

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15 (d) of the
Securities Exchange Act of 1934

For the quarterly period ended **June 26, 2015**

Commission File Number: 001-09249

GRACO INC.

(Exact name of registrant as specified in its charter)

Minnesota
(State of incorporation)

41-0285640
(I.R.S. Employer Identification Number)

88 - 11th Avenue N.E.
Minneapolis, Minnesota
(Address of principal executive offices)

55413
(Zip Code)

(612) 623-6000
(Registrant's telephone number, including area code)

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, 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 such shorter period that the registrant was required to submit and post such files).

Yes X No

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," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

| | | | |
|-------------------------|---------------|---------------------------|---------------|
| Large Accelerated Filer | <u> X </u> | Accelerated Filer | <u> </u> |
| Non-accelerated Filer | <u> </u> | Smaller reporting company | <u> </u> |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No X

57,729,000 shares of the Registrant's Common Stock, \$1.00 par value, were outstanding as of July 15, 2015.

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PART I Item 1.
GRACO INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited) (In thousands except per share amounts)

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|--|----------------------|------------------|------------------------|-------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Net Sales | \$ 335,489 | \$ 322,549 | \$ 641,942 | \$ 612,511 |
| Cost of products sold | 154,866 | 145,699 | 299,190 | 276,349 |
| Gross Profit | 180,623 | 176,850 | 342,752 | 336,162 |
| Product development | 14,907 | 13,405 | 30,197 | 26,564 |
| Selling, marketing and distribution | 50,126 | 49,503 | 101,550 | 95,845 |
| General and administrative | 31,699 | 28,094 | 61,883 | 53,200 |
| Operating Earnings | 83,891 | 85,848 | 149,122 | 160,553 |
| Interest expense | 4,125 | 4,676 | 9,428 | 9,264 |
| Held separate investment (income), net | (158,833) | (10,562) | (188,356) | (14,237) |
| Other expense (income), net | (438) | (202) | 272 | 45 |
| Earnings Before Income Taxes | 239,037 | 91,936 | 327,778 | 165,481 |
| Income taxes | 66,400 | 25,700 | 86,300 | 48,500 |
| Net Earnings | <u>\$ 172,637</u> | <u>\$ 66,236</u> | <u>\$ 241,478</u> | <u>\$ 116,981</u> |
| Per Common Share | | | | |
| Basic net earnings | \$ 2.96 | \$ 1.10 | \$ 4.12 | \$ 1.93 |
| Diluted net earnings | \$ 2.90 | \$ 1.07 | \$ 4.02 | \$ 1.88 |
| Cash dividends declared | \$ 0.30 | \$ 0.28 | \$ 0.60 | \$ 0.55 |

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited) (In thousands)

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|---|----------------------|------------------|------------------------|-------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Net Earnings | \$ 172,637 | \$ 66,236 | \$ 241,478 | \$ 116,981 |
| Other comprehensive income (loss) | | | | |
| Cumulative translation adjustment | 12,404 | (1,908) | 9,393 | (1,994) |
| Pension and postretirement medical liability adjustment | 1,919 | 1,225 | 4,357 | 2,413 |
| Income taxes | | | | |
| Pension and postretirement medical liability adjustment | (739) | (436) | (1,641) | (864) |
| Other comprehensive income (loss) | 13,584 | (1,119) | 12,109 | (445) |
| Comprehensive Income | <u>\$ 186,221</u> | <u>\$ 65,117</u> | <u>\$ 253,587</u> | <u>\$ 116,536</u> |

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited)
(In thousands)

| | June 26, 2015 | Dec 26, 2014 |
|---|------------------|-----------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 44,258 | \$ 23,656 |
| Accounts receivable, less allowances of \$9,300 and \$8,100 | 262,722 | 214,944 |
| Inventories | 194,568 | 159,797 |
| Deferred income taxes | 21,317 | 19,969 |
| Investment in businesses held separate | - | 421,767 |
| Other current assets | 12,277 | 19,374 |
| Total current assets | 535,142 | 859,507 |
| Property, Plant and Equipment | | |
| Cost | 447,367 | 433,751 |
| Accumulated depreciation | (275,968) | (272,521) |
| Property, plant and equipment, net | 171,399 | 161,230 |
| Goodwill | 403,529 | 292,574 |
| Other Intangible Assets, net | 244,234 | 176,278 |
| Deferred Income Taxes | 38,357 | 28,982 |
| Other Assets | 26,247 | 26,207 |
| Total Assets | \$ 1,418,908 | \$ 1,544,778 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Notes payable to banks | \$ 10,354 | \$ 5,016 |
| Trade accounts payable | 45,145 | 39,306 |
| Salaries and incentives | 38,589 | 40,775 |
| Dividends payable | 17,400 | 17,790 |
| Other current liabilities | 122,284 | 71,593 |
| Total current liabilities | 233,772 | 174,480 |
| Long-term Debt | 300,410 | 615,000 |
| Retirement Benefits and Deferred Compensation | 138,042 | 136,812 |
| Deferred Income Taxes | 22,854 | 22,454 |
| Other non-current liabilities | 11,475 | - |
| Shareholders' Equity | | |
| Common stock | 57,817 | 59,199 |
| Additional paid-in-capital | 399,499 | 384,704 |
| Retained earnings | 343,666 | 252,865 |
| Accumulated other comprehensive income (loss) | (88,627) | (100,736) |
| Total shareholders' equity | 712,355 | 596,032 |
| Total Liabilities and Shareholders' Equity | \$ 1,418,908 | \$ 1,544,778 |

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited) (In thousands)

| | Twenty-six Weeks Ended | |
|--|------------------------|------------------|
| | June 26, 2015 | June 27, 2014 |
| Cash Flows From Operating Activities | | |
| Net Earnings | \$ 241,478 | \$ 116,981 |
| Adjustments to reconcile net earnings to net cash provided by operating activities | | |
| Depreciation and amortization | 21,969 | 18,327 |
| Deferred income taxes | (11,324) | (5,710) |
| Share-based compensation | 10,990 | 9,818 |
| Excess tax benefit related to share-based payment arrangements | (700) | (2,300) |
| (Gain) loss on sale of business | (147,261) | - |
| Change in | | |
| Accounts receivable | (33,934) | (42,019) |
| Inventories | (24,540) | (9,806) |
| Trade accounts payable | 7,879 | 6,219 |
| Salaries and incentives | (8,230) | (9,670) |
| Retirement benefits and deferred compensation | 6,094 | 2,749 |
| Other accrued liabilities | 56,035 | 3,916 |
| Other | (21,792) | (4,476) |
| Net cash provided by operating activities | 96,664 | 84,029 |
| Cash Flows From Investing Activities | | |
| Property, plant and equipment additions | (19,886) | (17,062) |
| Acquisition of businesses, net of cash acquired | (187,853) | (65,219) |
| Proceeds from sale of assets | 589,808 | - |
| Investment in businesses held separate | - | 530 |
| Other | (250) | (599) |
| Net cash provided by (used in) investing activities | 381,819 | (82,350) |
| Cash Flows From Financing Activities | | |
| Borrowings (payments) on short-term lines of credit, net | 5,336 | 2,659 |
| Borrowings on long-term line of credit | 458,540 | 325,665 |
| Payments on long-term line of credit | (773,130) | (211,275) |
| Payments of debt issuance costs | - | (890) |
| Excess tax benefit related to share-based payment arrangements | 700 | 2,300 |
| Common stock issued | 14,511 | 17,792 |
| Common stock repurchased | (130,635) | (93,820) |
| Cash dividends paid | (35,339) | (33,485) |
| Net cash provided by (used in) financing activities | (460,017) | 8,946 |
| Effect of exchange rate changes on cash | 2,136 | (813) |
| Net increase (decrease) in cash and cash equivalents | 20,602 | 9,812 |
| Cash and cash equivalents | | |
| Beginning of year | 23,656 | 19,756 |
| End of period | <u>\$ 44,258</u> | <u>\$ 29,568</u> |

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. The consolidated balance sheet of Graco Inc. and Subsidiaries (the "Company") as of June 26, 2015 and the related statements of earnings for the thirteen and twenty-six weeks ended June 26, 2015 and June 27, 2014, and cash flows for the twenty-six weeks ended June 26, 2015 and June 27, 2014 have been prepared by the Company and have not been audited.

In the opinion of management, these consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of the Company as of June 26, 2015, and the results of operations and cash flows for all periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. Therefore, these statements should be read in conjunction with the financial statements and notes thereto included in the Company's 2014 Annual Report on Form 10-K.

The results of operations for interim periods are not necessarily indicative of results that will be realized for the full fiscal year.

2. The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|--|----------------------|------------------|------------------------|------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Net earnings available to common shareholders | \$ 172,637 | \$ 66,236 | \$ 241,478 | \$ 116,981 |
| Weighted average shares outstanding for basic earnings per share | 58,235 | 60,453 | 58,608 | 60,637 |
| Dilutive effect of stock options computed using the treasury stock method and the average market price | 1,387 | 1,575 | 1,436 | 1,596 |
| Weighted average shares outstanding for diluted earnings per share | 59,622 | 62,028 | 60,044 | 62,233 |
| Basic earnings per share | \$ 2.96 | \$ 1.10 | \$ 4.12 | \$ 1.93 |
| Diluted earnings per share | \$ 2.90 | \$ 1.07 | \$ 4.02 | \$ 1.88 |

Stock options to purchase 1,357,000 and 876,000 shares were not included in the June 26, 2015 and June 27, 2014 computations of diluted earnings per share, respectively, because they would have been anti-dilutive.

3. Options on common shares granted and outstanding, as well as the weighted average exercise price, are shown below (in thousands, except exercise prices):

| | Option Shares | Weighted Average Exercise Price | Options Exercisable | Weighted Average Exercise Price |
|--------------------------------|------------------|--|------------------------|--|
| Outstanding, December 26, 2014 | 4,975 | \$ 44.72 | 3,318 | \$ 34.86 |
| Granted | 537 | 74.23 | | |
| Exercised | (109) | 34.55 | | |
| Canceled | (11) | 71.93 | | |
| Outstanding, June 26, 2015 | <u>5,392</u> | \$ 47.81 | 3,726 | \$ 37.92 |

The Company recognized year-to-date share-based compensation of \$11.0 million in 2015 and \$9.8 million in 2014. As of June 26, 2015, there was \$17.2 million of unrecognized compensation cost related to unvested options, expected to be recognized over a weighted average period of 1.8 years.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions and results:

| | Twenty-six Weeks Ended | |
|---------------------------------------|------------------------|------------------|
| | June 26, 2015 | June 27, 2014 |
| Expected life in years | 6.5 | 6.5 |
| Interest rate | 1.7 % | 2.0 % |
| Volatility | 35.1 % | 36.1 % |
| Dividend yield | 1.6 % | 1.5 % |
| Weighted average fair value per share | \$ 23.22 | \$ 24.83 |

Under the Company's Employee Stock Purchase Plan, the Company issued 166,000 shares in 2015 and 193,000 shares in 2014. The fair value of the employees' purchase rights under this Plan was estimated on the date of grant. The benefit of the 15 percent discount from the lesser of the fair market value per common share on the first day and the last day of the plan year was added to the fair value of the employees' purchase rights determined using the Black-Scholes option-pricing model with the following assumptions and results:

| | Twenty-six Weeks Ended | |
|---------------------------------------|------------------------|------------------|
| | June 26, 2015 | June 27, 2014 |
| Expected life in years | 1.0 | 1.0 |
| Interest rate | 0.2 % | 0.1 % |
| Volatility | 18.9 % | 21.4 % |
| Dividend yield | 1.6 % | 1.4 % |
| Weighted average fair value per share | \$ 16.51 | \$ 17.81 |

In April 2015, shareholders of the Company approved the Graco Inc. 2015 Stock Incentive Plan. The plan provides for issuance of up to 3.5 million shares of Graco common stock.

Shares authorized for issuance under stock option and purchase plans are shown below (in thousands):

| | Total Shares Authorized | Available for Future Issuance as of June 26, 2015 |
|-------------------------------------|----------------------------|---|
| Stock Incentive Plan (2015) | 3,500 | 3,460 |
| Employee Stock Purchase Plan (2006) | 7,000 | 4,928 |
| Total | 10,500 | 8,388 |

Amounts available for future issuance exclude outstanding options. Options outstanding as of June 26, 2015 include options granted under three plans that were replaced by subsequent plans. No shares are available for future grants under those plans.

4. The components of net periodic benefit cost for retirement benefit plans were as follows (in thousands):

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|-------------------------------|----------------------|------------------|------------------------|------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Pension Benefits | | | | |
| Service cost | \$ 1,907 | \$ 1,697 | \$ 4,003 | \$ 3,439 |
| Interest cost | 3,605 | 3,940 | 7,380 | 8,076 |
| Expected return on assets | (4,659) | (5,211) | (9,576) | (10,630) |
| Amortization and other | 2,426 | 1,355 | 4,779 | 2,688 |
| Net periodic benefit cost | <u>\$ 3,279</u> | <u>\$ 1,781</u> | <u>\$ 6,586</u> | <u>\$ 3,573</u> |
| Postretirement Medical | | | | |
| Service cost | \$ 150 | \$ 125 | \$ 300 | \$ 250 |
| Interest cost | 227 | 278 | 453 | 555 |
| Amortization | (101) | (126) | (202) | (254) |
| Net periodic benefit cost | <u>\$ 276</u> | <u>\$ 277</u> | <u>\$ 551</u> | <u>\$ 551</u> |

5. Changes in components of accumulated other comprehensive income (loss), net of tax were (in thousands):

| | Pension and Post- retirement Medical | Cumulative Translation Adjustment | Total |
|--|---|---|--------------------|
| Thirteen Weeks Ended June 27, 2014 | | | |
| Beginning balance | \$ (49,372) | \$ 3,697 | \$ (45,675) |
| Other comprehensive income before reclassifications | - | (1,908) | (1,908) |
| Amounts reclassified from accumulated other comprehensive income | 789 | - | 789 |
| Ending balance | <u>\$ (48,583)</u> | <u>\$ 1,789</u> | <u>\$ (46,794)</u> |
| Thirteen Weeks Ended June 26, 2015 | | | |
| Beginning balance | \$ (75,048) | \$ (27,163) | \$ (102,211) |
| Other comprehensive income before reclassifications | - | 12,404 | 12,404 |
| Amounts reclassified from accumulated other comprehensive income | 1,180 | - | 1,180 |
| Ending balance | <u>\$ (73,868)</u> | <u>\$ (14,759)</u> | <u>\$ (88,627)</u> |
| Twenty-six Weeks Ended June 27, 2014 | | | |
| Beginning balance | \$ (50,132) | \$ 3,783 | \$ (46,349) |
| Other comprehensive income before reclassifications | - | (1,994) | (1,994) |
| Amounts reclassified from accumulated other comprehensive income | 1,549 | - | 1,549 |
| Ending balance | <u>\$ (48,583)</u> | <u>\$ 1,789</u> | <u>\$ (46,794)</u> |
| Twenty-six Weeks Ended June 26, 2015 | | | |
| Beginning balance | \$ (76,584) | \$ (24,152) | \$ (100,736) |
| Other comprehensive income before reclassifications | - | 9,393 | 9,393 |
| Amounts reclassified from accumulated other comprehensive income | 2,716 | - | 2,716 |
| Ending balance | <u>\$ (73,868)</u> | <u>\$ (14,759)</u> | <u>\$ (88,627)</u> |

Amounts related to pension and postretirement medical adjustments are reclassified to pension cost, which is allocated to cost of products sold and operating expenses based on salaries and wages, approximately as follows (in thousands):

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|-------------------------------------|----------------------|------------------|------------------------|------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Cost of products sold | \$ 707 | \$ 440 | \$ 1,645 | \$ 876 |
| Product development | 319 | 195 | 702 | 382 |
| Selling, marketing and distribution | 529 | 354 | 1,232 | 689 |
| General and administrative | 364 | 236 | 778 | 466 |
| Total before tax | \$ 1,919 | \$ 1,225 | \$ 4,357 | \$ 2,413 |
| Income tax (benefit) | (739) | (436) | (1,641) | (864) |
| Total after tax | \$ 1,180 | \$ 789 | \$ 2,716 | \$ 1,549 |

On May 11, 2015, the Company entered into an accelerated share repurchase arrangement (“ASR”) with a financial institution. In exchange for an up-front payment of \$60 million, the financial institution delivered 742,880 shares of Company common stock with a fair value of \$54 million. The total number of shares ultimately delivered under the ASR is determined at the end of the purchase period (up to three months, but not less than one month) based on the volume weighted-average price (“VWAP”) of the Company’s common stock during that period. If there were no change in the market price of the Company’s stock during the purchase period, the Company would receive approximately 90,000 additional shares at the end of the purchase period.

The Company accounted for the up-front payment as a reduction of shareholders’ equity in the period made. Shares received under the ASR were retired and reflected as a reduction of outstanding shares on the date delivered for purposes of calculating earnings per share. The forward contract aspect of the ASR met all of the applicable criteria for equity classification, and therefore, was accounted for as a derivative indexed to the Company’s equity.

Subsequent to the end of the second quarter, the purchase period ended and the Company received an additional 94,515 shares to complete the ASR at an average realized price of \$71.65 per share.

- Beginning with the first quarter of 2015 the Company revised the presentation of its financial reporting segments. Operations of the Process and the Oil and Natural Gas divisions, historically included in the Industrial segment, are now aggregated with the Lubrication division (formerly reported as a separate segment) in the newly-formed Process segment. This change aligns the types of products offered and markets served within the segments. Prior year segment information has been restated to conform to 2015 reporting.

A summary of the Company’s three reportable segments (Industrial, Process and Contractor) follows.

The Industrial segment includes our Industrial Products and Applied Fluid Technologies divisions. The Industrial segment markets equipment and pre-engineered packages for moving and applying paints, coatings, sealants, adhesives and other fluids. Markets served

include automotive and vehicle assembly and components production, wood and metal products, rail, marine, aerospace, farm, construction, bus, recreational vehicles, and various other industries.

The Process segment includes our Process, Oil and Natural Gas, and Lubrication divisions. The Process segment markets pumps, valves, meters and accessories to move and dispense chemicals, oil and natural gas, water, waste water, petroleum, food, lubricants and other fluids. Markets served include food and beverage, dairy, oil and natural gas, pharmaceutical, cosmetics, electronics, waste water, mining, fast oil change facilities, service garages, fleet service centers, automobile dealerships and industrial lubrication applications.

The Contractor segment remains unchanged. The Contractor segment markets sprayers for architectural coatings for painting, corrosion control, texture, and line striping.

Sales and operating earnings by segment were as follows (in thousands):

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|---------------------------------|----------------------|-------------------|------------------------|-------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Net Sales | | | | |
| Industrial | \$ 153,502 | \$ 156,578 | \$ 296,768 | \$ 308,624 |
| Process | 71,946 | 54,850 | 139,627 | 107,860 |
| Contractor | 110,041 | 111,121 | 205,547 | 196,027 |
| Total | \$ 335,489 | \$ 322,549 | \$ 641,942 | \$ 612,511 |
| Operating Earnings | | | | |
| Industrial | \$ 50,738 | \$ 50,892 | \$ 93,678 | \$ 99,997 |
| Process | 13,988 | 13,572 | 24,486 | 26,215 |
| Contractor | 27,040 | 28,289 | 46,415 | 46,539 |
| Unallocated corporate (expense) | (7,875) | (6,905) | (15,457) | (12,198) |
| Total | \$ 83,891 | \$ 85,848 | \$ 149,122 | \$ 160,553 |

Assets by segment were as follows (in thousands):

| | June 26, 2015 | Dec 26, 2014 |
|-----------------------|---------------------|---------------------|
| Industrial | \$ 567,759 | \$ 548,868 |
| Process | 499,113 | 304,903 |
| Contractor | 214,092 | 176,757 |
| Unallocated corporate | 137,944 | 514,250 |
| Total | \$ 1,418,908 | \$ 1,544,778 |

Unallocated corporate assets decreased due to the sale of the Liquid Finishing assets in the second quarter of 2015 (see note 12).

Geographic information follows (in thousands):

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|---|----------------------|-------------------|------------------------|-------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Net sales (based on customer location) | | | | |
| United States | \$ 170,921 | \$ 156,160 | \$ 330,249 | \$ 290,082 |
| Other countries | 164,568 | 166,389 | 311,693 | 322,429 |
| Total | <u>\$ 335,489</u> | <u>\$ 322,549</u> | <u>\$ 641,942</u> | <u>\$ 612,511</u> |
| | June 26, 2015 | Dec 26, 2014 | | |
| Long-lived assets | | | | |
| United States | \$ 140,935 | \$ 131,131 | | |
| Other countries | 30,464 | 30,099 | | |
| Total | <u>\$ 171,399</u> | <u>\$ 161,230</u> | | |

7. Major components of inventories were as follows (in thousands):

| | June 26, 2015 | Dec 26, 2014 |
|---|-------------------|-------------------|
| Finished products and components | \$ 108,684 | \$ 87,384 |
| Products and components in various stages of completion | 49,864 | 47,682 |
| Raw materials and purchased components | 82,105 | 69,212 |
| | 240,653 | 204,278 |
| Reduction to LIFO cost | (46,085) | (44,481) |
| Total | <u>\$ 194,568</u> | <u>\$ 159,797</u> |

8. Information related to other intangible assets follows (dollars in thousands):

| | Estimated Life (years) | Cost | Accumulated Amortization | Foreign Currency Translation | Book Value |
|---|------------------------------|-------------------|-----------------------------|------------------------------------|-------------------|
| June 26, 2015 | | | | | |
| Customer relationships | 3 - 14 | \$ 197,823 | \$ (29,364) | \$ (4,368) | \$ 164,091 |
| Patents, proprietary technology and product documentation | 3 - 11 | 20,499 | (8,134) | (318) | 12,047 |
| Trademarks, trade names and other | 5 | 495 | (91) | (42) | 362 |
| | | 218,817 | (37,589) | (4,728) | 176,500 |
| Not Subject to Amortization: | | | | | |
| Brand names | | 69,165 | - | (1,431) | 67,734 |
| Total | | \$ 287,982 | \$ (37,589) | \$ (6,159) | \$ 244,234 |
| December 26, 2014 | | | | | |
| Customer relationships | 3 - 14 | \$ 143,144 | \$ (21,948) | \$ (7,334) | \$ 113,862 |
| Patents, proprietary technology and product documentation | 3 - 11 | 18,268 | (7,126) | (655) | 10,487 |
| Trademarks, trade names and other | 5 | 175 | (44) | - | 131 |
| | | 161,587 | (29,118) | (7,989) | 124,480 |
| Not Subject to Amortization: | | | | | |
| Brand names | | 55,265 | - | (3,467) | 51,798 |
| Total | | \$ 216,852 | \$ (29,118) | \$ (11,456) | \$ 176,278 |

Amortization of intangibles for the quarter was \$4.4 million in 2015 and \$2.7 million in 2014 and for the year-to-date was \$8.5 million in 2015 and \$5.8 million in 2014. Estimated annual amortization expense is as follows: \$17.4 million in 2015, \$17.6 million in 2016, \$17.3 million in 2017, \$17.0 million in 2018, \$16.9 million in 2019 and \$98.8 million thereafter.

Changes in the carrying amount of goodwill in 2015 were as follows (in thousands):

| | Industrial | Process | Contractor | Total |
|--------------------------------------|-------------------|-------------------|------------------|-------------------|
| Beginning balance | \$ 188,273 | \$ 91,569 | \$ 12,732 | \$ 292,574 |
| Additions from business acquisitions | 5,037 | 101,730 | - | 106,767 |
| Foreign currency translation | 2,846 | 1,342 | - | 4,188 |
| Ending balance | <u>\$ 196,156</u> | <u>\$ 194,641</u> | <u>\$ 12,732</u> | <u>\$ 403,529</u> |

9. Components of other current liabilities were (in thousands):

| | June 26, 2015 | Dec 26, 2014 |
|--|-------------------|------------------|
| Accrued self-insurance retentions | \$ 7,371 | \$ 7,089 |
| Accrued warranty and service liabilities | 7,641 | 7,609 |
| Accrued trade promotions | 5,830 | 7,697 |
| Payable for employee stock purchases | 4,951 | 9,126 |
| Customer advances and deferred revenue | 15,763 | 8,918 |
| Income taxes payable | 48,104 | 5,997 |
| Other | 32,624 | 25,157 |
| Total other current liabilities | <u>\$ 122,284</u> | <u>\$ 71,593</u> |

A liability is established for estimated future warranty and service claims that relate to current and prior period sales. The Company estimates warranty costs based on historical claim experience and other factors including evaluating specific product warranty issues. Following is a summary of activity in accrued warranty and service liabilities (in thousands):

| | Twenty-six Weeks Ended June 26, 2015 | Year Ended Dec 26, 2014 |
|---------------------------------|---|-------------------------------|
| Balance, beginning of year | \$ 7,609 | \$ 7,771 |
| Assumed in business acquisition | - | 12 |
| Charged to expense | 3,169 | 6,069 |
| Margin on parts sales reversed | 1,035 | 1,920 |
| Reductions for claims settled | (4,172) | (8,163) |
| Balance, end of period | <u>\$ 7,641</u> | <u>\$ 7,609</u> |

10. Assets and liabilities measured at fair value on a recurring basis and fair value measurement level were as follows (in thousands):

| | Level | June 26, 2015 | Dec 26, 2014 |
|--|-------|------------------|------------------|
| Assets | | | |
| Cash surrender value of life insurance | 2 | \$ 13,597 | \$ 13,187 |
| Forward exchange contracts | 2 | - | 280 |
| Total assets at fair value | | <u>\$ 13,597</u> | <u>\$ 13,467</u> |
| Liabilities | | | |
| Contingent consideration | 3 | \$ 8,100 | \$ - |
| Deferred compensation | 2 | 3,205 | 2,676 |
| Forward exchange contracts | 2 | 62 | - |
| Total liabilities at fair value | | <u>\$ 11,367</u> | <u>\$ 2,676</u> |

Contracts insuring the lives of certain employees who are eligible to participate in certain non-qualified pension and deferred compensation plans are held in trust. Cash surrender value of the contracts is based on performance measurement funds that shadow the deferral investment allocations made by participants in certain deferred compensation plans. The deferred compensation liability balances are valued based on amounts allocated by participants to the underlying performance measurement funds.

Contingent consideration liability represents the estimated value (using a market approach) of future payments to be made to previous owners of an acquired business (see Note 11).

Long-term notes payable with fixed interest rates have a carrying amount of \$300 million and an estimated fair value of \$330 million as of June 26, 2015 and \$330 million as of December 26, 2014. The fair value of variable rate borrowings approximates carrying value. The Company uses significant other observable inputs to estimate fair value (level 2 of the fair value hierarchy) based on the present value of future cash flows and rates that would be available for issuance of debt with similar terms and remaining maturities.

11. On January 20, 2015, the Company completed the acquisition of High Pressure Equipment Holdings, LLC (HiP) for \$160 million cash. HiP designs and manufactures valves, fittings and other flow control equipment engineered to perform in ultra-high pressure environments. HiP's products and business relationships will enhance Graco's position in the oil and natural gas industry and complement Graco's core competencies of designing and manufacturing advanced flow control technologies. HiP had sales of \$38 million in 2014. Results of HiP operations, including \$15 million of sales, have been included in the Company's Process segment from the date of acquisition.

Purchase consideration was allocated to assets acquired and liabilities assumed based on estimated fair values as follows (in thousands):

| | | |
|--------------------------------|----|----------------|
| Cash and cash equivalents | \$ | 1,904 |
| Accounts receivable | | 4,714 |
| Inventories | | 7,605 |
| Other current assets | | 69 |
| Property, plant and equipment | | 1,962 |
| Deferred income taxes | | 1,840 |
| Identifiable intangible assets | | 60,100 |
| Goodwill | | 86,149 |
| Total assets acquired | | 164,343 |
| Liabilities assumed | | (3,414) |
| Net assets acquired | \$ | <u>160,929</u> |

Post-closing working capital adjustments that completed the HIP purchase price allocation resulted in a \$0.5 million reduction of goodwill in the second quarter of 2015.

Identifiable intangible assets and estimated useful life are as follows (dollars in thousands):

| | | Estimated Life (years) |
|--------------------------------------|------------------|---------------------------|
| Customer relationships | 47,100 | 12 |
| Trade names | 13,000 | Indefinite |
| Total identifiable intangible assets | <u>\$ 60,100</u> | |

Approximately two-thirds of the goodwill acquired with HiP is deductible for tax purposes.

On January 2, 2015 the Company acquired White Knight Fluid Handling for \$16 million cash and a commitment for additional consideration if future revenues exceed certain thresholds, valued at \$8 million. The maximum payout is not limited. White Knight designs and manufactures high purity, metal-free pumps used in the production process of manufacturing semiconductors, solar panels, LED flat panel displays and various other electronics. The products, brands and distribution channels of White Knight expand and complement the offerings of the Company's Process segment. The purchase price was allocated based on estimated fair values, including \$12 million of goodwill, \$9 million of other identifiable intangible assets and \$3 million of net tangible assets.

Post-closing working capital adjustments that completed the Alco purchase price allocation, acquired in the fourth quarter of 2014, resulted in a \$4 million addition to goodwill in the first quarter of 2015.

The Company completed other acquisitions in 2015 that were not material to the consolidated financial statements.

12. In April 2015, the Company sold the Liquid Finishing assets acquired in 2012 that were held as a cost-method investment. Selling price was \$590 million cash, subject to customary post-closing adjustments. The \$147 million pre-tax gain on the sale, net of transaction and other related expenses, was included in investment income in the Company's consolidated statements of earnings. Prior to the sale, income was recognized on dividends received from after-tax earnings of Liquid Finishing and also included in investment income. Dividend income for the quarter totaled \$12 million in 2015 and \$11 million in 2014. Year-to-date dividend income was \$42 million in 2015 and \$15 million in 2014.
13. The effective income tax rate was 28 percent for the quarter, consistent with the comparable period last year, and 26 percent for the year-to-date, down 3 percentage points compared to last year. In the second quarter, the Company asserted that it will indefinitely reinvest earnings of foreign subsidiaries to support expansion of its international business. The change in assertion decreased deferred income taxes related to undistributed foreign earnings by \$7 million and reduced the effective tax rate compared to last year. The tax rate effects of the gain on the sale of the Liquid Finishing assets offset the effects of the foreign earnings reinvestment assertion. Higher post-tax dividend income and an additional non-recurring tax benefit of \$2 million further reduced the year-to-date effective tax rate.

Item 2.

GRACO INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The Company designs, manufactures and markets systems and equipment to move, measure, control, dispense and spray fluid and coating materials. Management classifies the Company's business into three reportable segments: Industrial, Process and Contractor. Key strategies include developing and marketing new products, expanding distribution globally, opening new markets with technology and channel expansion and completing strategic acquisitions.

The following Management's Discussion and Analysis reviews significant factors affecting the Company's results of operations and financial condition. This discussion should be read in conjunction with the financial statements and the accompanying notes to the financial statements.

Consolidated Results

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

| | Thirteen Weeks Ended | | | Twenty-six Weeks Ended | | |
|---------------------------------------|----------------------|------------------|-------------|------------------------|------------------|-------------|
| | June 26, 2015 | June 27, 2014 | % Change | June 26, 2015 | June 27, 2014 | % Change |
| Net Sales | \$ 335.5 | \$ 322.5 | 4% | \$ 641.9 | \$ 612.5 | 5% |
| Operating Earnings | \$ 83.9 | \$ 85.8 | (2)% | \$ 149.1 | \$ 160.6 | (7)% |
| Net Earnings | \$ 172.6 | \$ 66.2 | 161% | \$ 241.5 | \$ 117.0 | 106% |
| Diluted Net Earnings per Common Share | \$ 2.90 | \$ 1.07 | 171% | \$ 4.02 | \$ 1.88 | 114% |

In April 2015, the Company sold the Liquid Finishing business assets acquired in 2012. Held separate investment income includes the net gain on sale of \$147 million and dividends of \$12 million for the quarter and \$42 million year-to-date. Net earnings include after-tax net gain on the sale and dividend income totaling \$110 million (\$1.85 per diluted share) for the quarter and \$139 million (\$2.32 per diluted share) for the year-to-date. Net earnings in 2014 included after-tax net investment income of \$11 million (\$0.18 per diluted share) for the quarter and \$15 million (\$0.23 per diluted share) for the year-to-date. No further Liquid Finishing dividends will be received.

Results excluding Liquid Finishing investment income and expense are a better measure of the Company's on-going operations and provide a more consistent base of comparison to future results. A calculation of the non-GAAP measurement of net earnings excluding investment income and expense follows (in millions except per share amounts):

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|--|----------------------|------------------|------------------------|------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Net Earnings, as reported | \$ 172.6 | \$ 66.2 | \$ 241.5 | \$ 117.0 |
| Held separate investment (income), net | (158.8) | (10.6) | (188.4) | (14.2) |
| Income tax effect | 49.1 | (0.2) | 48.9 | (0.3) |
| Net Earnings, adjusted | <u>\$ 62.9</u> | <u>\$ 55.4</u> | <u>\$ 102.0</u> | <u>\$ 102.5</u> |
| Diluted earnings per share | | | | |
| As reported | \$ 2.90 | \$ 1.07 | \$ 4.02 | \$ 1.88 |
| Adjusted | 1.05 | 0.89 | 1.70 | 1.65 |

The following table presents components of changes in sales:

| | Quarter | | | | | | |
|------------------|--------------|-------------|--------------|-------------|--------------|--------------|------------|
| | Segment | | | Region | | | |
| | Industrial | Process | Contractor | Americas | EMEA | Asia Pacific | Total |
| Volume and Price | 3 % | 4 % | 3 % | 3 % | 1 % | 5 % | 3 % |
| Acquisitions | 1 % | 32 % | - % | 5 % | 9 % | 8 % | 6 % |
| Currency | (6) % | (5) % | (4) % | (1) % | (15) % | (5) % | (5) % |
| Total | <u>(2) %</u> | <u>31 %</u> | <u>(1) %</u> | <u>7 %</u> | <u>(5) %</u> | <u>8 %</u> | <u>4 %</u> |
| | Year-to-Date | | | | | | |
| | Segment | | | Region | | | |
| | Industrial | Process | Contractor | Americas | EMEA | Asia Pacific | Total |
| Volume and Price | 1 % | 4 % | 9 % | 7 % | - % | (2) % | 4 % |
| Acquisitions | 1 % | 30 % | - % | 5 % | 9 % | 6 % | 6 % |
| Currency | (6) % | (5) % | (4) % | (1) % | (15) % | (4) % | (5) % |
| Total | <u>(4) %</u> | <u>29 %</u> | <u>5 %</u> | <u>11 %</u> | <u>(6) %</u> | <u>- %</u> | <u>5 %</u> |

Sales by geographic area were as follows (in millions):

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|-----------------------|----------------------|------------------|------------------------|------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Americas ¹ | \$ 197.3 | \$ 184.8 | \$ 382.1 | \$ 343.6 |
| EMEA ² | 75.6 | 79.7 | 144.4 | 153.1 |
| Asia Pacific | 62.6 | 58.0 | 115.4 | 115.8 |
| Consolidated | <u>\$ 335.5</u> | <u>\$ 322.5</u> | <u>\$ 641.9</u> | <u>\$ 612.5</u> |

¹ North and South America, including the U.S.

² Europe, Middle East and Africa

Changes in currency translation rates reduced sales and net earnings by approximately \$17 million and \$6 million, respectively, for the quarter and \$30 million and \$10 million, respectively for the year-to-date.

Sales for the quarter increased 4 percent, with increases in the Americas and Asia Pacific partially offset by a decrease in EMEA. Sales from operations acquired in the fourth quarter of 2014 and the first half of 2015 totaled \$19 million for the quarter, contributing 6 percentage points of growth. Organic sales at consistent translation rates increased 3 percent, with increases of 3 percent in the Americas, 1 percent in EMEA and 5 percent in Asia Pacific.

Year-to-date sales increased 5 percent, with a double digit percentage increase in the Americas partially offset by decreases in EMEA and Asia Pacific. Sales from acquired operations totaled \$34 million, contributing 6 percentage points of growth. Organic sales at consistent translation rates increased 4 percent, including a 7 percent increase in the Americas, a slight increase in EMEA and a 2 percent decrease in Asia Pacific.

Gross profit margin rates for the quarter and year-to-date were lower than rates in the comparable periods last year due mostly to changes in currency translation rates. Lower average gross margin rates of acquired operations (including purchase accounting effects) decreased overall gross margin rates by approximately one-half percentage point for both the quarter and the year-to-date.

Total operating expenses for the quarter were \$6 million (6 percent) higher than the second quarter last year. Year-to-date operating expenses were \$18 million (10 percent) higher than last year. The increases included expenses of acquired operations totaling \$7 million for the quarter and \$13 million for the year-to-date. Spending related to regional and product expansion initiatives increased year-to-date expenses by approximately \$3 million. Unallocated corporate expenses increased \$1 million for the quarter and \$3 million year-to-date, mostly from increases in pension, stock compensation and new central warehouse.

The effective income tax rate was 28 percent for the quarter, consistent with the comparable period last year, and 26 percent for the year-to-date, down 3 percentage points compared to last year. In the second quarter, the Company asserted that it will indefinitely reinvest earnings of foreign subsidiaries to support expansion of its international business. The change in assertion decreased deferred income taxes related to undistributed foreign earnings by \$7 million and reduced the effective tax rate compared to last year. The tax rate effects of the gain on the sale of the Liquid Finishing assets offset the effects of the foreign earnings reinvestment assertion. Higher post-tax dividend income and an additional non-recurring tax benefit of \$2 million further reduced the year-to-date effective tax rate.

Segment Results

Certain measurements of segment operations compared to last year are summarized below:

Industrial

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|---|----------------------|------------------|------------------------|------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Net sales (in millions) | | | | |
| Americas | \$ 71.6 | \$ 69.4 | \$ 139.3 | \$ 135.1 |
| EMEA | 41.4 | 49.4 | 82.4 | 97.0 |
| Asia Pacific | 40.5 | 37.8 | 75.1 | 76.5 |
| Total | <u>\$ 153.5</u> | <u>\$ 156.6</u> | <u>\$ 296.8</u> | <u>\$ 308.6</u> |
| Operating earnings as a percentage of net sales | <u>33 %</u> | <u>33 %</u> | <u>32 %</u> | <u>32 %</u> |

Industrial segment sales for the quarter decreased 2 percent, but increased 4 percent at consistent translation rates. Sales in this segment increased 3 percent in the Americas, decreased 16 percent in EMEA (2 percent at consistent translation rates) and increased 7 percent in Asia Pacific (12 percent at consistent translation rates). Year-to-date sales decreased 4 percent, but increased 2 percent at consistent translation rates. Sales increased 3 percent in the Americas, decreased 15 percent in EMEA (1 percent at consistent translation rates) and decreased 2 percent in Asia Pacific (increased 2 percent at consistent translation rates). Operating margin rates for the Industrial segment for the quarter and year-to-date were consistent with last year.

Process

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|---|----------------------|------------------|------------------------|------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Net sales (in millions) | | | | |
| Americas | \$ 44.4 | \$ 36.3 | \$ 87.3 | \$ 70.8 |
| EMEA | 14.9 | 9.0 | 28.8 | 18.4 |
| Asia Pacific | 12.6 | 9.6 | 23.5 | 18.7 |
| Total | <u>\$ 71.9</u> | <u>\$ 54.9</u> | <u>\$ 139.6</u> | <u>\$ 107.9</u> |
| Operating earnings as a percentage of net sales | <u>19 %</u> | <u>25 %</u> | <u>18 %</u> | <u>24 %</u> |

Process segment sales for the quarter increased 31 percent (36 percent at consistent translation rates), including double-digit percentage increases in all regions. Year-to-date sales in this segment increased 29 percent (34 percent at consistent translation rates). Most of the sales increases were from acquired operations including Alco Valves (acquired fourth quarter of 2014), White Knight Fluid Handling and High Pressure Equipment (both acquired in January 2015). Organic sales growth at consistent translation rates was 4 percent for both the quarter and the year-to-date. Lower average profit margins of acquired operations, changes in currency translation rates and incremental investment in oil and natural gas products led to decreases in operating margin rates for this segment.

Contractor

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|---|----------------------|------------------|------------------------|------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Net sales (in millions) | | | | |
| Americas | \$ 81.3 | \$ 79.2 | \$ 155.5 | \$ 137.7 |
| EMEA | 19.3 | 21.3 | 33.2 | 37.7 |
| Asia Pacific | 9.4 | 10.6 | 16.8 | 20.6 |
| Total | <u>\$ 110.0</u> | <u>\$ 111.1</u> | <u>\$ 205.5</u> | <u>\$ 196.0</u> |
| Operating earnings as a percentage of net sales | <u>25 %</u> | <u>25 %</u> | <u>23 %</u> | <u>24 %</u> |

Contractor segment sales for the quarter decreased 1 percent, but increased 3 percent at consistent translation rates, mostly in the Americas. Year-to-date sales in this segment increased 5 percent (9 percent at consistent translation rates). Sales increased 13 percent in the Americas, decreased 12 percent in EMEA (but increased 2 percent at consistent translation rates) and decreased 18 percent in Asia Pacific (15 percent at consistent translation rates). Operating margin rate for the quarter was consistent with the comparable period last year. Year-to-date operating margin rate decreased by one percentage point, mostly due to changes in currency translation rates and additional marketing spending, including new product launch costs and other volume-related increases.

Liquidity and Capital Resources

Net cash provided by operating activities was \$97 million in 2015, a \$13 million increase over the comparable period of 2014. Accounts receivable and inventory balances increased since the end of 2014 due to acquisitions, increases in business activity and inventory increases to improve customer service levels. Proceeds of \$590 million from the sale of Liquid Finishing assets were principally used to retire debt. Other significant uses of cash in the first half of 2015 included business acquisitions totaling \$188 million, purchases of Company common stock of \$131 million and dividend payments to shareholders of \$35 million.

In January 2015, the Company completed the acquisition of High Pressure Equipment Holdings, LLC (HiP) for \$160 million. HiP designs and manufactures valves, fittings and other flow control equipment engineered to perform in ultra-high pressure environments. The Company also acquired White Knight Fluid Handling, a manufacturer of high purity, metal-free pumps used in the production process of manufacturing semiconductors, solar panels, LED flat panel displays and various other electronics. The Company completed other acquisitions in the second quarter that were not material to the consolidated financial statements.

At June 26, 2015, the Company had various lines of credit totaling \$549 million, of which \$539 million was unused. Internally generated funds and unused financing sources are expected to provide the Company with the flexibility to meet its liquidity needs in 2015.

Outlook

The Company continues to target mid-single-digit organic sales growth, on a constant currency basis, and growth in all reportable segments and regions for the full-year 2015. The Americas remains our strongest performing region and we are optimistic Contractor Americas will perform in the second half. Currency uncertainty and geopolitical instability continue to generate volatility and present challenges for EMEA and Asia Pacific growth. At current exchange rates, unfavorable changes in foreign currency translation rates create a full-year headwind of approximately 5 percent on sales and 11 percent on earnings in 2015.

SAFE HARBOR CAUTIONARY STATEMENT

The Company desires to take advantage of the “safe harbor” provisions regarding forward-looking statements of the Private Securities Litigation Reform Act of 1995 and is filing this Cautionary Statement in order to do so. From time to time various forms filed by our Company with the Securities and Exchange Commission, including this Form 10-Q and our Form 10-K and Form 8-Ks, and other disclosures, including our 2014 Overview report, press releases, earnings releases, analyst briefings, conference calls and other written documents or oral statements released by our Company, may contain forward-looking statements. Forward-looking statements generally use words such as “expect,” “foresee,” “anticipate,” “believe,” “project,” “should,” “estimate,” “will,” and similar expressions, and reflect our Company’s expectations concerning the future. All forecasts and projections are forward-looking statements. Forward-looking statements are based upon currently available information, but various risks and uncertainties may cause our Company’s actual results to differ materially from those expressed in these statements. The Company undertakes no obligation to update these statements in light of new information or future events.

Future results could differ materially from those expressed, due to the impact of changes in various factors. These risk factors include, but are not limited to: our Company’s growth strategies, which include making acquisitions, investing in new products, expanding geographically and targeting new industries; economic conditions in the United States and other major world economies; changes in currency translation rates; changes in laws and regulations; compliance with anti-corruption laws; new entrants who copy our products or infringe on our intellectual property; risks incident to conducting business internationally; the ability to meet our customers’ needs and changes in product demand; supply interruptions or delays; security breaches; political instability; results of and costs associated with, litigation, administrative proceedings and regulatory reviews incident to our business as well as indemnification claims under our asset purchase agreement with Carlisle Companies Incorporated, Carlisle Fluid Technologies, Inc., and Finishing Brands Holdings Inc.; the possibility of decline in purchases from few large customers of the Contractor segment; variations in activity in the construction and automotive industries; and natural disasters. Please refer to Item 1A of our Annual Report on Form 10-K for fiscal year 2014 for a more comprehensive discussion of these and other risk factors. These reports are available on the Company’s website at www.graco.com and the Securities and Exchange Commission’s website at www.sec.gov. Shareholders, potential investors and other readers are urged to consider these factors in evaluating forward-looking statements and are cautioned not to place undue reliance on such forward-looking statements.

Investors should realize that factors other than those identified above and in Item 1A might prove important to the Company’s future results. It is not possible for management to identify each and every factor that may have an impact on the Company’s operations in the future as new factors can develop from time to time.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes related to market risk from the disclosures made in the Company's 2014 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

As of the end of the fiscal quarter covered by this report, the Company carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures. This evaluation was done under the supervision and with the participation of the Company's President and Chief Executive Officer, the Chief Financial Officer, the Vice President, Controller and Information Systems, and the Vice President, General Counsel and Secretary. Based upon that evaluation, they concluded that the Company's disclosure controls and procedures are effective.

Changes in internal controls

During the quarter, there was no change in the Company's internal control over financial reporting that has materially affected or is reasonably likely to materially affect the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes to the Company's risk factors from those disclosed in the Company's 2014 Annual Report on Form 10-K, except for the changes disclosed in the Company's Quarterly Report on Form 10-Q for the quarter ended March 27, 2015 and except for the update to the "Legal Proceedings" risk factor as follows:

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. We also may be exposed to litigation, claims for indemnification or other claims relating to acquisitions or the divestiture of the liquid finishing business assets under the asset purchase agreement with Carlisle Companies Incorporated, Carlisle Fluid Technologies, Inc., and Finishing Brands Holdings Inc. 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.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

On September 14, 2012, 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, 2015. On April 24, 2015, the Board of Directors authorized the purchase of up to an additional 6,000,000 shares over an indefinite period of time or until terminated by the Board.

In addition to shares purchased under the Board authorizations, the Company purchases shares of common stock held by employees who wish to tender owned shares to satisfy the exercise price or tax due upon exercise of options or vesting of restricted stock.

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) |
|-----------------------------|---|---------------------------------------|--|--|
| Mar 28, 2015 – Apr 24, 2015 | 190,000 | \$ 71.68 | 190,000 | 7,647,377 |
| Apr 25, 2015 – May 22, 2015 | 110,000 | \$ 72.27 | 110,000 | 7,537,377 |
| May 2015 ASR (1) | 742,880 | (1) | 742,880 | 6,794,497 |
| May 23, 2015 – Jun 26, 2015 | - | \$ - | - | 6,794,497 |

(1) On May 11, 2015, the Company entered into an accelerated share repurchase arrangement (“ASR”) with a financial institution. In exchange for an up-front payment of \$60 million, the financial institution delivered 742,880 shares of Company common stock with a fair value of \$54 million. The total number of shares ultimately delivered and the average price per share will be determined at the end of the purchase period (up to three months, but not less than one month) based on the volume weighted-average price of the Company’s common stock during that period. Subsequent to the end of the second quarter, the purchase period ended and the Company received an additional 94,515 shares to complete the ASR at an average realized price of \$71.65 per share.

Item 6. Exhibits

- 3.1 Restated Articles of Incorporation as amended June 13, 2014. (Incorporated by reference to Exhibit 3.1 to the Company's Report on Form 8-K filed June 16, 2014.)
- 3.2 Restated Bylaws as amended February 14, 2014. (Incorporated by reference to Exhibit 3.2 to the Company's 2013 Annual Report on Form 10-K.)
- 10.1 Graco Inc. 2015 Stock Incentive Plan. (Incorporated by reference to Appendix A to the Company's Definitive Proxy Statement on Schedule 14A filed March 11, 2015.)
- 31.1 Certification of President and Chief Executive Officer pursuant to Rule 13a-14(a).
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a).
- 32 Certification of President and Chief Executive Officer and Chief Financial Officer pursuant to Section 1350 of Title 18, U.S.C.
- 99.1 Press Release Reporting First Quarter Earnings dated July 22, 2015.
- 101 Interactive Data File.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GRACO INC.

| | |
|----------------------------|---|
| Date: <u>July 22, 2015</u> | By: <u>/s/ Patrick J. McHale</u> Patrick J. McHale President and Chief Executive Officer (Principal Executive Officer) |
|----------------------------|---|

| | |
|----------------------------|---|
| Date: <u>July 22, 2015</u> | By: <u>/s/ James A. Graner</u> James A. Graner Chief Financial Officer (Principal Financial Officer) |
|----------------------------|---|

| | |
|----------------------------|--|
| Date: <u>July 22, 2015</u> | By: <u>/s/ Caroline M. Chambers</u> Caroline M. Chambers Vice President, Corporate Controller and Information Systems (Principal Accounting Officer) |
|----------------------------|--|

CERTIFICATION

I, Patrick J. McHale, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 22, 2015

/s/ Patrick J. McHale

Patrick J. McHale
President and Chief Executive Officer

CERTIFICATION

I, James A. Graner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 22, 2015

/s/ James A. Graner
James A. Graner
Chief Financial Officer

CERTIFICATION UNDER SECTION 1350

Pursuant to Section 1350 of Title 18 of the United States Code, each of the undersigned certifies that this periodic report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in this periodic report fairly presents, in all material respects, the financial condition and results of operations of Graco Inc.

Date: July 22, 2015

/s/ Patrick J. McHale
Patrick J. McHale
President and Chief Executive Officer

Date: July 22, 2015

/s/ James A. Graner
James A. Graner
Chief Financial Officer

News Release

FOR IMMEDIATE RELEASE:
Wednesday, July 22, 2015

FOR FURTHER INFORMATION:
Financial Contact: James A. Graner (612) 623-6635
Media Contact: Bryce Hallowell (612) 623-6679
bhallowell@graco.com

Graco Reports Second Quarter Results Divestiture and Investment Income Add More Than \$100 Million to Net Earnings

MINNEAPOLIS, MN (July 22, 2015) - Graco Inc. (NYSE: GGG) today announced results for the quarter and six months ended June 26, 2015.

Summary

\$ in millions except per share amounts

| | Thirteen Weeks Ended | | | Twenty-six Weeks Ended | | |
|---------------------------------------|----------------------|------------------|-------------|------------------------|------------------|-------------|
| | June 26, 2015 | June 27, 2014 | % Change | June 26, 2015 | June 27, 2014 | % Change |
| Net Sales | \$ 335.5 | \$ 322.5 | 4% | \$ 641.9 | \$ 612.5 | 5 % |
| Operating Earnings | 83.9 | 85.8 | (2)% | 149.1 | 160.6 | (7)% |
| Net Earnings | 172.6 | 66.2 | 161 % | 241.5 | 117.0 | 106 % |
| Diluted Net Earnings per Common Share | \$ 2.90 | \$ 1.07 | 171 % | \$ 4.02 | \$ 1.88 | 114 % |

- In April, the Company sold the Liquid Finishing business assets acquired in 2012. Net earnings include after-tax net gain on the sale and other Liquid Finishing investment income totaling \$110 million (\$1.85 per diluted share) for the quarter and \$139 million (\$2.32 per diluted share) for the year-to-date. Net earnings in 2014 included after-tax Liquid Finishing investment income of \$11 million (\$0.18 per diluted share) for the quarter and \$15 million (\$0.23 per diluted share) for the year-to-date.
- Non-recurring income tax benefits increased net earnings by a total of \$9 million, or \$0.15 per diluted share for both the quarter and the year-to-date.
- Changes in currency translation rates reduced sales by approximately \$17 million for the quarter and \$30 million for the year-to-date, and decreased net earnings by approximately \$6 million for the quarter and \$10 million for the year-to-date.
- Year-to-date sales increased 5 percent, including 4 percentage points of organic sales growth and 6 percentage points of growth from acquired operations, partially offset by a decrease of 5 percentage points from currency translation. Components of the 4 percent increase in sales for the quarter were approximately the same as for the year-to-date increase.
- Gross margin rates for the quarter and year-to-date were lower than the comparable periods last year mostly due to currency translation.
- Year-to-date operating expenses increased due to expenses of acquired operations, spending related to regional expansion and product initiatives, and additional unallocated corporate expenses.
- Year-to-date operating income as a percentage of sales decreased to 23 percent, 3 percentage points lower than the comparable period last year. Half of the decrease as a percentage of sales was from foreign currency translation, with the remainder related to acquisitions and increases in unallocated corporate expenses.

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“On a constant currency basis, the Company achieved low-to-mid-single-digit organic sales growth in all reportable segments and regions during the second quarter,” said Patrick J. McHale, Graco’s President and CEO. “Contractor segment sales growth moderated to a low single-digit pace in the quarter following significant outperformance in the first quarter of 2015 and against a strong comparable from 2014. In the EMEA region, on a constant currency basis, double-digit organic sales growth in the developed economies in the second quarter was nearly offset by sales declines in the emerging markets, namely Russia and the Middle East. The Asia Pacific region grew at a mid-single-digit pace organically in the quarter, on a constant currency basis, reflecting increased shipments in all geographies except Southeast Asia and Australia.”

Consolidated Results

Changes in currency translation rates reduced sales and net earnings by approximately \$17 million and \$6 million, respectively, for the quarter and \$30 million and \$10 million, respectively for the year-to-date.

Sales for the quarter increased 4 percent, with increases in the Americas and Asia Pacific partially offset by a decrease in EMEA. Sales from operations acquired in the fourth quarter of 2014 and the first half of 2015 totaled \$19 million for the quarter, contributing 6 percentage points of growth. Organic sales at consistent translation rates increased 3 percent, with increases of 3 percent in the Americas, 1 percent in EMEA and 5 percent in Asia Pacific.

Year-to-date sales increased 5 percent, with a double digit percentage increase in the Americas partially offset by decreases in EMEA and Asia Pacific. Sales from acquired operations totaled \$34 million, contributing 6 percentage points of growth. Organic sales at consistent translation rates increased 4 percent, including a 7 percent increase in the Americas, a slight increase in EMEA and a 2 percent decrease in Asia Pacific.

Gross profit margin rates for the quarter and year-to-date were lower than rates in the comparable periods last year due mostly to changes in currency translation rates. Lower average gross margin rates of acquired operations (including purchase accounting effects) decreased overall gross margin rates by approximately one-half percentage point for both the quarter and the year-to-date.

Total operating expenses for the quarter were \$6 million (6 percent) higher than the second quarter last year. Year-to-date operating expenses were \$18 million (10 percent) higher than last year. The increases included expenses of acquired operations totaling \$7 million for the quarter and \$13 million for the year-to-date. Spending related to regional and product expansion initiatives increased year-to-date expenses by approximately \$3 million. Unallocated corporate expenses increased \$1 million for the quarter and \$3 million year-to-date, mostly from increases in pension, stock compensation and new central warehouse.

In April, the Company sold the Liquid Finishing business assets acquired in 2012. Held separate investment income includes the net gain on sale of \$147 million and dividends of \$12 million for the quarter and \$42 million year-to-date. Net earnings include after-tax net gain on the sale and dividend income totaling \$110 million (\$1.85 per diluted share) for the quarter and \$139 million (\$2.32 per diluted share) for the year-to-date. Net earnings in 2014 included after-tax net investment income of \$11 million (\$0.18 per diluted share) for the quarter and \$15 million (\$0.23 per diluted share) for the year-to-date. No further Liquid Finishing dividends will be received.

The effective income tax rate was 28 percent for the quarter, consistent with the comparable period last year, and 26 percent for the year-to-date, down 3 percentage points compared to last year. In the second quarter, the Company asserted that it will indefinitely reinvest earnings of foreign subsidiaries to support expansion of its international business. The change in assertion decreased deferred income taxes related to undistributed foreign earnings by \$7 million and reduced the effective tax rate compared to last year. The tax rate effects of the gain on the sale of the Liquid Finishing assets offset the effects of

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the foreign earnings reinvestment assertion. Higher post-tax dividend income and an additional non-recurring tax benefit of \$2 million further reduced the year-to-date effective tax rate.

Change in Financial Reporting Segments

Beginning with the first quarter of 2015 the Company revised the presentation of its financial reporting segments. Operations of the Process and the Oil and Natural Gas divisions, historically included in the Industrial segment, are now aggregated with the Lubrication division (formerly reported as a separate segment) in the newly-formed Process segment. This change aligns the types of products offered and markets served within the segments. Prior year segment information has been restated to conform to 2015 reporting.

A summary of the Company's three reportable segments (Industrial, Process and Contractor) follows.

The Industrial segment includes our Industrial Products and Applied Fluid Technologies divisions. The Industrial segment markets equipment and pre-engineered packages for moving and applying paints, coatings, sealants, adhesives and other fluids. Markets served include automotive and vehicle assembly and components production, wood and metal products, rail, marine, aerospace, farm, construction, bus, recreational vehicles, and various other industries.

The Process segment includes our Process, Oil and Natural Gas, and Lubrication divisions. The Process segment markets pumps, valves, meters and accessories to move and dispense chemicals, oil and natural gas, water, waste water, petroleum, food, lubricants and other fluids. Markets served include food and beverage, dairy, oil and natural gas, pharmaceutical, cosmetics, electronics, waste water, mining, fast oil change facilities, service garages, fleet service centers, automobile dealerships and industrial lubrication applications.

The Contractor segment remains unchanged. The Contractor segment markets sprayers for architectural coatings for painting, corrosion control, texture, and line striping.

Segment Results

Certain measurements of segment operations are summarized below:

| | Thirteen Weeks | | | Twenty-six Weeks | | |
|---|----------------|---------|------------|------------------|----------|------------|
| | Industrial | Process | Contractor | Industrial | Process | Contractor |
| Net sales (in millions) | \$ 153.5 | \$ 71.9 | \$ 110.0 | \$ 296.8 | \$ 139.6 | \$ 205.5 |
| Percentage change from last year | | | | | | |
| Sales | (2)% | 31 % | (1)% | (4)% | 29 % | 5 % |
| Operating earnings | 0 % | 3 % | (4)% | (6)% | (7)% | 0 % |
| Operating earnings as a percentage of sales | | | | | | |
| 2015 | 33 % | 19 % | 25 % | 32 % | 18 % | 23 % |
| 2014 | 33 % | 25 % | 25 % | 32 % | 24 % | 24 % |

Industrial segment sales for the quarter decreased 2 percent, but increased 4 percent at consistent translation rates. Sales in this segment increased 3 percent in the Americas, decreased 16 percent in EMEA (2 percent at consistent translation rates) and increased 7 percent in Asia Pacific (12 percent at consistent translation rates). Year-to-date sales decreased 4 percent, but increased 2 percent at consistent translation rates. Sales increased 3 percent in the Americas, decreased 15 percent in EMEA

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(1 percent at consistent translation rates) and decreased 2 percent in Asia Pacific (increased 2 percent at consistent translation rates). Operating margin rates for the Industrial segment for the quarter and year-to-date were consistent with last year.

Process segment sales for the quarter increased 31 percent (36 percent at consistent translation rates), including double-digit percentage increases in all regions. Year-to-date sales in this segment increased 29 percent (34 percent at consistent translation rates). Most of the sales increases were from acquired operations including Alco Valves (acquired fourth quarter of 2014), White Knight Fluid Handling and High Pressure Equipment (both acquired in January 2015). Organic sales growth at consistent translation rates was 4 percent for both the quarter and the year-to-date. Lower average profit margins of acquired operations, changes in currency translation rates and incremental investment in oil and natural gas products led to decreases in operating margin rates for this segment.

Contractor segment sales for the quarter decreased 1 percent, but increased 3 percent at consistent translation rates, mostly in the Americas. Year-to-date sales in this segment increased 5 percent (9 percent at consistent translation rates). Sales increased 13 percent in the Americas, decreased 12 percent in EMEA (but increased 2 percent at consistent translation rates) and decreased 18 percent in Asia Pacific (15 percent at consistent translation rates). Operating margin rate for the quarter was consistent with the comparable period last year. Year-to-date operating margin rate decreased by one percentage point, mostly due to changes in currency translation rates and additional marketing spending, including new product launch costs and other volume-related increases.

In April 2015, the Company sold the Liquid Finishing assets acquired in 2012 that were held as a cost-method investment. The \$147 million pre-tax gain on the sale, net of transaction and other related expenses, was included in investment income in the Company's consolidated statements of earnings. Prior to the sale, income was recognized on dividends received from after-tax earnings of Liquid Finishing and also included in investment income. Dividend income for the quarter totaled \$12 million in 2015 and \$11 million in 2014. Year-to-date dividend income was \$42 million in 2015 and \$15 million in 2014. Results excluding Liquid Finishing investment income and expense are a better measure of the Company's on-going operations and provide a more consistent base of comparison to future results. A calculation of the non-GAAP measurement of net earnings excluding investment income and expense follows (in millions except per share amounts):

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|--|----------------------|------------------|------------------------|------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Net Earnings, as reported | \$ 172.6 | \$ 66.2 | \$ 241.5 | \$ 117.0 |
| Held separate investment (income), net | (158.8) | (10.6) | (188.4) | (14.2) |
| Income tax effect | 49.1 | (0.2) | 48.9 | (0.3) |
| Net Earnings, adjusted | <u>\$ 62.9</u> | <u>\$ 55.4</u> | <u>\$ 102.0</u> | <u>\$ 102.5</u> |
| Diluted earnings per share | | | | |
| As reported | \$ 2.90 | \$ 1.07 | \$ 4.02 | \$ 1.88 |
| Adjusted | 1.05 | 0.89 | 1.70 | 1.65 |

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Outlook

"The Company continues to target mid-single-digit organic sales growth, on a constant currency basis, and growth in all reportable segments and regions for the full-year 2015," said McHale. "The Americas remains our strongest performing region and we are optimistic Contractor Americas will perform in the second half. Currency uncertainty and geopolitical instability continue to generate volatility and present challenges for EMEA and Asia Pacific growth. At current exchange rates, unfavorable changes in foreign currency translation rates create a full-year headwind of approximately 5 percent on sales and 11 percent on earnings in 2015."

Cautionary Statement Regarding Forward-Looking Statements

The Company desires to take advantage of the "safe harbor" provisions regarding forward-looking statements of the Private Securities Litigation Reform Act of 1995 and is filing this Cautionary Statement in order to do so. From time to time various forms filed by our Company with the Securities and Exchange Commission, including this Form 10-Q and our Form 10-K and Form 8-Ks, and other disclosures, including our 2014 Overview report, press releases, earnings releases, analyst briefings, conference calls and other written documents or oral statements released by our Company, may contain forward-looking statements. Forward-looking statements generally use words such as "expect," "foresee," "anticipate," "believe," "project," "should," "estimate," "will," and similar expressions, and reflect our Company's expectations concerning the future. All forecasts and projections are forward-looking statements. Forward-looking statements are based upon currently available information, but various risks and uncertainties may cause our Company's actual results to differ materially from those expressed in these statements. The Company undertakes no obligation to update these statements in light of new information or future events.

Future results could differ materially from those expressed, due to the impact of changes in various factors. These risk factors include, but are not limited to: our Company's growth strategies, which include making acquisitions, investing in new products, expanding geographically and targeting new industries; economic conditions in the United States and other major world economies; changes in currency translation rates; changes in laws and regulations; compliance with anti-corruption laws; new entrants who copy our products or infringe on our intellectual property; risks incident to conducting business internationally; the ability to meet our customers' needs and changes in product demand; supply interruptions or delays; security breaches; political instability; results of and costs associated with, litigation, administrative proceedings and regulatory reviews incident to our business as well as indemnification claims under our asset purchase agreement with Carlisle Companies Incorporated, Carlisle Fluid Technologies, Inc., and Finishing Brands Holdings Inc.; the possibility of decline in purchases from few large customers of the Contractor segment; variations in activity in the construction and automotive industries; and natural disasters. Please refer to Item 1A of our Annual Report on Form 10-K for fiscal year 2014 (and most recent Form 10-Q) for a more comprehensive discussion of these and other risk factors. These reports are available on the Company's website at www.graco.com/ir and the Securities and Exchange Commission's website at www.sec.gov. Shareholders, potential investors and other readers are urged to consider these factors in evaluating forward-looking statements and are cautioned not to place undue reliance on such forward-looking statements.

Investors should realize that factors other than those identified above and in Item 1A might prove important to the Company's future results. It is not possible for management to identify each and every factor that may have an impact on the Company's operations in the future as new factors can develop from time to time.

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Conference Call

Graco management will hold a conference call, including slides via webcast, with analysts and institutional investors on Thursday, July 23, 2015, at 10:00 a.m. CT, 11:00 a.m. ET, to discuss Graco's second quarter results.

A real-time webcast of the conference call will be broadcast live over the Internet. Individuals wanting to listen and view slides can access the call at the Company's website at www.graco.com/ir. Listeners should go to the website at least 15 minutes prior to the live conference call to install any necessary audio software.

For those unable to listen to the live event, a replay will be available soon after the conference call at Graco's website, or by telephone beginning at approximately 1:00 p.m. CT on July 23, 2015, by dialing 888-203-1112, Conference ID #7932377, if calling within the U.S. or Canada. The dial-in number for international participants is 719-457-0820, with the same Conference ID #. The replay by telephone will be available through July 27, 2015.

Graco Inc. supplies technology and expertise for the management of fluids and coatings in both industrial and commercial applications. It designs, manufactures and markets systems and equipment to move, measure, control, dispense and spray fluid and powder materials. A recognized leader in its specialties, Minneapolis-based Graco serves customers around the world in the manufacturing, processing, construction and maintenance industries. For additional information about Graco Inc., please visit us at www.graco.com.

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GRACO INC. AND SUBSIDIARIES
Consolidated Statement of Earnings (Unaudited)

| (in thousands, except per share amounts) | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|--|----------------------|------------------|------------------------|-------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Net Sales | \$ 335,489 | \$ 322,549 | \$ 641,942 | \$ 612,511 |
| Cost of products sold | 154,866 | 145,699 | 299,190 | 276,349 |
| Gross Profit | 180,623 | 176,850 | 342,752 | 336,162 |
| Product development | 14,907 | 13,405 | 30,197 | 26,564 |
| Selling, marketing and distribution | 50,126 | 49,503 | 101,550 | 95,845 |
| General and administrative | 31,699 | 28,094 | 61,883 | 53,200 |
| Operating Earnings | 83,891 | 85,848 | 149,122 | 160,553 |
| Interest expense | 4,125 | 4,676 | 9,428 | 9,264 |
| Held separate investment (income), net | (158,833) | (10,562) | (188,356) | (14,237) |
| Other expense (income), net | (438) | (202) | 272 | 45 |
| | 239,037 | 91,936 | 327,778 | 165,481 |
| Income taxes | 66,400 | 25,700 | 86,300 | 48,500 |
| | <u>\$ 172,637</u> | <u>\$ 66,236</u> | <u>\$ 241,478</u> | <u>\$ 116,981</u> |
| Net Earnings per Common Share | | | | |
| Basic | \$ 2.96 | \$ 1.10 | \$ 4.12 | \$ 1.93 |
| Diluted | \$ 2.90 | \$ 1.07 | \$ 4.02 | \$ 1.88 |
| Weighted Average Number of Shares | | | | |
| Basic | 58,235 | 60,453 | 58,608 | 60,637 |
| Diluted | 59,622 | 62,028 | 60,044 | 62,233 |

Segment Information (Unaudited)

| | Thirteen Weeks Ended | | Twenty-six Weeks Ended | |
|---------------------------------|----------------------|-------------------|------------------------|-------------------|
| | June 26, 2015 | June 27, 2014 | June 26, 2015 | June 27, 2014 |
| Net Sales | | | | |
| Industrial | \$ 153,502 | \$ 156,578 | \$ 296,768 | \$ 308,624 |
| Process | 71,946 | 54,850 | 139,627 | 107,860 |
| Contractor | 110,041 | 111,121 | 205,547 | 196,027 |
| Total | <u>\$ 335,489</u> | <u>\$ 322,549</u> | <u>\$ 641,942</u> | <u>\$ 612,511</u> |
| Operating Earnings | | | | |
| Industrial | \$ 50,738 | \$ 50,892 | \$ 93,678 | \$ 99,997 |
| Process | 13,988 | 13,572 | 24,486 | 26,215 |
| Contractor | 27,040 | 28,289 | 46,415 | 46,539 |
| Unallocated corporate (expense) | (7,875) | (6,905) | (15,457) | (12,198) |
| Total | <u>\$ 83,891</u> | <u>\$ 85,848</u> | <u>\$ 149,122</u> | <u>\$ 160,553</u> |

All figures are subject to audit and adjustment at the end of the fiscal year.

The consolidated Balance Sheets, Consolidated Statements of Cash Flows and Management's Discussion and Analysis are available in our Quarterly Report on Form 10-Q on our website at www.graco.com.

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