, we do have flexibility to do something further in price increases in 2011.

Christopher Wiggins: Okay, great. And then on Contractor, the—you had done some spending for advertising—I know we had talked about. Any feedback as far as whether or not that was successful and if you expect to re-up that in 2011? Is that what the 2 to $3 million in the first half is related to, or could that be potentially incremental to that extra cost?

Patrick McHale: I'm expecting that 2 to 3 million to be an all-in kind of a cost. I'll tell you that that advertising that we did was not particularly effective, and of course there's a difference between the spring and the fall. But we did more than just the TV advertising. We did some other sorts of approaches and some of those, we think, actually are more effective so we're going to be tweaking our program. A majority of the cost that you're looking at – that 2 to $3 million – has to do with store sets.

You know, we're picking up the full line in 1,700 additional home centers that we didn't have in 2010, and then in about another 1,700 outlets in both home center and propane, we're actually redoing our product displays that we can fit some new product in. And that's really driving, I think, the biggest chunk of that cost.

Christopher Wiggins: Okay, great. And then following up on that, is there any update you can provide as far as in the Contractor segment? You referenced conversion rates before in Europe and Asia, and I'm just curious as to where they kind of sit now and maybe where you think you can get those to over the next couple of years.

Patrick McHale: We continue to see conversion happening. You know, there was, I would say, a little stall in conversion in Contractor in Europe during the depths of the recession. People were just afraid and they weren't spending money, even though we were out there doing the end user conversion. But I believe that we're back on track there. You know, we—outside of the handheld in Europe, we grew 20% our Contractor base business in 2010, and I feel like we're in pretty good shape going into '11. So that conversion continues.

In terms of a percentage basis, I don't have an updated conversion estimate for you at this time. Certainly it's still really low in the East – you know, probably a 10% or less kind of number; and in Western Europe, it's becoming stronger. Asia is kind of a tale of multiple stories. Of course, in Australia the conversion rate is high but in the main growth markets over there, like China, the conversion rate is still disappointingly low. We're the only person out there in the world really trying to do the conversion, and it's a big job. It'd be nice if all of a sudden people started to pick up equipment and put down their brush and roller. But I really think that's a long-term game and we're in early innings of that, and we're going to continue to put resources towards it and we'll make progress every year. We ought to be growing Contractor in Asia on a double-digit basis probably as long as I'm breathing.

Christopher Wiggins: Okay, great. And then, just if I can on lubrication – nice step up sequentially in the fourth quarter, and with the strength you're seeing on the industrial side and the penetration in Asia, I mean, is this kind of revenue number a reasonable run rate to assume for the rest of the year, or is does it kind of step back down to maybe what we were seeing, kind of a 3Q, 2Q range?

Patrick McHale: I'm expecting a good year in lube. You know, we don't give specific guidance, but my anticipation is that the lube division is going to have nice growth in 2011.

Christopher Wiggins: Sorry, and then if I could actually just add on one more comment onto that. I mean, to get the lube back to—margins back up to kind of the 20% range, could you do that? You know, if you get back to kind of the 2007 numbers, any idea, you know, how much absorption tailwinds you would have to kind of get that margin back up towards 20%?

Patrick McHale: Yes, you know, if we get revenue back up to that 90 million kind of a number, we better be at least up in the high teens.

Christopher Wiggins: Okay. Thank you very much.

Operator: Thank you. The next question comes from Ned Borland from Hudson Securities. Please state your question.

Ned Borland: Good morning, guys. Most of my questions have been answered, but I just want a little color on the propane channel. I guess you said that the base business is going to be flat. Is that correct?

Patrick McHale: I think it will be up modestly, but I don't expect that 2011 is going to be the year that we get to ring the bell and all of a sudden things start cooking again. You know, the forecast for housing starts is up modestly. Commercial depends on which data you look at, but I would say that that could be flat to maybe a slight improvement. Remodeling is getting a little bit better. But for our own planning purposes, we expect that the growth we get out of Contractor in '11 is going to be based upon full-year impact of the 2010 new product, and we've got a nice slate of products coming out in 2011 and we're converting more outlets to Graco. So we think that's going to be the way we're going to have to get growth in '11, and if we get some help from the end markets, then we'll take it.

Ned Borland: Okay. And then on your product development efforts and expected product launches for 2011, could you maybe sort of segment what your launches or where your launches are going to come from? Is it mostly Contractor? Is it also industrial?

Patrick McHale: All the divisions have nice product launches scheduled for 2011, and we launched some things late in 2010 that we are pretty excited about as well. You know, the big one that was big enough on an individual product family basis to get the attention was the handheld in Contractor, and we launched that in midyear. So we're going to have to make some hay here in the first half of the year, when we didn't have that product last year, and give ourselves a running start. But in addition to that we've also got some other interesting new products and Contractors, so I would say 2011 has got at least the opportunity across the organization to be as strong as 2010, even though we had the handheld for half a year.

Ned Borland: But you wouldn't expect your new Contractor product launches to carry the same sales and marketing costs that the handheld did, would you?

Patrick McHale: To the extent that we have expanded the handheld product line, they will. I'll tell you that we were at a major trade show recently and we do have some new products coming out in the first half in the handheld line that are different than what we have today, and to the extent that we do that, we'll have some additional costs associated with those.

Ned Borland: Okay, thank you.

Operator: Thank you. The next question comes from Charlie Brady from BMO Capital Markets. Please state your question.

Charles Brady: Hey, thanks. Good morning. I just want to go back to your comment a moment ago on the opportunity in '11. If I heard you correctly, are you saying that from a revenue standpoint, you believe there is potential for '11 to be as strong as '10?

Patrick McHale: I'm specifically talking about new products, and I think there is a potential for our 2011 new products to have as much revenue impact as our 2010 did; and 2010, of course, included the nice launch of the handheld in that May/June kind of timeframe.

Charles Brady: Okay. I appreciate the clarification. And then just specifically on Contractor, I guess what I'm trying to understand from a revenue standpoint, the impact in Q4, and maybe 2010 as a whole. How much of that really is driven by going into new outlets—in cases you're not in before, so you're putting inventory in places it wasn't there before, and once there, kind of what the follow through is or sell-through is once the initial inventory is put in place into that channel. I'm trying to get a sense of the impact from an initial channel placement of the product relative to potential follow-through.

Patrick McHale: Well, let's talk about—let's talk about on the propane side of the business. You know, we had the handheld product launch and we had the pipeline fill that really took place in the second and third quarter of last year, and not really a lot of ordering activity in the fourth quarter. We didn't expect it - I think I talked about that on the prior conference call – as people are working to sell down the load that we had, and of course it wasn't the painting season in the fourth quarter. There's still some inventory in the channel. We're working hard to get that sold out here so that we can get some refill, either late first quarter or into the second quarter, on that product family.

In terms of additional channel, you know, we didn't have any real incremental new channel that was substantial in 2010. We did have spending in the fourth quarter for some incremental channel that we're going to be putting in place here in 2011. In 2010, the primary driver of the handheld revenue was our existing propane accounts, and then I'll call it a modest load on a non-big, kind of a skid sitting in the aisle basis in September for trials through one of our home center partners. So the expense in the fourth quarter and in the first half, a lot of that is going to go to outlets that are new.

Charles Brady: Great, thanks. Very helpful.

Operator: Thank you. The next question comes from Matt Summerville from Keybanc. Please state your question.

Matt Summerville: Morning, Pat. I just wanted to build on some of the color you provided a moment ago. So around midyear, you started launching in propane. That was pretty much fully done in the second and third quarter. You haven't done much yet on the home center side. Now, are you launching currently with one home center versus the other, or are both of these guys going to be customers for this handheld product? You threw around a lot of different numbers in terms of 1,700 here, 1,700 there. I just want to make sure that I have the right picture.

Patrick McHale: The handheld product line will be launched through one of our home center partners.

Matt Summerville: And then are you in all of the major propane outlets that you have sought to be in here in North America?

Patrick McHale: We are with part of our product line. We have a new handheld product that we will be launching. I would guess that we'll most likely start to see revenue on that in the second quarter. That's going to require us to go in and do some work in our existing propane customers' displays in order to get the incremental new handheld product seeded in those locations. So that's how you get to Jim's number of, say, 3,400 locations. 1,700 we're going to have a full line of displays in a home center, and then we've got maybe about another 1,700, maybe even more, where we've got to get in and we've got to rework displays at existing accounts to be able to take the new new handheld line.

James Graner: Matt, I would also like to add a comment to expand on Pat's discussion of the handheld. We did have a successful launch of the handheld in Europe, and we had significant sales in Europe in the fourth quarter with the handheld. It looks like it's going to be a success there again in the professional main channel. But we did have some sales in the fourth quarter for the handheld that were significant.

Patrick McHale: That's a good point. And we also started the launch of handheld product in some countries in Asia in the fourth quarter.

Matt Summerville: Okay. So as far as these heightened levels of expense, I just want to be sure we're thinking about this right. As we move into the back half of 2011, that's when you should see profitability on these newer products start to—I'll use the word normalize. Is that a correct statement?

James Graner: Yes, that's our message. Again, part of it is the caveat with respect to other products that should come out that may also have incremental expense that we're unaware of at this time.

Matt Summerville: Based on where you guys are from a learning curve standpoint on the factory floor with these new products in Contractor, could you maybe spend a minute talking about that? And then if we look out, you know, a year, or two or three years beyond today, how do you think the profitability may or may not differ between what I'll refer to as your core product offering in Contractor versus where you're moving things on the handheld side?

Patrick McHale: Yes, sure. Our factory performance on the handheld product line has improved pretty continuously since the start of production back in the April/May timeframe last year. We've got a lot better productivity and things are running a lot smoother for us out there. So we have seen improvements in our overall performance there.

We're also putting capital in place here. We started—we approved capital last year and we got some of it in the door, but most of it's not up and running yet. It will be through the first half of this year. This should take additional cost out both on machine components and on assembly of the core handheld product itself. So we anticipate further improvements on our manufacturing performance on the handheld as we move through 2011.

In terms of overall impact on profitability, I would anticipate that this would be a lower margin product category than our professional, but I'm expecting that our standard margins and our actual margins will be north of 40 when things settle in.

Matt Summerville: And then just one final – if we look at the absolute level of, I'll call it new product support related spend 2010 versus 2011, is there a number that you guys are budgeting—is there a dollar number that you can give us in absolute terms?

Patrick McHale: For Contractor or for Graco?

Matt Summerville: You know what, Pat? If you're able to give them both, that's great. If you only want to give out Contractor, I certainly understand that.

Patrick McHale: You know, my view is we're probably going to be looking fairly flat, and Jim can, I guess—we haven't talked about that but that's my view. New product development is going to be up a little bit. We're going to have some pressures here in Contractor in the first half, but we had some in the fourth quarter. And we had, I'll call it a fair amount of expediting kind of fees to blow the ProShot through when we were able to get up into production in May and June of last year, and we're hoping that some of that is not going to recur. So I'm hoping it's more or less a wash.

Jim, you want to comment?

James Graner: Yes, Matt, I think if we're talking this category that we've loosely talked about as one-time costs, it should be flat year-over-year; but seasonal, it will be different. They were—at the tail end of 2011, they'll be at the beginning of—excuse me, tail end of 2010, they'll be at the beginning of 2011. I would expect our revenues with respect to this product to be up year-over-year due to the factors that Pat talked about and the additional product offering that we're going to launch in the second quarter.

Matt Summerville: Appreciate the color. Thanks a lot.

Operator: Thank you. The next question comes from Eddie Setso [ph] from Goldman Sachs. Please state your question.

Eddie Setso: Hi, thanks. Just a quick question – I know there have been a lot on Contractor, but just thinking ex-this spending and kind of there is a bit of a new mix there, how should we be thinking about base incrementals for the business? It came in at about 34% in Q4. How should we think about that going forward?

James Graner: Well again, part of the issue, Eddie, is that with respect to the seasonality of the business. You know, the fourth quarter is generally our lowest volume in the Contractor segment, but what you're seeing there is both a reflection of smaller volume growth in North America as opposed to the earlier months. So Pat talked a little bit about the gross margin percentages in the 40s. I would say our expectations for operating margins are no different than they were before in the 20s with this product and for the Contractor division. But we need to get back to the mix we've had before in the professional channel and more volume in the home center business.

Eddie Setso: Okay. And just going on to organic in 2011, you guys did upper 20s – about 20, 29%. How much of that was core market growth versus Graco outperformance versus inventory restock? Just how we calibrate it there.

James Graner: Well, we don't think there is much on the inventory restock, and from what we see that's visible to us from our competitors, we think our outperformance is at least a full 10 percentage points. But that's an estimate.

Eddie Setso: Okay. Just lastly – thinking into Q1 of next year from Q4 of this year, obviously you guys typically see some seasonal drop quarter to quarter. I don't know if there's anything out of the ordinary that you guys are thinking for this quarter—or this quarter versus next quarter, but any color there would be very helpful.

James Graner: Eddie, we're really not seeing anything other than the few dollars in spending we're talking about on the Contractor area. We're expecting the growth to be strong, as Pat mentioned, the expense side to be not as a dramatic as it was in the fourth quarter, but a little bit of noise of going through there.

Eddie Setso: Okay, very good. Thank you very much.

Operator: Thank you. Once again, if you'd like to ask a question, please press the star followed by the one on your telephone.

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

Patrick McHale: All right. Well, thank you for your time this morning. We are optimistic about 2011. We like where we've spent our money. We know spending was high in the fourth quarter, but we've got a lot of good things going on on the new product front. We think the international markets are going to continue to be good, and you know, we've been very aggressive in making investments there. We're going to continue to do that. We think Graco's a great story and we think our underlying business fundamentals are intact; and we're not afraid to put money into organic growth and we think that's going to have a great payback for everybody over the long term. So again, thanks for your time this morning and we'll talk to you in a quarter.

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

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