

GRACO INC
Form 10-K
February 18, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended **December 27, 2013**, 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
(State or other jurisdiction of incorporation or organization)

41-0285640
(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

Shares registered on the New York Stock Exchange.

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

None

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

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 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 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. [X]

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 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

The aggregate market value of 60,501,329 shares of common stock held by non-affiliates of the registrant was \$3,824,289,015 as of June 28, 2013.

60,862,154 shares of common stock were outstanding as of February 4, 2014.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive Proxy Statement for its Annual Meeting of Shareholders to be held on April 25, 2014, are incorporated by reference into Part III, as specifically set forth in said Part III.

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ON FORM 10-K**

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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 the 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.

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PART I

Item 1. Business

Graco Inc. and its subsidiaries (Graco, us, we, or our Company) design, manufacture and market premium equipment to pump, meter, mix and dispense a wide variety of fluids and coatings. Our equipment is used around the world in a broad range of industries, including construction; automotive; industrial and machinery; mining, oil and gas; public works and other industries.

We sell our products in the following geographic markets: North, Central and South America (the Americas); Europe, Middle East and Africa (EMEA); and Asia Pacific. Sales in the Americas represent approximately 54 percent of our Company's total sales; sales in EMEA approximately 26 percent; and sales in Asia Pacific approximately 20 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. We provide marketing and product design in each of these geographic regions. Our Company also provides application assistance to distributors 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 our 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 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. We aim to serve niche markets, providing high customer value through product differentiation. Our products enable customers to reduce their use of labor, material and energy, improve quality and achieve environmental compliance.

We strive for, and we believe we achieve, manufacturing and engineering excellence. We centralize our manufacturing operations, which allows for leveraging overhead. Graco has a continuous improvement culture, and we make ongoing capital investments in our manufacturing facilities. Our high quality manufacturing and engineering drive cost savings, reliability and quality in our products.

Our strategies for long-term growth include investing in new products, expanding geographically, targeting new industries and making acquisitions. We make significant investments in developing innovative, high quality products. We strategically add commercial resources focused on expanding third party distribution in growing and emerging markets. We leverage our product technologies for new applications and markets. We make targeted acquisitions, including one small acquisition in 2013 and a second small acquisition in early fiscal year 2014. We coordinate and drive these long-term growth strategies across our geographic regions.

We have strong relationships with material suppliers, end users and channel partners. Our channel partners, which include independent distributors and selective retailers, are present and active throughout our geographic regions. We have been successful in growing third party distribution with experience in specialized end user applications. We intend to further add and develop specialized third party distribution in all geographic regions to reach the new end

user markets and applications that are the focus of many of our new product development initiatives.

Our Company's financial performance has been consistently strong, in part due to an ability to leverage our operations. Our management strives to provide excellent returns for our shareholders.

Manufacturing and Distribution

We manufacture most of our products in the United States. We also manufacture some of our products in Belgium, Romania, Switzerland and the People's Republic of China (P.R.C.). Our manufacturing is aligned with our business segments and is co-located with product development to accelerate technology improvements and improve our cost structure. We do critical machining, assembly and testing in-house for most of our products to control quality, improve response time and maximize cost-effectiveness. We make our products in focused factories and product cells. We source raw materials and components from suppliers around the world.

We sell our equipment primarily through third party distributors worldwide. We primarily distribute our products from our warehouses to distributors, who sell our products to end users. Outside of the United States, our subsidiaries located in Australia,

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Belgium, Japan, Italy, Korea, Mexico, the P.R.C. and Switzerland distribute our Company's products. Significant operations in Maasmechelen, Belgium; St. Gallen, Switzerland; and Shanghai, P.R.C. reinforce our commitment to their regions.

During 2013, 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

Our primary product development efforts are carried out in facilities located in Minneapolis, Anoka and Rogers, Minnesota; North Canton, Ohio; St. Gallen, Switzerland; and Suzhou, P.R.C. The product development and engineering groups 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 \$51 million in 2013, \$49 million in 2012, and \$42 million in 2011.

Our Company consistently makes significant investments in new products, and in 2013 we invested \$51 million, or 4.6 percent of sales, in our product development activities. Our product development activities are focused both on upgrades to our current product lines to provide features and benefits that will provide a return-on-investment to our end user customers and on development of products that will reach into new industries and applications to incrementally grow our sales. Sales of products that refresh and upgrade our product lines are measured and compared to planned results. Sales of products that provide entry into new industries and applications are also measured, with additional focus on commercial resources and activities to build specialized third party distribution and market acceptance by end users.

Business Segments

Industrial Segment

The Industrial segment is the largest of our Company's businesses and represents approximately 59 percent of our total sales. This segment includes the Applied Fluid Technologies division, Industrial Products division and Process division. The Industrial segment primarily makes products for industrial customers that manufacture their own products (such as appliances, vehicles, airplanes and furniture).

Most Industrial segment equipment is sold worldwide through specialized third party distributors, integrators, design centers, original equipment manufacturers and material suppliers. Some products are sold directly to end users. We 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 manufacturers 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.

Applied Fluid Technologies

In addition to making products for use by industrial customers, the Applied Fluid Technologies division also sells equipment for use by construction contractors. The Applied Fluid Technologies division makes 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 and adhesives and composites (advanced fluid dispense).

We make plural component proportioning equipment that applies polyurethane foam to insulate walls, roofing, water heaters, refrigerators, hot tubs and other items. This equipment is used in packaging, architectural design and cavity filling. We also make equipment that applies two-component polyurea coatings to tanks, pipes, roofs, truck beds and concrete. In 2013, we purchased EcoQuip Inc. EcoQuip manufactures vapor-abrasive blasting equipment, which is a product category complementary to protective coatings equipment.

Our advanced fluid dispense products include pumps, meters, applicators and valves that meter, mix and dispense sealant and adhesives. This equipment bonds, molds, seals, vacuum encapsulates, laminates and gaskets parts and devices in a wide variety of industrial applications. We also offer advanced composites equipment, which includes gel coat equipment, chop and wet-out systems, resin transfer molding systems and applicators. This equipment is used, for example, in the manufacture of vehicles, aircraft, boats, wind turbines and bridge materials.

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A key product strategy of the Applied Fluid Technologies division is to create and sell technologically superior equipment. We also strive 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.

Industrial Products

The Industrial Products division makes finishing equipment that applies paint and other coatings to products such as motor vehicles, appliances, furniture and other industrial and consumer products. Our finishing equipment includes liquid and powder finishing products. Our finishing equipment pumps, meters and applies liquids on wood, metals and plastics, and coats powder finish on metals. Finishing strategies include creating and selling technologically superior equipment, providing environmental compliance solutions and providing excellent end user service through specialized third party distribution.

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 into the air. Manufacturers in the automotive, automotive feeder, commercial and recreational vehicle, military and utility vehicle, aerospace, farm, construction, wood and general metals industries use our liquid finishing products.

Our powder finishing products are sold under the Gema® trademark. Gema powder systems coat window frames, metallic furniture, automotive components and sheet metal. Primary end-users of our Gema powder finishing products include manufacturers in the construction, home appliance, automotive component and custom coater industries. We strive to provide innovative production solutions in powder coating for end users in emerging and developed markets.

Process

Our Process division makes pumps that move chemicals, petroleum, food and other fluids. The Process division strives to provide high quality, long lasting products with differentiated technology for specified applications. Manufacturers and processors in the food and beverage, dairy, pharmaceutical, cosmetic, oil and gas, electronics, wastewater, mining and ceramics industries use our pumps. We offer pumps for sanitary applications including FDA-compliant 3-A sanitary pumps, diaphragm pumps, transfer pumps and drum and bin unloaders. Our 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. Subsequent to the 2013 fiscal year end, we purchased QED Environmental Systems, Inc. QED Environmental Systems is a manufacturer of fluid management solutions for the environmental monitoring and remediation industries, an industry in which we have had little previous presence.

Contractor Segment

The Contractor segment generated approximately 31 percent of our Company's 2013 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 (spray guns, hoses and filters) and spare parts (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 outside of North America. Certain sprayers and accessories are distributed

globally through the home center channel.

Contractor equipment includes a wide variety of sprayers, such as 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. Contractor equipment includes scarifiers that remove markings on roads and other surfaces. We also offer several models of professional grade handheld paint sprayers.

Our Contractor segment sells broad product families with multiple offerings. Our Contractor segment strives for technological innovation in its products. Painters are encouraged to upgrade their equipment regularly to take advantage of the new and/or more advanced features. The Contractor segment strives to expand base markets using new and core technologies.

Contractor products are marketed and sold in all major geographic areas. We continue to add distributors throughout the world that specialize in the sale of Contractor products. Throughout the world, we are pursuing a broad strategy of converting contractors accustomed to manually applying paint and other coatings by brush-and-roller to spray technology.

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Lubrication Segment

The Lubrication segment represented approximately 10 percent of our Company's sales during 2013. The Lubrication segment focuses its engineering, marketing and sales efforts on two main applications: vehicle services and industrial lubrication. The Lubrication segment markets and sells our lubrication equipment worldwide, although the bulk of its sales come from North America. Our lubrication products are sold through independent third party distributors 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. We continue to expand our Lubrication segment sales and marketing resources in EMEA, Asia Pacific, and South and Central America.

In vehicle services, we supply pumps, hose reels, meters, valves and accessories. Our customers include fast oil change facilities, service garages, fleet service centers, automobile dealerships, auto parts stores, service truck builders and heavy equipment service centers.

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. We offer products that automatically lubricate bearings, gears and generators, and products that evacuate and dispense lubricants. Industries served include gas transmission and petrochemical, pulp and paper, mining and construction, agricultural equipment, food and beverage, material handling, metal manufacturing, wind energy and oil and gas exploration. In 2013, we introduced new electric grease pumps for the mining and heavy equipment industries.

Raw Materials

The primary materials and components in our products 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 materials and components that we use are generally adequately available through multiple sources of supply. To manage cost, we engage in significant global sourcing of materials and components, primarily in the Asia Pacific region.

In 2013, our raw material costs were fairly stable, although we experienced price decreases in copper, stainless steel, aluminum and rare earth metals. These price decreases were somewhat offset by price increases in certain specialty resins and steels. We did not experience any significant shortages of materials in 2013.

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. We have performed risk assessments of our key suppliers, 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, Gema, several forms of a capital G, and various product trademarks that are material to our business, inasmuch as they identify Graco and our products to our customers.

Competition

We encounter a wide variety of competitors that vary by product, industry and geographic area. Each of our segments generally has several competitors. Our competitors are both U.S. and foreign companies and range in size. We believe that our ability to compete depends upon product quality, product reliability, innovation, design, customer support and service, personal relationships, specialized engineering and competitive pricing. 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 may offer competitive products at lower prices. We may have to refresh our product line and continue development of our distribution channel to stay competitive. We are also facing competitors who illegally sell counterfeits of our products or otherwise infringe on our intellectual property rights. We may have to increase our intellectual property enforcement activities.

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 27, 2013.

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Employees

As of December 27, 2013, we employed approximately 2,700 persons, excluding the employees of the held separate Liquid Finishing businesses (see below). Of this total, approximately 850 were employees based outside the United States, and 800 were hourly factory workers in the United States. None of our Company's United States 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.

Acquisition and Planned Divestiture of ITW Liquid Finishing Businesses

We purchased the finishing businesses of Illinois Tool Works Inc. (ITW Finishing Group) in April 2012 (the Finishing Brands Acquisition). The acquisition included powder and liquid finishing equipment operations, technologies and brands. In liquid finishing, brands include Binks® spray finishing equipment, DeVilbiss® spray guns and accessories, Ransburg® electrostatic equipment and accessories and BGK curing technology (Liquid Finishing). In powder finishing, we acquired the Gema® business (Powder Finishing). In March 2012, the Federal Trade Commission (FTC) issued an order for our Company to hold the Liquid Finishing assets separate from our other businesses. In May 2012, the FTC issued a proposed decision and order that requires us to sell the held separate Liquid Finishing business assets no later than 180 days from the date the order becomes final. The FTC has not yet issued a final decision and order. We believe that the FTC will require us to sell all of the Liquid Finishing assets that are currently held separate. We have retained the services of an investment bank to help us market the held separate businesses and identify potential buyers.

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 and the complexity of new or revised laws and regulations globally appear 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 laws and regulations increase our costs of doing business, may affect the manner in which our products will be produced or delivered 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 may depress demand for our equipment in all major geographies and markets. If our distributors and original equipment manufacturers 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. An economic downturn may affect our ability to satisfy the financial covenants in the terms of our financing arrangements.

Growth Strategies Our growth strategies may not provide the return on investment desired if we are not successful in implementation of these strategies.

Making acquisitions, investing in new products, expanding geographically and targeting new industries are among our growth strategies. We may not obtain the return on investment desired if we are not successful in implementing these

growth strategies. Suitable acquisitions must be located, completed and effectively integrated into or added to our existing businesses or corporate structure for this growth strategy to be successful. We may not be able to obtain financing at a reasonable cost. We may be unsuccessful in acquiring and effectively integrating into or adding businesses to our current operations or corporate structure, and may not realize projected efficiencies and cost-savings from the businesses we acquire. We cannot predict how customers, competitors, suppliers and employees will react to the acquisitions that we make. We make significant investments in developing products that have innovative features and differentiated technology in their industries and in niche markets. We are expanding the geographies in which we do business with third party distributors. We cannot predict whether and when we will be able to realize the expected financial results and accretive effect of the acquisitions that we make, the new products that we develop and the channel expansions that we make.

Acquisition - Our acquisition of the finishing businesses of ITW includes a requirement that we divest the acquired Liquid Finishing businesses, which has not been completed and remains subject to FTC approval.

On April 2, 2012, the Company closed its \$650 million acquisition of the ITW finishing businesses. The acquisition added the Gema business, a global leader in powder coating technology, which represented approximately one-third of the businesses purchased. The remaining two-thirds of the acquisition is a collection of Liquid Finishing businesses, which the FTC has ordered to be held separate

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from Gema and other Graco businesses while the FTC investigates and considers a settlement proposal from Graco. In compliance with the FTC's order, the Liquid Finishing businesses are being run independently by existing management under the supervision of a trustee who reports directly to the FTC. In May 2012, the FTC issued a proposed decision and order, subject to a 30-day comment period, which requires Graco to sell the Liquid Finishing business assets, including business activities related to the development, manufacture, and sale of Liquid Finishing products under the Binks®, DeVilbiss®, Ransburg® and BGK brand names, no later than 180 days from the date the order becomes final. The FTC has not yet issued its final decision and order. The Company has retained the services of an investment bank to help it market the Liquid Finishing businesses and identify potential buyers. Until the sale of the Liquid Finishing business assets is completed, Graco must continue to hold the Liquid Finishing business assets separate from its other businesses and maintain them as viable and competitive. The hold separate order requires the Company to provide sufficient resources to maintain the viability, competitiveness and marketability of the Liquid Finishing businesses, including general funds, capital, working capital and reimbursement of losses. We cannot predict to what extent or when the required regulatory approvals will be obtained. We cannot predict the extent of the acquired businesses required to be divested, although we believe that the FTC will require us to sell all of the Liquid Finishing business assets that are currently held separate. Additional risk factors include whether the Company will be able to find a suitable purchaser(s) and structure the divestiture on acceptable terms, and whether the Company will be able to complete a divestiture in a time frame that is satisfactory to the FTC.

Political Instability Uncertainty surrounding political leadership may limit our growth opportunities.

Domestic political instability, including government shut downs, may limit our ability to grow our business. International political instability may prevent us from expanding our business into certain geographies and may also limit our ability to grow our business. Terrorist activities and civil disturbances may harm our business.

Intellectual Property Demand for our products may be affected by new entrants who copy our products and/or infringe on our intellectual property.

From time to time, our Company has been faced with instances where competitors have infringed or improperly used our intellectual property and/or taken advantage of our design and development efforts. The ability to enforce intellectual property varies across jurisdictions. Asian copiers are becoming more prevalent. If our Company is unable to effectively meet these challenges, they could adversely affect our revenues and profits and hamper our ability to grow.

Suppliers Risks associated with foreign sourcing, supply interruption, delays in raw material or component delivery, supply shortages and counterfeit components 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 or other political factors. Raw materials may become limited in availability from certain regions. Port labor disputes may delay shipments. We source a large volume and a variety of electronic components, which exposes us to an increased risk of counterfeit components entering our supply chain. If counterfeit components unknowingly become part of our products, we may need to stop delivery and rebuild our products. We may be subject to warranty claims and may need to recall products.

Foreign Operations Conducting business internationally exposes our Company to risks that could harm our business.

In 2013, approximately 55 percent of our sales were generated by customers located outside the United States. We are increasing our presence in advancing economies. Operating and selling outside of the United States exposes us to certain risks that could adversely impact our sales volume, rate of growth or profitability. These risks include: complying with foreign legal and regulatory requirements, international trade factors (export controls, trade sanctions, duties, tariff barriers and other restrictions), protection of our proprietary technology in certain countries, potentially burdensome taxes, potential difficulties staffing and managing local operations, and changes in exchange rates. Changes in exchange rates will impact our reported sales and earnings and may make it difficult for some of our distributors to purchase products.

Competition Our success depends upon our ability to develop, market and sell new products that meet our customers' needs, and anticipate industry changes.

Our profitability will be affected if we do not develop new products and technologies that meet our customers' needs. Our ability to develop, market and sell products that meet our customers' needs depends upon a number of factors, including anticipating the

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features and products that our customers will need in the future, identifying and entering into new markets, and training our distributors. Changes in industries in which we participate, including consolidation of competitors and customers, could affect our success. Price competition and competitor strategies could affect our success.

Legal Proceedings Costs associated with claims, litigation, administrative proceedings and regulatory reviews, and potentially adverse outcomes, may affect our profitability.

As our Company grows, we are at an increased risk of being a target in litigation, administrative proceedings and regulatory reviews. The cost of defending such matters appears to be increasing, particularly in the United States. We may also need to pursue claims or litigation to protect our interests. Such costs may adversely affect our Company's profitability. Our businesses expose us to potential toxic tort, product liability and commercial claims. Successful claims against the Company may adversely affect our results.

Anti-Corruption Laws We may incur costs and suffer damages if our employees, agents, distributors or suppliers violate anti-bribery, anti-corruption or trade laws and regulations.

Bribery, corruption and trade laws and regulations, and enforcement thereof, is increasing in frequency and severity on a global basis. If our internal controls and compliance program do not successfully prevent our employees, agents, distributors, suppliers and other third parties with whom we do business from violating anti-corruption laws, we may incur defense costs, fines, penalties and reputational damage.

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.

Variable Industries Our success may be affected by variations in the construction and automotive industries.

Our business may be affected by fluctuations in residential, commercial and institutional building and remodeling activity. Changes in construction materials and techniques may also impact our business. Our business may also be affected by fluctuations in the automotive industry.

Security Breaches Intrusion into our information systems may impact our business.

Security breaches or intrusion into our information systems, and the breakdown, interruption in or inadequate upgrading or maintenance of our information processing software, hardware or networks may impact our business. Security breaches or intrusion into the systems or data of the third parties with whom we conduct business may also harm our business.

Natural Disasters Our operations are at risk of damage or destruction by natural disasters.

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. Flooding, tornadoes, typhoons, unusually heavy precipitation or earthquakes

could adversely impact our operations.

Item 1B. Unresolved Staff Comments

None.

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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
North America			
Tlalnepantla, State of Mexico, Mexico	Leased	4,000	Manufacturing, warehouse and office for Industrial segment
Oakland, California, United States	Leased	1,500	Warehouse for Industrial segment
San Leandro, California, United States	Leased	12,100	Manufacturing, warehouse and office for Industrial segment
Indianapolis, Indiana, United States	Owned	63,500	Warehouse, office, product development and application laboratory for Industrial segment
Dexter, Michigan, United States	Leased	31,300	Manufacturing, warehouse, office, and product development for Industrial segment
Minneapolis, Minnesota, United States	Owned	142,000	Corporate office; office and product development for Industrial segment
Minneapolis, Minnesota, United States	Owned	42,000	Office for Information Systems, Accounting Services and Purchasing Departments

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Minneapolis, Minnesota, United States	Owned	405,000	Manufacturing, warehouse and office for Industrial segment
Minneapolis, Minnesota, United States	Owned	86,700	Warehouse
Anoka, Minnesota, United States	Owned	207,000	Manufacturing, warehouse, office and product development for Lubrication segment
Rogers, Minnesota, United States	Owned	333,000	Manufacturing, warehouse, office and product development for Contractor segment
Rogers, Minnesota, United States	Leased	227,100	Warehouse and office
Rogers, Minnesota, United States	Leased	42,900	Warehouse and office
North Canton, Ohio, United States	Owned	132,000	Manufacturing, warehouse, office, product development and application laboratory for Industrial segment
Sioux Falls, South Dakota, United States	Owned	149,000	Manufacturing, warehouse and office for Industrial and Contractor segment spray guns and accessories
Chesapeake, Virginia, United States	Leased	9,600	Manufacturing and office for Industrial segment
Chesapeake, Virginia, United States	Leased	3,300	Warehouse for Industrial segment
Europe			
Maasmechelen, Belgium	Owned	175,000	Warehouse, office and assembly; European training, testing and education center

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Valence, France	Leased	3,900	Office for Industrial segment
Rödermark, Germany	Leased	8,600	Warehouse and office for Industrial segment
Milan, Italy	Leased	7,500	Office and warehouse for Industrial segment
Sibiu, Romania	Leased	31,000	Manufacturing for Industrial segment
St. Gallen, Switzerland	Owned	78,000	Manufacturing, warehouse, office, product development and application laboratory for Industrial segment
St. Gallen, Switzerland	Leased	9,000	Manufacturing for Industrial segment
Poole, Dorset, United Kingdom	Leased	3,500	Office and warehouse for Industrial segment

Asia Pacific

Bundoora, Australia	Leased	2,500	Office
Derrimut, Australia	Leased	7,500	Warehouse
Shanghai, P.R.C.	Leased	29,000	Office; Asia Pacific training, testing and education center
Shanghai Waiqaoqiao Free Trade Zone, P.R.C.	Leased	13,700	Warehouse
Shanghai, P.R.C.	Leased	27,000	Office and warehouse for Industrial segment

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Suzhou, P.R.C.	Owned	79,000	Manufacturing, warehouse, office and product development
Yokohama, Japan	Leased	18,500	Office
Anyang, South Korea	Leased	5,100	Office
Gwangjoo, South Korea	Leased	10,700	Warehouse

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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 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 18, 2014:

Patrick J. McHale, 52, 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, Manufacturing and Distribution Operations from April 2001 to June 2003. He served as Vice President, Contractor Equipment Division from February 2000 to April 2001. From September 1999 to February 2000, he was Vice President, Lubrication Equipment Division. Prior to 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, 55, 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, 49, was elected Vice President, Corporate Controller and Information Systems on December 6, 2013. She has also served as the Company's principal accounting officer since September 2007. From April 2009 to December 2013, she was Vice President and Corporate Controller. She served as Vice President and Controller from December 2006 to April 2009. 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.

Mark D. Eberlein, 53, is Vice President and General Manager, Process Division, a position he has held since January 2013. From November 2008 to December 2012, he was Director, Business Development, Industrial Products Division. He was Director, Manufacturing Operations, Industrial Products Division from January to October 2008. From 2001 to 2008, he was Manufacturing Operations Manager of a variety of Graco business divisions. Prior to joining Graco, Mr. Eberlein worked as an engineer at Honeywell and at Sheldahl. He joined the Company in 1996.

Karen Park Gallivan, 57, 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, 69, became Chief Financial Officer in September 2005, a position he held in conjunction with 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, 59, 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, 54, became Vice President and General Manager, EMEA in January 2013. From February 2008 to December 2012 he was Vice President and General Manager, Asia Pacific. 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,

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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, 58, became Executive Vice President, Industrial Products Division in April 2012. From February 2005 to April 2012, he was Vice President and General Manager, Industrial Products Division. 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.

Bernard J. Moreau, 53, is Vice President and General Manager, South and Central America, a position he has held since January 2013. From November 2003 to December 2012, he was Sales and Marketing Director, EMEA, Industrial/Automotive Equipment Division. From January 1997 to October 2003, he was Sales Manager, Middle East, Africa and East Europe. Prior to 1997, he worked in various Graco sales engineering and sales management positions, mainly to support Middle East, Africa and southern Europe territories. He joined the Company in 1985.

Peter J. O Shea, 49, became Vice President and General Manager, Asia Pacific in January 2013. From January 2012 until December 2012, he was Director of Sales and Marketing, Industrial Products Division, and from 2008 to 2012, he was Director of Sales and Marketing, Industrial Products Division and Applied Fluid Technologies Division. He was Country Manager, Australia - New Zealand from 2005 to 2008, and from 2002 to 2005 he served as Business Development Manager, Australia - New Zealand. Prior to becoming Business Development Manager, Australia - New Zealand, he worked in various Graco sales management positions. Mr. O Shea joined the Company in 1995.

Charles L. Rescorla, 62, was elected Vice President, Corporate Manufacturing, Distribution Operations and Corporate Development on December 6, 2013. From June 2011 to December 2013, he was Vice President, Corporate Manufacturing, Information Systems and Distribution Operations. 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 September 2005, he was Vice President, Manufacturing/Distribution Operations and Information Systems. From April 2001 until June 2003, he was Vice President and General Manager, Industrial/Automotive Equipment Division. Prior to April 2001, he held various positions in manufacturing and engineering management. Mr. Rescorla joined the Company in 1988.

Christian E. Rothe, 40, 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, 49, 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. He joined the Company in 1995.

Brian J. Zumbolo, 44, 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 and 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.

Except as otherwise noted above, the Board of Directors elected or re-elected the above executive officers to their current positions on December 7, 2012, effective January 1, 2013.

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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 4, 2014, the share price was \$67.67 and there were 60,862,154 shares outstanding and 2,767 common shareholders of record, which includes nominees or broker dealers holding stock on behalf of an estimated 42,000 beneficial owners.

High and low sales prices for the Company&