GRACO INC
Form 10-K
February 21, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

[X] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the fiscal year ended **December 30, 2011**, or

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the transition period from ____________ to ____________.

Commission File No. 001-09249

Graco Inc.

(Exact name of Registrant as specified in its charter)

Minnesota	41-0285640
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

88 11th Avenue Northeast

Minneapolis, MN 55413

(Address of principal executive offices) (Zip Code)

(612) 623-6000

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value $1.00 per share

Preferred Share Purchase Rights

Shares registered on the New York Stock Exchange.

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes X No__

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ___ No X

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No___

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes X No___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer and accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer X Accelerated filer___ Non-accelerated filer___ Smaller reporting company___
Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Act). Yes __ No X

The aggregate market value of 59,733,761 shares of common stock held by non-affiliates of the registrant was $3,078,080,694 as of July 1, 2011.

59,849,230 shares of common stock were outstanding as of February 7, 2012.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company s definitive Proxy Statement for its Annual Meeting of Shareholders to be held on April 20, 2012, are incorporated by reference into Part III, as specifically set forth in said Part III.

Table of Contents

INDEX TO ANNUAL REPORT

ON FORM 10-K

ACCESS TO REPORTS

Investors may obtain access free of charge to the Graco Inc. annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, other reports and amendments to those reports by visiting the Graco website at www.graco.com. These reports

will be available as soon as reasonably practicable following electronic filing with, or furnishing to, the Securities and Exchange Commission.

Table of Contents

PART I

ITEM 1 BUSINESS

Graco Inc. and its subsidiaries (Graco, us, we, or our Company) design, manufacture and sell equipment that pumps, meters, mixes, dispenses and sprays a wide variety of fluids and semi-solids. Primary users of our equipment include contractors and original equipment manufacturers, who use our equipment in a wide variety of applications in the construction, manufacturing, processing and maintenance industries. Our equipment is used to paint, finish, fill, glue and seal a wide range of goods and materials. We sell our equipment primarily through third-party distributors worldwide.

We sell our products in the following geographic markets: the Americas (North and South America), Europe (including the Middle East and Africa) and Asia Pacific. Sales in the Americas represent approximately 53 percent of our Company s total sales; sales in Europe approximately 24 percent; and sales in Asia Pacific approximately 23 percent. Part II, Item 7, *Results of Operations* and Note B to the Consolidated Financial Statements of this Form 10-K contain financial information about these geographic markets. Our Company provides marketing, product design and application assistance to, and employs sales personnel in, each of these geographic regions.

We classify our business into three reportable segments, each with a worldwide focus: Industrial, Contractor and Lubrication. Financial information concerning these segments is set forth in Part II, Item 7, *Results of Operations* and Note B to the Consolidated Financial Statements of this Form 10-K.

Graco Inc. is a Minnesota corporation and was incorporated in 1926. For more information about our Company and its products, services and solutions, visit our website at www.graco.com. The information on the website is not part of this report nor any other report filed or furnished to the Securities and Exchange Commission (SEC).

Our Company s Strengths and Objectives

We invest in development of technologically superior, multi-functional, high quality products. We specialize in providing fluid handling equipment solutions for difficult-to-handle materials with high viscosities, abrasive or corrosive properties and multiple component materials that require precise ratio control. Our products enable customers to reduce their use of labor, material and energy, improve quality and achieve environmental compliance.

We provide a broad product offering to many industries. We consistently make significant investments in new product development and manufacturing capabilities to provide high quality products. We strive to provide strong returns for our stakeholders. Our strong operating results are based on many factors, including strong partnerships with material suppliers, close relationships with end users, and outstanding channel partners that add value. We make market leading investments in new product development, provide products to niche end users with stringent product requirements and provide best-in-class quality and delivery.

All business segments target growth with new products, through global expansion, particularly in advancing economies, and in new markets. Targeted acquisitions, and the worldwide addition of specialized sales employees and specialized distributors, are key components to our Company s growth strategy. We coordinate and drive these growth strategies across our geographic regions.

Our Company has strong financial performance and operating leverage. We have well-positioned channel partners, including independent distributors and selective big box retailers, throughout our geographic regions. Our aftermarket parts and accessories provide a recurring revenue stream.

Manufacturing and Distribution

Manufacturing is a key competency of Graco. Our manufacturing is aligned with our business segments and is co-located with product development to accelerate new product development and improve our cost structure and enhance product quality. Our Company invests significant resources in maximizing the quality, responsiveness and cost-effectiveness of our production operations by investing in equipment and doing critical machining, assembly and testing in-house. Products are manufactured in focused factories and product cells. We source raw materials and components from suppliers around the world. The segments manage operations devoted to the manufacture of their products. Our corporate manufacturing staff provides oversight and strategic direction of our manufacturing resources. Our corporate manufacturing staff also manages those factories not fully aligned with a single segment, and our warehouses, customer service and other shared corporate manufacturing functions. The majority of our manufacturing occurs in the United States, but certain products are manufactured or assembled in the People s Republic of China (P.R.C.) and Belgium.

We distribute our products from our warehouses to third party distributors, who sell Graco products to end-users or re-sellers. Outside of the U.S., our subsidiaries located in Belgium, the P.R.C., Australia, Japan and Korea distribute our Company s products to third party distributors in those regions. Expansion of distribution and sales outside of the United States, in particular in the Asia Pacific region, is a growth strategy of our Company. Our European headquarters in Maasmechelen, Belgium, and our Asia Pacific headquarters in Shanghai, P.R.C. reinforce our long-term commitment to those regions.

During 2011, manufacturing capacity met business demand. Production requirements in the immediate future are expected to be met through existing facilities, the installation of new automatic and semi-automatic machine tools, efficiency and productivity improvements, the use of leased space and available subcontract services.

For more details on our facilities, see Item 2, Properties.

Product Development

Product development efforts are carried out in facilities located in Minneapolis, Anoka and Rogers, Minnesota; North Canton, Ohio; and Suzhou, P.R.C. The product development and engineering groups in each segment focus on new product design, product improvements, new applications for existing products and strategic technologies for their specific customer base. Our product development efforts focus on bringing new and supplemental return-on-investment value to end-users of our products. Total product development expenditures for all segments were $42 million in 2011, $38 million in 2010, and $38 million in 2009.

Our Company strives to generate 30 percent of our annual sales from products introduced in the prior three years. In 2011, we generated 20 percent of our sales from new products. In 2010, the percentage of sales represented by new products was 27 percent and in 2009 it was 26 percent.

Business Segments

Industrial Segment

The Industrial segment is the largest of our Company s businesses and represents approximately 56 percent of our total sales. This segment includes the Industrial Products and the Applied Fluid Technologies divisions. End users of our industrial equipment require solutions to their manufacturing and maintenance challenges and are driven to purchase our industrial equipment by the return on investment that our products provide. The Industrial Products division markets its equipment and services to customers who manufacture, assemble, maintain, repair and refinish products such as appliances, vehicles, airplanes, electronics, cabinets and furniture, and other articles. In addition to marketing its equipment to customers in similar industries, the Applied Fluid Technology division also sells to contractors who use its plural component equipment to apply foam insulation and protective coatings to buildings and other structures.

Most Industrial segment equipment is sold worldwide through general and specialized third-party distributors, integrators, design centers, original equipment manufacturers and material suppliers. We also work with material suppliers to develop or adapt our equipment for use with specialized and hard-to-handle materials. Distributors promote and sell the equipment, hold inventory, provide product application expertise and offer on-site service, technical support and integration capabilities. Integrators implement large individual installations in manufacturing plants where products and services from a number of different vendors are aggregated into a single system. Design centers engineer systems for their customers using our products. Original equipment manufacturers incorporate our Company s Industrial segment products into systems and assemblies that they then supply to their customers.

Industrial Products

The Industrial Products division focuses its product development and sales efforts on two main applications: equipment that applies paint and other coatings to products such as motor vehicles, appliances, furniture and other industrial and consumer products (finishing); and process pump equipment that moves and dispenses chemicals and liquid and semi-solid foods (process pumps).

Our finishing equipment pumps, meters and applies liquids on all types of wood, metal and plastic. Manufacturers in the automotive, automotive feeder, truck/bus/recreational vehicle, military and utility vehicle, aerospace, farm and construction, wood and general metals industries use our liquid finishing products. Our liquid finishing equipment includes paint circulating and paint supply pumps, paint circulating advanced control systems, plural component coating proportioners, various accessories to filter, transport, agitate and regulate fluid, and spare parts such as spray tips, seals and filter screens. We also offer a variety of applicators that use different methods of atomizing and spraying the paint or other coatings depending on the viscosity of the fluid, the type of finish desired, and the need to maximize transfer efficiency, minimize overspray and minimize the release of volatile organic compounds (VOCs) into the air. Our finishing application strategies include being a technology leader and providing environmental compliance solutions.

Our process pumps move chemicals, petroleum, food and other fluids. Manufacturers and processors in the food and beverage, dairy, pharmaceutical, cosmetic, oil and gas, electronics, wastewater, mining and ceramics industries use our process pumps. We offer pumps for sanitary applications including FDA-compliant 3-A sanitary pumps, diaphragm pumps, transfer pumps and drum and bin

Table of Contents

unloaders. Our process pumps provide a mechanized solution to a traditionally manual process in a factory of moving fluids from large barrels into equipment that dispenses the fluid into jars or other containers. In 2011, we purchased certain peristaltic pumps assets of Eccentric Pumps, LLC, providing us with an entry into the industrial peristaltic pump industry.

Applied Fluid Technologies

The Applied Fluid Technologies division directs its engineering, sales and marketing efforts toward two broad types of applications: equipment to pump, meter, mix and dispense high performance protective coatings and polyurethane foam (protective coatings and foam); and equipment to pump, meter, mix and dispense sealants, adhesives, molded polyurethane parts and composites (advanced fluid dispense).

We offer sprayer systems and plural component proportioning equipment to apply protective coatings and foam to a wide variety of surfaces. Reactor® plural component pumps are used to apply foam to insulate things such as walls, water heaters, refrigeration, and hot tubs, create commercial roofing membranes and for packaging, architectural design and cavity filling. This equipment is also used to apply two-component polyurea coatings to tanks, pipes, roofs, truck beds and foundations. In 2011, we expanded the Reactor offering by introducing an entry-level unit in response to needs of the Chinese marketplace and a unit that targets air sealing and insulation in existing homes. Graco s XM Plural-Component Sprayer series is and XP70 plural component sprayers are used for corrosion-control applications such as tank and pipeline coatings, shipbuilding, marine and railcar maintenance, wind tower coating, bridge and infrastructure projects and coating structural steel. The XM sprayers provide precise and variable ratio control in a highly configurable system. The XP70 sprayers are fixed ratio units and intended for applications where variable ratio capability is not required.

Our Company offers pumps, meters, applicators and valves for the metering, mixing and dispensing of precision beads of sealant and adhesive to bond, mold, seal, vacuum encapsulate, pot, laminate and gasket parts and devices in a wide variety of industrial applications. The HFR Metering System is an in-plant, hydraulic, fixed-ratio metering system that applies a range of materials used for noise dampening, insulation and structural integrity. We also offer advanced composites equipment, which includes gel coat equipment, chop and wet-out systems, resin transfer molding systems and applicators , which are used for example in the manufacture of vehicles, aircraft, boats, wind turbines and bridge materials.

In 2011, we entered into an agreement with H.B. Fuller Company pursuant to which Graco will provide specialized equipment that will pump, process and dispense Liquamelt® adhesive manufactured by H.B. Fuller. The Liquamelt system is a new alternative to adhesive systems that provides cool on delivery, hot on demand technology.

Key product strategies of the Applied Fluid Technologies division are to maintain technology leadership in plural component applications, process controls, and electric pumps; and to offer a full range of best-value standard products by using a standardized, modular product structure, with pre-engineered products to cover a broad range of configurations and applications.

Contractor Segment

The Contractor segment generated approximately 33 percent of our Company s 2011 total sales. The Contractor segment directs its product development, sales and marketing efforts toward three broad applications: paint, texture, and pavement maintenance. The Contractor segment markets airless paint and texture sprayers (air, gas, hydraulically- and electrically-powered), accessories such as spray guns, hoses and filters and spare parts such as tips and seals to professional painters in the construction and maintenance industries, tradesmen and do-it-yourselfers. The products are distributed primarily through distributor outlets whose main products are paint and other coatings. Contractor products are also sold through general equipment distributors. Certain sprayers and accessories are distributed globally through the home center channel.

Contractor equipment encompasses a wide variety of sprayers, including sprayers that apply markings on roads, parking lots, fields, bike paths, crosswalks and floors; texture to walls and ceilings; highly viscous coatings to roofs; and paint to walls and structures. Many of these sprayers and their accessories contain one or more technological features such as micro-processor-based controls for consistent spray and protective shut-down, a pump that may be removed and re-installed without tools, an easy-clean feature, gas/electric convertibility, and a durable pump finish. We offer a line of professional grade handheld paint sprayers, and in 2011, we introduced a fine finish handheld paint sprayer that sprays lacquers, varnishes, urethanes, sealers, stains and enamels. Contractor equipment also includes pressure washers, and scarifiers that remove markings on roads and other surfaces.

Continual technological innovation and broad product families with multiple offerings are characteristic of our Contractor segment. Painters are encouraged to upgrade their equipment regularly to take advantage of the new and/or more advanced features. Strategies of the Contractor segment include expanding base markets using new and core technologies.

Contractor products are marketed and sold in all major geographic areas. In 2011, we continued to add distributors throughout the world that specialize in the sale of particular Contractor products as we expand our product offerings. In Europe and Asia Pacific, we are pursuing a broad strategy of converting contractors accustomed to the manual application of paint and other coatings by brush and roller to spray technology. This requires extensive in-person demonstration of the productivity advantages, cost savings and finish quality of our spray equipment. This also requires the conversion of local paint distributors who may have a different method of selling their product.

Lubrication Segment

The Lubrication segment represented approximately 11 percent of our Company s sales during 2011. The Lubrication segment focuses its engineering, marketing and sales efforts on two main lubrication applications: vehicle services and industrial. The Lubrication segment markets and sells our lubrication equipment worldwide, although the bulk of its sales come from North America. Products are distributed in each major geographic region. Our lubrication products are sold through independent third party distributors and oil jobbers, and directly to original equipment manufacturers. Our key Lubrication segment strategies are to provide products with differentiated features that are unique to the industries served, and to develop products for geographic expansion. In 2011, our Lubrication segment further expanded its focus on new industries and global end-user needs.

We supply pumps, hose reels, meters, valves and accessories to the motor vehicle lubrication industry. Our customers include fast oil change facilities, service garages, fleet service centers, automobile dealerships and auto parts stores.

In industrial lubrication, we offer systems, components, and accessories for the automatic lubrication of industrial and commercial equipment, compressors, turbines, and on- and off-road vehicles. Industries served include gas transmission and petrochemical, pulp and paper, mining and construction, agricultural equipment, food and beverage, material handling, metal manufacturing and wind energy. We offer products that automatically lubricate bearings, gears and generators, and products that evacuate and dispense oil, grease, anti-freeze and hydraulic fluids, from wind power components.

Raw Materials

The primary materials and components that we use in our manufacturing processes are steel of various alloys, sizes and hardness; specialty stainless steel and aluminum bar stock, tubing and castings; tungsten carbide; electric and gas motors; injection molded plastics; sheet metal; forgings; powdered metal; hoses; and electronic components. The raw materials and components that we use are generally adequately available through multiple sources of supply. In order to manage cost, we continue to increase our global sourcing of materials and components, primarily in the Asia Pacific region.

During the first half of 2011, the prices of aluminum, nickel, copper, steel, rubber, plastics, and tungsten carbide significantly increased over 2010 pricing levels. During the second half of the year, prices of these materials stabilized, with some exceptions. Nickel, copper, and aluminum declined significantly from mid-2011 pricing levels. Prices of specialty plastics have increased significantly from mid-2011 pricing levels. The March 2011 tsunami in Japan had no major impact on our ability to obtain the materials and components that we had previously sourced in that geography.

We endeavor to address fluctuations in the price and availability of various materials and components through adjustable surcharges and credits, close management of current suppliers, price negotiations and an intensive search for new suppliers. Worldwide electronic component supply shortages have increased lead times on these components. We have performed risk assessments of our key suppliers of electronic components and other commodities, and we factor the risks identified into our commodity plans.

Intellectual Property

We own a number of patents and have patent applications pending both in the United States and in other countries, license our patents to others, and are a licensee of patents owned by others. In our opinion, our business is not materially dependent upon any one or more of these patents or licenses. Our Company also owns a number of trademarks in the United States and foreign countries, including registered trademarks for GRACO, several forms of a capital G, Airlessco, ASM, and various product trademarks that are material to our business, inasmuch as they identify Graco and our products to our customers.

Competition

We face substantial competition in all of our markets. The nature and extent of this competition varies in different markets due to the depth and breadth of our Company s products. Product quality, reliability, design, customer support and service, personal relationships, specialized engineering and pricing are the major competitive factors in the industries we serve. Although no competitor duplicates all of our products, some competitors are larger than our Company, both in terms of sales of directly competing products and in terms of total sales and financial resources. We also face competitors with different cost structures and expectations of profitability and these companies offer competitive products at lower prices. We believe we are one of the world s leading producers of high-quality specialized fluid handling equipment in the industries we serve.

Environmental Protection

Our compliance with federal, state and local environmental laws and regulations did not have a material effect upon our capital expenditures, earnings or competitive position during the fiscal year ended December 30, 2011.

Employees

As of December 30, 2011, we employed approximately 2,300 persons. Of this total, approximately 550 were employees based outside the United States, and 800 were hourly factory workers in the United States. None of our Company s U.S. employees are covered by a collective bargaining agreement. Various national industry-wide labor agreements apply to certain employees in various countries outside the United States. Compliance with such agreements has no material effect on our Company or our operations.

Item 1A. Risk Factors

Changes in Laws and Regulations   Changes may impact how we can do business and the cost of doing business around the world.

The speed and frequency of implementation of new laws and regulations globally appears to be increasing. In addition, as our business grows and/or geographically expands, we may become subject to laws and regulations previously inapplicable to our business. These new laws and regulations are increasing our costs of doing business and may impact our long-term ability to provide returns to our shareholders.

Economic Environment   Demand for our products depends on the level of commercial and industrial activity worldwide.

An economic downturn or financial market turmoil, including the European sovereign debt crisis, may depress demand for our equipment in all major geographies and markets. If our distributors and OEMs are unable to purchase our products because of unavailable credit or unfavorable credit terms or are simply unwilling to purchase our products, our net sales and earnings will be adversely affected.

Acquisitions   Our growth strategy includes acquisitions. Suitable acquisitions must be located, completed and effectively integrated into or added to our existing businesses in order for this strategy to be successful.

We have identified acquisitions as one of the strategies by which we intend to grow our business. If we are unable to obtain financing at a reasonable cost, are unsuccessful in acquiring and effectively integrating into or adding businesses to our current operations, or do not realize projected efficiencies and cost-savings from the businesses we acquire, we may be unable to meet our growth or profit objectives.

Proposed Acquisition   Our proposed acquisition of the finishing business operations of Illinois Tool Works Inc. is subject to regulatory approvals and the expected benefits from the acquisition may not be fully realized.

We have entered into a definitive agreement to purchase the finishing business of Illinois Tools Works Inc. (ITW) in a $650 million cash transaction. We cannot predict whether or when the required regulatory approvals will be obtained or if the closing conditions will be satisfied. On December 15, 2011, the Federal Trade Commission (FTC) issued an administrative complaint against our Company, seeking to stop the acquisition, and commenced a civil lawsuit in United States District Court, seeking to temporarily enjoin us from acquiring the finishing business of ITW, pending resolution of the administrative proceeding. The Court recently scheduled a trial on the FTC s motion to enjoin the transaction, commencing July 17, 2012. The purchase agreement with ITW allows for termination by either party after April 1, 2012. We continue to have discussions with ITW and with the FTC regarding possible resolution. The FTC may condition approval of the acquisition on conduct remedies or the divestiture of certain products, certain product categories or other portion of the ITW finishing business, which, if agreed to by the Company, may materially affect the anticipated benefits of the proposed acquisition, and there can be no assurance that such a divestiture can be completed on terms satisfactory to us and the FTC. If we terminate the agreement before April 1, 2012 due to failure to obtain regulatory approval, we will be required to pay a $20 million termination fee. If the transaction closes, significant changes to our financial condition as a result of global economic changes or difficulties in the integration of the newly acquired businesses may affect our ability to obtain the expected benefits from the transaction or to satisfy the financial covenants included in the terms of the financing arrangements.

Foreign Operations   Conditions in foreign countries and changes in foreign exchange rates may impact our sales volume, rate of growth or profitability.

In 2011, approximately 56 percent of our sales were generated by customers located outside the United States. Operations located outside the United States expose us to special risks, including the risk of terrorist activities, civil disturbances, environmental

catastrophes, supply chain disruptions, corruption, and special taxes, regulations and restrictions. Changes in foreign regulations could reduce our growth. We are increasing our presence in advancing economies and political instability, war and volatile economic conditions that are more prevalent in these regions may adversely affect our revenues and net income. Changes in exchange rates between the U.S. dollar and other currencies will impact our reported sales and earnings and may make it difficult for some of our distributors to purchase products.

Suppliers   Risks associated with foreign sourcing of raw materials and components, supply interruption, delays in raw material or component delivery or supply shortages may adversely affect our production or profitability.

We are sourcing an increasing percentage of our materials and components from suppliers outside the United States, and from suppliers within the United States who engage in foreign sourcing. Long lead times or supply interruptions associated with a global supply base may reduce our flexibility and make it more difficult to respond promptly to fluctuations in demand or respond quickly to product quality problems. Changes in exchange rates between the U.S. dollar and other currencies and fluctuations in the price of commodities may impact the manufacturing costs of our products and affect our profitability. Protective tariffs, unpredictable changes in duty rates, and trade regulation changes may make certain foreign-sourced parts no longer competitively priced. Long supply chains may be disrupted by environmental events. Raw materials such as rare earth metals may become limited in availability from certain regions.

Competition   Demand for our products may be affected by new entrants who copy our products and infringe on our intellectual property.

From time to time, our Company has been faced with instances where competitors have intentionally infringed our intellectual property and/or taken advantage of our design and development efforts. In some instances, these competitors have launched broad marketing campaigns. If our Company is unable to effectively meet these challenges, they could adversely affect our revenues and profits and hamper our ability to grow.

Major Customers   Our Contractor segment depends on a few large customers for a significant portion of its sales. Significant declines in the level of purchases by these customers could reduce our sales and impact segment profitability.

Our Contractor segment derives a significant amount of revenue from a few large customers. Substantial decreases in purchases by these customers, difficulty in collecting amounts due or the loss of their business would adversely affect the profitability of this segment. The business of these customers is dependent upon the economic vitality of the construction and home maintenance markets. If these markets decline, the business of our customers could be adversely affected and their purchases of our equipment could decrease.

Natural Disasters   Our operations are at risk of damage or destruction by natural disasters, such as earthquakes, tornadoes or unusually heavy precipitation.

The loss of, or substantial damage to, one of our facilities could make it difficult to supply our customers with product and provide our employees with work. Our manufacturing and distribution facility in Minneapolis is on the banks of the Mississippi River where it is exposed to flooding. Flooding could also damage our European headquarters and warehouse in Maasmechelen, Belgium, our factory in Suzhou, P.R.C., or our Asia Pacific headquarters in Shanghai, P.R.C. Tornadoes could damage or destroy our facilities in Sioux Falls, Rogers, Minneapolis or Anoka and a typhoon could do the same to our facilities in Suzhou or Shanghai. An earthquake may adversely impact our operations in Suzhou, Shanghai, or Yokohama.

Item 1B. Unresolved Staff Comments

None.

Table of Contents

Item 2. Properties

Our facilities are in satisfactory condition, suitable for their respective uses, and are generally adequate to meet current needs. A description of our principal facilities is set forth in the chart below. Facilities are used by all segments, unless otherwise noted.

Facility	Owned or Leased	Square Footage	Facility Activities
United States			
Worldwide Headquarters, Russell J. Gray Technical Center, in Minneapolis, Minnesota	Owned	142,000	Corporate office; Office and product development for Industrial segment
Riverside Office Complex in Minneapolis, Minnesota	Owned	42,000	Office for Information Systems, Accounting Services and Purchasing Departments
George Aristides Riverside Center in Minneapolis, Minnesota	Owned	405,000	Manufacturing, warehouse and office for Industrial segment
Warehouse in Minneapolis, Minnesota	Owned	46,000	Warehouse for Contractor and Lubrication segments
Anoka, Minnesota	Owned	207,000	Manufacturing, warehouse, office and product development for Lubrication segment
David A. Koch Center in Rogers, Minnesota	Owned	333,000	Manufacturing, warehouse, office and product development for Contractor segment
North Canton, Ohio	Owned	132,000	Manufacturing, warehouse, office, product development and application laboratory for Industrial segment
Sioux Falls, South Dakota	Owned	149,000	Manufacturing, warehouse and office for Industrial and Contractor segment spray guns and accessories
Europe			
European Headquarters in Maasmechelen, Belgium	Owned	129,000	Office, warehouse and assembly; European training, testing and education center
Asia Pacific			
Bundoora, Australia	Leased	2,500	Office
Derrimut, Australia	Leased	7,500	Warehouse
Asia Pacific Headquarters in Shanghai, P.R.C.	Leased	29,000	Office; Asia Pacific training, testing and education center
Shanghai Waigaoqiao Free Trade Zone, P.R.C.	Leased	13,700	Warehouse
Suzhou, P.R.C.	Owned	79,000	Manufacturing, warehouse, office and product development

Hong Kong Special Admin. Region, P.R.C.	Leased	600	Office
Gurgaon, India	Leased	150	Office
Yokohama, Japan	Leased	18,500	Office
Anyang, South Korea	Leased	5,100	Office
Gwangjoo, South Korea	Leased	10,700	Warehouse
Ho Chi Minh City, Vietnam	Leased	230	Office

Table of Contents

Item 3. Legal Proceedings

Our Company is engaged in routine litigation, administrative proceedings and regulatory reviews incident to our business. It is not possible to predict with certainty the outcome of these unresolved matters, but management believes that they will not have a material adverse effect upon our operations or consolidated financial position.

Item 4. Mine Safety Disclosures

Not applicable.

Executive Officers of Our Company

The following are all the executive officers of Graco Inc. as of February 21, 2012:

Patrick J. McHale, 50, is President and Chief Executive Officer, a position he has held since June 2007. He served as Vice President and General Manager, Lubrication Equipment division from June 2003 to June 2007. He was Vice President of Manufacturing and Distribution Operations from April 2001 to June 2003. He served as Vice President, Contractor Equipment division from February 2000 to March 2001. Prior to becoming Vice President, Lubrication Equipment division in September 1999, he held various manufacturing management positions in Minneapolis, Minnesota; Plymouth, Michigan; and Sioux Falls, South Dakota. Mr. McHale joined the Company in 1989.

David M. Ahlers, 53, became Vice President, Human Resources and Corporate Communications in April 2010. From September 2008 through March 2010, he served as the Company s Vice President, Human Resources. Prior to joining Graco, Mr. Ahlers held various human resources positions, including, most recently, Chief Human Resources Officer and Senior Managing Director of GMAC Residential Capital, from August 2003 to August 2008. He joined the Company in 2008.

Caroline M. Chambers, 47, became Vice President and Controller in December 2006 and has served as the Company s principal accounting officer since September 2007. She was Corporate Controller from October 2005 to December 2006 and Director of Information Systems from July 2003 through September 2005. Prior to becoming Director of Information Systems, she held various management positions in the internal audit and accounting departments. Prior to joining Graco, Ms. Chambers was an auditor with Deloitte & Touche in Minneapolis, Minnesota and Paris, France. Ms. Chambers joined the Company in 1992.

Karen Park Gallivan, 55, became Vice President, General Counsel and Secretary in September 2005. She was Vice President, Human Resources from January 2003 to September 2005. Prior to joining Graco, she was Vice President of Human Resources and Communications at Syngenta Seeds, Inc., from January 1999 to January 2003. From 1988 through January 1999, she was the general counsel of Novartis Nutrition Corporation. Prior to joining Novartis, Ms. Gallivan was an attorney with the law firm of Rider, Bennett, Egan & Arundel, L.L.P. She joined the Company in 2003.

James A. Graner, 67, became Chief Financial Officer in September 2005, and he also served as Treasurer from September 2005 to June 2011. He served as Vice President and Controller from March 1994 to September 2005. He was Treasurer from May 1993 through February 1994. Prior to becoming Treasurer, he held various managerial positions in the treasury, accounting and information systems departments. He joined the Company in 1974.

Dale D. Johnson, 57, became Vice President and General Manager, Contractor Equipment division in April 2001. From January 2000 through March 2001, he served as President and Chief Operating Officer. From December 1996 to January 2000, he was Vice President, Contractor Equipment division. Prior to becoming the Director of Marketing, Contractor Equipment division, in June 1996, he held various marketing and sales positions in the Contractor Equipment division and the Industrial Equipment division. He joined the Company in 1976.

Jeffrey P. Johnson, 52, is Vice President and General Manager, Asia Pacific, a position he has held since February 2008. He served as Director of Sales and Marketing, Applied Fluid Technologies division, from June 2006 until February 2008. Prior to joining Graco, he held various sales and marketing positions, including, most recently, President of Johnson Krumwiede Roads, a full-service advertising agency, and European sales manager at General Motors Corp. He joined the Company in 2006.

David M. Lowe, 56, became Vice President and General Manager, Industrial Products division in February 2005. He was Vice President and General Manager, European Operations from September 1999 to February 2005. Prior to becoming Vice President, Lubrication Equipment division in December 1996, he was Treasurer. Mr. Lowe joined the Company in 1995.

Simon J.W. Paulis, 64, became Vice President and General Manager, Europe in September 2005. From February 2005 to September 2005, he served as Director and General Manager, Europe. He served as Sales and Marketing Director, Contractor Equipment Europe

Table of Contents

from January 1999 to September 2005. Prior to joining Graco, he served as business unit manager for Black & Decker N.V., general sales manager for Alberto Culver, and marketing manager for Ralston Purina/Quaker Oats. Mr. Paulis joined the Company in 1999.

Charles L. Rescorla, 60, became Vice President, Corporate Manufacturing, Information Systems and Distribution Operations in June 2011. He was Vice President, Manufacturing, Information Systems and Distribution Operations from April 2009 to June 2011. He served as Vice President, Manufacturing and Distribution Operations from September 2005 to April 2009. From June 2003 to until September 2005, he was Vice President, Manufacturing/Distribution Operations and Information Systems. From April 2001 until June 2003, he was Vice President of the Industrial/Automotive Equipment division. Prior to June 2003, he held various positions in manufacturing and engineering management. Mr. Rescorla joined the Company in 1988.

Christian E. Rothe, 37, became Vice President and Treasurer in June 2011. Prior to joining Graco, he held various positions in business development, accounting and finance, including, most recently, at Gardner Denver, Inc., a manufacturer of highly engineered products, as Vice President, Treasurer from January 2011 to June 2011, Vice President - Finance, Industrial Products Group from October 2008 to January 2011, and Director, Strategic Planning and Development from October 2006 to October 2008. Mr. Rothe joined the Company in 2011.

Mark W. Sheahan, 47, became Vice President and General Manager, Applied Fluid Technologies division in February 2008. He served as Chief Administrative Officer from September 2005 until February 2008, and was Vice President and Treasurer from December 1998 to September 2005. Prior to becoming Treasurer in December 1996, he was Manager, Treasury Services, where he was responsible for strategic and financial activities. He joined the Company in 1995.

Brian J. Zumbolo, 42, became Vice President and General Manager, Lubrication Equipment division in August 2007. He was Director of Sales and Marketing, Lubrication Equipment and Applied Fluid Technologies, Asia Pacific, from November 2006 through July 2007. From February 2005 to November 2006, he was the Director of Sales and Marketing, High Performance Coatings & Foam, Applied Fluid Technologies division. Mr. Zumbolo was the Director of Sales and Marketing, Finishing Equipment from May 2004 to February 2005. Prior to May 2004, he held various marketing positions in the Industrial Equipment division. Mr. Zumbolo joined the Company in 1999.

The Board of Directors elected or re-elected the above executive officers to their current positions on June 10, 2011.

Table of Contents

PART II

Item 5. Market for the Company s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

Graco Common Stock

Graco common stock is traded on the New York Stock Exchange under the ticker symbol GGG. As of February 7, 2012, the share price was $48.56 and there were 59,849,230 shares outstanding and 2,874 common shareholders of record, which includes nominees or broker dealers holding stock on behalf of an estimated 48,000 beneficial owners.

The graph below compares the cumulative total shareholder return on the common stock of the Company for the last five fiscal years with the cumulative total return of the S&P 500 Index and the Dow Jones Industrial Machinery Index over the same period (assuming the value of the investment in Graco common stock and each index was $100 on December 29, 2006, and all dividends were reinvested).

Table of Contents

Quarterly Financial Information (Unaudited)

(In thousands, except per share amounts)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2011				
Net sales	$ 217,679	$ 234,663	$ 227,347	$ 215,594
Gross profit	124,397	132,446	126,349	117,013
Net earnings	37,253	38,099	36,552	30,424
Per common share				
Basic net earnings	$ 0.62	$ 0.63	$ 0.60	$ 0.51
Diluted net earnings	0.61	0.61	0.60	0.50
Dividends declared	0.21	0.21	0.21	0.23
Stock price (per share)				
High	$ 46.40	$ 52.10	$ 54.41	$ 45.20
Low	38.83	42.56	32.84	32.01

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2010				
Net sales	$ 164,721	$ 192,088	$ 189,963	$ 197,293
Gross profit	89,295	101,920	104,558	107,672
Net earnings	20,565	24,836	30,431	27,008
Per common share				
Basic net earnings	$ 0.34	$ 0.41	$ 0.51	$ 0.45
Diluted net earnings	0.34	0.41	0.50	0.44
Dividends declared	0.20	0.20	0.20	0.21
Stock price (per share)				
High	$ 31.82	$ 35.98	$ 32.61	$ 40.56
Low	25.82	28.74	27.05	30.05

Table of Contents

Issuer Purchases of Equity Securities

On September 18, 2009, the Board of Directors authorized the Company to purchase up to 6,000,000 shares of its outstanding common stock, primarily through open-market transactions. The authorization expires on September 30, 2012.

In addition to shares purchased under the Board authorization, the Company purchases shares of common stock held by employees who wish to tender owned shares to satisfy the exercise price or tax withholding on stock option exercises.

Information on issuer purchases of equity securities follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (at end of period)
Oct 1, 2011 - Oct 28, 2011	130,000	$ 33.97	130,000	3,990,978
Oct 29, 2011 - Nov 25, 2011	10,153	$ 45.06	-	3,990,978
Nov 26, 2011 - Dec 30, 2011	-	$ -	-	3,990,978

Item 6. Selected Financial Data

Graco Inc. and Subsidiaries (in thousands, except per share amounts)

	2011	2010	2009	2008	2007
Net sales	$ 895,283	$ 744,065	$ 579,212	$ 817,270	$ 841,339
Net earnings	142,328	102,840	48,967	120,879	152,836
Per common share					
Basic net earnings	$ 2.36	$ 1.71	$ 0.82	$ 2.01	$ 2.35
Diluted net earnings	2.32	1.69	0.81	1.99	2.32
Cash dividends declared	0.86	0.81	0.77	0.75	0.68
Total assets	$ 874,309	$ 530,474	$ 476,434	$ 579,850	$ 536,724
Long-term debt (including current portion)	300,000	70,255	86,260	180,000	107,060

Table of Contents

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following Management s Discussion and Analysis reviews significant factors affecting the Company s consolidated results of operations, financial condition and liquidity. This discussion should be read in conjunction with our financial statements and the accompanying notes to the financial statements. The discussion is organized in the following sections:

- Overview
- Results of Operations
- Segment Results
- Financial Condition and Cash Flow
- Critical Accounting Estimates
- Outlook

Overview

Graco designs, manufactures and markets systems and equipment to pump, meter, mix and dispense a wide variety of fluids. The Company specializes in equipment for applications that involve difficult-to-handle materials with high viscosities, materials with abrasive or corrosive properties and multiple-component materials that require precise ratio control. Graco sells primarily through independent third-party distributors worldwide to industrial and contractor end-users. More than half of our sales are outside of the United States. Graco s business is classified by management into three reportable segments, each responsible for product development, manufacturing, marketing and sales of their products. The segments are headquartered in North America. They have responsibility for sales and marketing in the Americas and joint responsibility with Europe and Asia Pacific regional management for sales and marketing in those geographic areas.

Graco s key strategies include developing and marketing new products, expanding distribution globally, opening new markets with technology and channel expansion and completing strategic acquisitions. Long-term financial growth targets accompany these strategies, including our expectation of 10 percent revenue growth and 12 percent net earnings growth.

Manufacturing is a key competency of the Company. Our management team in Minneapolis provides strategic manufacturing expertise, and is also responsible for factories not fully aligned with a single division. Our primary manufacturing facilities are in the United States and distribution facilities are located in the United States, Belgium, P.R.C., Japan, Korea and Australia.

In April 2011, we entered into an agreement to purchase the finishing businesses of Illinois Tools Works Inc. (ITW) for $650 million in cash. The purchase agreement allows for termination by either party after April 1, 2012. The ITW businesses manufacture and distribute equipment for industrial liquid finishing, powder coating and automotive refinishing, worldwide, with 2010 revenues exceeding $305 million annually. The Federal Trade Commission (FTC) issued an administrative complaint and commenced a civil lawsuit to challenge our purchase of these businesses. A trial on the civil matter has been scheduled commencing July 17, 2012. We strongly believe the transaction is pro-competitive and will benefit both end users and distributor partners. We continue to have discussions with ITW and with the FTC regarding possible resolution.

Results of Operations

Net sales, operating earnings, net earnings and earnings per share were as follows (in millions except per share amounts):

	2011	2010	2009
Net Sales	$ 895	$ 744	$ 579
Operating Earnings	220	153	74
Net Earnings	142	103	49
Diluted Net Earnings per Common Share	$ 2.32	$ 1.69	$ 0.81

2011 Summary:

- Our revenues grew by 20 percent, with double-digit growth in all regions and segments. Fiscal 2010 included an additional week as compared to fiscal 2011. By region, sales increased by 17 percent in the Americas, 19 percent in Europe and 32 percent in Asia Pacific. Sales in the Industrial segment grew by 23 percent; sales in the Contractor segment grew by 13 percent and sales in the

Lubrication segment increased by 32 percent.
Foreign currency translation rates increased sales by $17 million and increased net income by $7 million in 2011 as compared to the translation rates in 2010, with strength in Asian currencies and the euro during much of the year.
Operating earnings were $220 million as compared to $153 million in the prior year, and as a percentage of sales were 25 percent as compared to 21 percent in 2010.

Net earnings totaled $142 million or $2.32 diluted earnings per share as compared to $103 million or $1.69 diluted earnings per share in 2010.
Gross profit margin as a percentage of sales improved by 2 percentage points from 2010, due to higher production volumes, pricing and favorable translation rates, partially offset by higher material costs.
Investment in new product development was $42 million or 5 percent of sales in 2011.
Total operating expenses were $30 million higher than 2010. Half of the increase was in selling, marketing and distribution expenses, including strategic spending to generate and support growth, especially in Asia Pacific. General and administrative expenses for the year increased by $11 million, including $8 million related to the proposed acquisition of ITW s finishing businesses.
The effective tax rate was 32 percent as compared to 31 percent in 2010. The rate in the prior year reflected the benefit from changes in unrecognized tax benefits.
Cash flows from operations grew to $162 million compared to $101 million. Working capital investments to support the increased business included an increase in inventories of $13 million and an increase in accounts receivable of $27 million.
We sold $300 million of unsecured notes in a private placement, with maturities of 7 to 15 years. An additional committed $450 million revolving credit facility was also secured to fully finance the proposed acquisition of the ITW finishing businesses and provide additional liquidity for general business purposes. This revolving credit facility is contingent on closing of the proposed acquisition and issuance of an additional $75 million in long-term notes.
Dividends totaled $51 million in 2011 and share repurchases totaled $43 million.

2010 Summary:

Revenues grew by 28 percent, benefiting from the global industrial recovery and the Company s investments in new products, innovative technologies and commercial capabilities to support geographic expansion. Sales growth in all segments and regions exceeded 20 percent. By region, sales increased 24 percent in the Americas, 25 percent in Europe and 46 percent in Asia Pacific. Sales in the Industrial segment grew by 31 percent; sales in the Contractor segment grew by 23 percent and sales in the Lubrication segment increased by 35 percent.
Translation rates did not have a significant impact on sales and earnings in 2010. Changes in Asian currencies and the Canadian dollar largely offset the effects of changes in the euro.
Operating earnings were $153 million as compared to $74 million in the prior year, and as a percentage of sales were 21 percent, up from 13 percent in 2009.
Net earnings totaled $103 million or $1.69 diluted earnings per share as compared to $49 million or $0.81 diluted earnings per share in 2009.
There were 53 weeks in fiscal 2010 and 52 weeks in fiscal 2009.
Gross profit margin as a percentage of sales improved by 3 $^{1}/2$ percentage points from 2009, mainly due to reduction in unabsorbed manufacturing costs as compared to the prior year. Other factors contributing to improvement in the gross margin rate included selling price increases and lower pension costs in 2010, and costs related to workforce reductions that lowered the 2009 rate.
Investment in new product development was $38 million or 5 percent of sales in 2010.
Total operating expenses were $32 million higher than 2009. The significant recovery in sales and earnings in 2010 resulted in higher incentive expense, accounting for approximately two-thirds of the increase in operating expense for the year. Operating expense as a percentage of sales decreased to 33 $^{1}/2$ percent in 2010 from 37 $^{1}/2$ percent.
The effective tax rate was 31 percent as compared to 29 percent in 2009. The effect of the federal R&D tax credit of $2 $^{1}/2$ million and the domestic production deduction was lower in 2010 as a percentage of pre-tax earnings as compared to 2009.
Cash flows from operations were strong at $101 million, though lower than the prior year as working capital requirements for accounts receivable and inventory increased in-line with sales growth.

The following table presents net sales by geographic region (in millions):

	2011	2010	2009
Americas[1]	$ 476	$ 408	$ 329
Europe[2]	211	178	143
Asia Pacific	208	158	107
Total	$ 895	$ 744	$ 579

1

North and South America, including the United States. Sales in the United States were $394 million in 2011, $341 million in 2010 and $280 million in 2009.

[2] Europe, Africa and Middle East

Table of Contents

In 2011, sales in the Americas increased by 17 percent, with increases of 17 percent in the Industrial segment, 13 percent in the Contractor segment and 25 percent in the Lubrication segment as compared to the prior year. Although residential and commercial construction activity remains low, industrial end-markets continued to strengthen in 2011.

In 2011, sales in Europe increased by 19 percent or 14 percent at consistent translation rates, with increases of 23 percent in the Industrial segment, 9 percent in the Contractor segment and 38 percent in the Lubrication segment. We continue to invest in commercial resources in the developing economies of Eastern Europe, Middle East and Africa, and despite the Eurozone sovereign debt crisis, industrial and lubrication end-markets continue to grow.

In 2011, sales growth in Asia Pacific was 32 percent or 27 percent at consistent translation rates, with an increase of 31 percent in the Industrial segment, 25 percent in the Contractor segment and 57 percent in the Lubrication segment. Additional commercial resources were added in each segment in Asia Pacific in 2011, and our focus on new distribution to support these growing economies continued in 2011.

In 2010, sales in the Americas increased by 24 percent overall, with increases of 26 percent in the Industrial segment, 22 percent in the Contractor segment and 23 percent in the Lubrication segment as compared to the prior year. Most end-markets strengthened in 2010, though some select industries, such as residential and commercial construction, remain weak. More than half of the increase in the Contractor segment was due to new product launches.

In 2010, sales in Europe were strong across all segments, with an increase of 25 percent overall and 24 percent in the Industrial segment, 24 percent in the Contractor segment and 56 percent in the Lubrication segment. Sales growth was strong throughout the region.

In 2010, sales growth in Asia Pacific was especially significant, increasing 46 percent overall and exceeding pre-recession levels. Sales grew 49 percent in the Industrial segment, 24 percent in the Contractor segment and more than double the prior year sales in the Lubrication segment. The Company has continued to invest in this region with additional commercial resources and focus on new distribution to support growing end markets.

The following table presents components of net sales change:

	2011						
	Segment			Region			
	Industrial	Contractor	Lubrication	Americas	Europe	Asia Pacific	Consolidated
Volume and Price	20 %	11 %	30 %	16 %	14 %	27 %	18 %
Currency	3 %	2 %	2 %	1 %	5 %	5 %	2 %
Total	23 %	13 %	32 %	17 %	19 %	32 %	20 %

	2010						
	Segment			Region			
	Industrial	Contractor	Lubrication	Americas	Europe	Asia Pacific	Consolidated
Volume and Price	30 %	23 %	33 %	23 %	29 %	41 %	28 %
Currency	1 %	- %	2 %	1 %	(4) %	5 %	- %
Total	31 %	23 %	35 %	24 %	25 %	46 %	28 %

Table of Contents

The following table presents an overview of components of operating earnings as a percentage of net sales:

	2011	2010		2009
Net Sales	100.0 %	100.0 %		100.0 %
Cost of products sold	44.1	45.8		49.4
Gross profit	55.9	54.2		50.6
Product development	4.7	5.1	&nbs	