Table of Contents

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 **September 27, 2013**

Commission File Number: 001-09249

GRACO INC.
(Exact name of registrant as specified in its charter)

Minnesota	41-0285640
(State of incorporation)	(I.R.S. Employer Identification Number)

88 - 11th Avenue N.E. Minneapolis, Minnesota	55413
(Address of principal executive offices)	(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	X	Accelerated Filer	____
Non-accelerated Filer	____	Smaller reporting company	____

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

Yes ____ No X

61,233,000 shares of the Registrant's Common Stock, $1.00 par value, were outstanding as of October 17, 2013.

Table of Contents

INDEX

Table of Contents

Item 1.

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

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012	Sep 27, 2013	Sep 28, 2012
Net Sales	$277,035	$256,472	$ 832,101	$ 758,778
Cost of products sold	126,162	116,539	371,845	347,136
Gross Profit	150,873	139,933	460,256	411,642
Product development	12,508	12,485	37,396	36,625
Selling, marketing and distribution	44,297	41,230	132,207	121,803
General and administrative	24,342	29,887	74,213	86,439
Operating Earnings	69,726	56,331	216,440	166,775
Interest expense	4,450	5,233	13,837	14,281
Other expense (income), net	(8,425)	(3,233)	(23,671)	(6,170)
Earnings Before Income Taxes	73,701	54,331	226,274	158,664
Income taxes	17,600	17,200	60,200	51,800
Net Earnings	$ 56,101	$ 37,131	$ 166,074	$ 106,864
Per Common Share				
Basic net earnings	$ 0.91	$ 0.61	$ 2.71	$ 1.77
Diluted net earnings	$ 0.89	$ 0.60	$ 2.65	$ 1.73
Cash dividends declared	$ 0.25	$ 0.23	$ 0.75	$ 0.68

See notes to consolidated financial statements.

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

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012	Sep 27, 2013	Sep 28, 2012
Net Earnings	$ 56,101	$ 37,131	$ 166,074	$ 106,864
Other comprehensive income (loss)				
Cumulative translation adjustment	8,866	3,440	3,011	(6,018)
Pension and postretirement medical liability adjustment	2,304	2,394	7,090	7,203
Income taxes				
Pension and postretirement medical liability adjustment	(835)	(862)	(2,555)	(2,593)
Other comprehensive income (loss)	10,335	4,972	7,546	(1,408)
Comprehensive Income	$ 66,436	$ 42,103	$ 173,620	$ 105,456

See notes to consolidated financial statements.

Table of Contents

GRACO INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In thousands)

	Sep 27, 2013	Dec 28, 2012
ASSETS		
Current Assets		
Cash and cash equivalents	$ 17,267	$ 31,120
Accounts receivable, less allowances of $6,300 and $6,600	194,859	172,143
Inventories	132,745	121,549
Deferred income taxes	19,292	17,742
Investment in businesses held separate	422,297	426,813
Other current assets	8,315	7,629
Total current assets	794,775	776,996
Property, Plant and Equipment		
Cost	400,454	389,067
Accumulated depreciation	(250,868)	(237,523)
Property, plant and equipment, net	149,586	151,544
Goodwill	181,543	181,228
Other Intangible Assets, net	143,713	151,773
Deferred Income Taxes	39,456	38,550
Other Assets	22,827	21,643
Total Assets	$ 1,331,900	$ 1,321,734
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Notes payable to banks	$ 9,463	$ 8,133
Trade accounts payable	32,930	28,938
Salaries and incentives	35,235	34,001
Dividends payable	15,422	15,206
Other current liabilities	70,742	65,393
Total current liabilities	163,792	151,671
Long-term Debt	404,315	556,480
Retirement Benefits and Deferred Compensation	140,735	137,779
Deferred Income Taxes	21,764	21,690
Shareholders' Equity		
Common stock	61,280	60,767
Additional paid-in-capital	333,959	287,795
Retained earnings	282,254	189,297
Accumulated other comprehensive income (loss)	(76,199)	(83,745)
Total shareholders' equity	601,294	454,114
Total Liabilities and Shareholders' Equity	$ 1,331,900	$ 1,321,734

See notes to consolidated financial statements.

Table of Contents

GRACO INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited) (In thousands)

	Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012
Cash Flows From Operating Activities		
Net Earnings	$ 166,074	$ 106,864
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	27,748	28,444
Deferred income taxes	(5,873)	(4,663)
Share-based compensation	11,178	10,035
Excess tax benefit related to share-based payment arrangements	(5,100)	(3,300)
Change in		
Accounts receivable	(23,685)	(5,517)
Inventories	(11,012)	6,580
Trade accounts payable	2,771	(1,203)
Salaries and incentives	114	(6,675)
Retirement benefits and deferred compensation	9,819	746
Other accrued liabilities	11,189	(781)
Other	(2,188)	1,471
Net cash provided by operating activities	181,035	132,001
Cash Flows From Investing Activities		
Property, plant and equipment additions	(15,218)	(13,780)
Acquisition of businesses, net of cash acquired	-	(240,068)
Investment in businesses held separate	4,516	(426,813)
Proceeds from sale of assets	1,600	-
Other	(770)	(2,116)
Net cash used in investing activities	(9,872)	(682,777)
Cash Flows From Financing Activities		
Borrowings (payments) on short-term lines of credit, net	1,265	(1,116)
Borrowings on long-term line of credit	313,560	546,220
Payments on long-term line of credit	(465,725)	(256,600)
Payments of debt issuance costs	-	(1,921)
Excess tax benefit related to share-based payment arrangements	5,100	3,300
Common stock issued	33,598	27,057
Common stock repurchased	(28,438)	(682)
Cash dividends paid	(45,834)	(40,654)
Net cash provided by (used in) financing activities	(186,474)	275,604
Effect of exchange rate changes on cash	1,458	(663)
Net increase (decrease) in cash and cash equivalents	(13,853)	(275,835)
Cash and cash equivalents		
Beginning of year	31,120	303,150
End of period	$ 17,267	$ 27,315

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 September 27, 2013 and the related statements of earnings for the thirteen and thirty-nine weeks ended September 27, 2013 and September 28, 2012, and cash flows for the thirty-nine weeks ended September 27, 2013 and September 28, 2012 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 September 27, 2013, 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 2012 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		Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012	Sep 27, 2013	Sep 28, 2012
Net earnings available to common shareholders	$ 56,101	$ 37,131	$ 166,074	$ 106,864
Weighted average shares outstanding for basic earnings per share	61,333	60,570	61,222	60,369
Dilutive effect of stock options computed using the treasury stock method and the average market price	1,663	1,208	1,526	1,271
Weighted average shares outstanding for diluted earnings per share	62,996	61,778	62,748	61,640
Basic earnings per share	$ 0.91	$ 0.61	$ 2.71	$ 1.77
Diluted earnings per share	$ 0.89	$ 0.60	$ 2.65	$ 1.73

Stock options to purchase 387,000 and 945,000 shares were not included in the September 27, 2013 and September 28, 2012 computations of diluted earnings per share, respectively, because they would have been anti-dilutive.

3. Information on option shares outstanding and option activity for the thirty-nine weeks ended September 27, 2013 is shown below (in thousands, except per share amounts):

	Option Shares	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
Outstanding, December 28, 2012	5,192	$ 34.85	3,194	$ 32.99
Granted	563	58.80		
Exercised	(739)	33.39		
Canceled	(18)	39.99		
Outstanding, September 27, 2013	4,998	$ 37.74	3,230	$ 32.80

The Company recognized year-to-date share-based compensation of $11.2 million in 2013 and $10.0 million in 2012. As of September 27, 2013, there was $11.2 million of unrecognized compensation cost related to unvested options, expected to be recognized over a weighted average period of 1.9 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:

	Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012
Expected life in years	6.5	6.5
Interest rate	1.2 %	1.3 %
Volatility	36.3 %	36.6 %
Dividend yield	1.7 %	1.8 %
Weighted average fair value per share	$ 18.29	$ 15.61

Under the Company's Employee Stock Purchase Plan, the Company issued 197,000 shares in 2013 and 239,000 shares in 2012. 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:

	Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012
Expected life in years	1.0	1.0
Interest rate	0.2 %	0.2 %
Volatility	26.0 %	40.6 %
Dividend yield	1.7 %	1.7 %
Weighted average fair value per share	$ 14.16	$ 15.58

In the first quarter of 2013, the Company granted 4,000 Restricted Share Awards to certain key employees that will vest on the fourth anniversary of the date of grant. The Company also granted 1,700 Restricted Share Units to a key employee that will vest on the third anniversary of the date of grant. The market value of the awards and units at the date of grant will be charged to operations over the vesting periods. The expense related to these arrangements is not significant.

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

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012	Sep 27, 2013	Sep 28, 2012
Pension Benefits				
Service cost	$ 1,948	$ 1,565	$ 5,538	$ 4,579
Interest cost	3,627	3,458	10,625	10,256
Expected return on assets	(4,625)	(4,188)	(13,874)	(11,872)
Amortization and other	2,964	2,918	8,256	8,413
Net periodic benefit cost	$ 3,914	$ 3,753	$ 10,545	$ 11,376
Postretirement Medical				
Service cost	$ 160	$ 167	$ 470	$ 442
Interest cost	228	240	721	740
Amortization	(32)	(122)	(134)	(197)
Net periodic benefit cost	$ 356	$ 285	$ 1,057	$ 985

Table of Contents

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 September 27, 2013			
Beginning balance	$ (76,650)	$ (9,884)	$(86,534)
Other comprehensive income before reclassifications	-	8,866	8,866
Amounts reclassified from accumulated other comprehensive income	1,469	-	1,469
Ending balance	$ (75,181)	$ (1,018)	$(76,199)
Thirty-nine Weeks Ended September 27, 2013			
Beginning balance	$ (79,716)	$ (4,029)	$(83,745)
Other comprehensive income before reclassifications	-	3,011	3,011
Amounts reclassified from accumulated other comprehensive income	4,535	-	4,535
Ending balance	$ (75,181)	$ (1,018)	$(76,199)

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 Sep 27, 2013	Thirty-nine Weeks Ended Sep 27, 2013
Cost of products sold	$ 824	$ 2,577
Product development	368	1,131
Selling, marketing and distribution	663	1,987
General and administrative	449	1,395
Total before tax	$ 2,304	$ 7,090
Income tax (benefit)	(835)	(2,555)
Total after tax	$ 1,469	$ 4,535

6. The Company has three reportable segments: Industrial (which aggregates four operating segments), Contractor and Lubrication. Sales and operating earnings by segment for the thirteen and thirty-nine weeks ended September 27, 2013 and September 28, 2012 were as follows (in thousands):

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012	Sep 27, 2013	Sep 28, 2012
Net Sales				
Industrial	$ 156,654	$ 154,704	$ 480,500	$ 447,027
Contractor	92,942	74,851	269,068	228,943
Lubrication	27,439	26,917	82,533	82,808
Total	$ 277,035	$ 256,472	$ 832,101	$ 758,778
Operating Earnings				
Industrial	$ 49,429	$ 47,162	$ 156,178	$ 138,646
Contractor	21,459	12,835	62,370	43,339
Lubrication	5,497	5,356	17,285	16,988
Unallocated corporate (expense)	(6,659)	(9,022)	(19,393)	(32,198)
Total	$ 69,726	$ 56,331	$ 216,440	$ 166,775

Unallocated corporate expenses in 2012 included acquisition-related expenses of $4 million in the third quarter and $15 million for the year-to-date.

Assets by segment were as follows (in thousands):

	Sep 27, 2013	Dec 28, 2012
Industrial	$ 573,309	$ 567,879
Contractor	166,407	141,094
Lubrication	83,761	84,079
Unallocated corporate	508,423	528,682
Total	$ 1,331,900	$ 1,321,734

Geographic information follows (in thousands):

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012	Sep 27, 2013	Sep 28, 2012
Net sales				
(based on customer location)				
United States	$ 132,503	$ 111,426	$ 383,756	$ 332,048
Other countries	144,532	145,046	448,345	426,730
Total	$ 277,035	$ 256,472	$ 832,101	$ 758,778

	Sep 27, 2013	Dec 28, 2012
Long-lived assets		
United States	$ 117,849	$ 119,331
Other countries	31,737	32,213
Total	$ 149,586	$ 151,544

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

	Sep 27, 2013	Dec 28, 2012
Finished products and components	$ 64,767	$ 58,703
Products and components in various stages of completion	41,914	44,001
Raw materials and purchased components	66,078	59,190
	172,759	161,894
Reduction to LIFO cost	(40,014)	(40,345)
Total	$ 132,745	$ 121,549

Table of Contents

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

	Estimated Life (years)	Cost	Accumulated Amortization	Foreign Currency Translation	Book Value
September 27, 2013					
Customer relationships	3 - 14	$ 117,805	$ (23,893)	$ (339)	$ 93,573
Patents, proprietary technology and product documentation	3 - 11	15,325	(5,455)	(57)	9,813
Other	5	25	(5)	-	20
		133,155	(29,353)	(396)	103,406
Not Subject to Amortization:					
Brand names		40,400	-	(93)	40,307
Total		$ 173,555	$ (29,353)	$ (489)	$ 143,713
December 28, 2012					
Customer relationships	2 - 14	$ 132,245	$ (30,041)	$ (1,510)	$ 100,694
Patents, proprietary technology and product documentation	3 - 11	20,830	(9,679)	(147)	11,004
Trademarks, trade names and other	1 - 5	85	(27)	-	58
		153,160	(39,747)	(1,657)	111,756
Not Subject to Amortization:					
Brand names		40,580	-	(563)	40,017
Total		$ 193,740	$ (39,747)	$ (2,220)	$ 151,773

Amortization of intangibles for the quarter was $3.1 million in 2013 and $4.1 million in 2012, and for the year-to-date was $9.6 million in 2013 and $11.0 million in 2012. Estimated annual amortization expense is as follows: $12.5 million in 2013, $9.3 million in 2014, $8.8 million in 2015, $8.5 million in 2016, $8.3 million in 2017 and $65.6 million thereafter.

Changes in the carrying amount of goodwill in 2013 were as follows (in thousands):

	Industrial	Contractor	Lubrication	Total
Beginning balance	$ 148,999	$ 12,732	$ 19,497	$181,228
Foreign currency translation	1,200	-	-	1,200
Other	(885)	-	-	(885)
Ending balance	$ 149,314	$ 12,732	$ 19,497	$181,543

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

	Sep 27, 2013	Dec 28, 2012
Accrued self-insurance retentions	$ 6,400	$ 6,952
Accrued warranty and service liabilities	7,692	7,943
Accrued trade promotions	6,581	5,669
Payable for employee stock purchases	5,699	7,203
Customer advances and deferred revenue	12,229	10,617
Income taxes payable	12,517	4,305
Other	19,624	22,704
Total other current liabilities	$ 70,742	$ 65,393

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):

	Thirty-nine Weeks Ended Sep 27, 2013	Year Ended Dec 28, 2012
Balance, beginning of year	$ 7,943	$ 6,709
Assumed in business acquisition	-	1,121
Charged to expense	4,369	6,182
Margin on parts sales reversed	1,857	2,244
Reductions for claims settled	(6,477)	(8,313)
Balance, end of period	$ 7,692	$ 7,943

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

	Level	Sep 27, 2013	Dec 28, 2012
Assets			
Cash surrender value of life insurance	2	$ 10,641	$ 9,483
Forward exchange contracts	2	-	491
Total assets at fair value		$ 10,641	$ 9,974
Liabilities			
Deferred compensation	2	$ 3,587	$ 3,016
Forward exchange contracts	2	276	-
Total liabilities at fair value		$ 3,863	$ 3,016

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.

Long-term notes payable with fixed interest rates have a carrying amount of $300 million and an estimated fair value of $320 million as of September 27, 2013 and $330 million as of December 28, 2012. 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. The Company accounts for all derivatives, including those embedded in other contracts, as either assets or liabilities and measures those financial instruments at fair value. The accounting for changes in the fair value of derivatives depends on their intended use and designation.

As part of its risk management program, the Company may periodically use forward exchange contracts and interest rate swaps to manage known market exposures. Terms of derivative instruments are structured to match the terms of the risk being managed and are generally held to maturity. The Company does not hold or issue derivative financial instruments for trading purposes. All other contracts that contain provisions meeting the definition of a derivative also meet the requirements of, and have been designated as, normal purchases or sales. The Company's policy is to not enter into contracts with terms that cannot be designated as normal purchases or sales.

The Company periodically evaluates its monetary asset and liability positions denominated in foreign currencies. The Company enters into forward contracts or options, or borrows in various currencies, in order to hedge its net monetary positions. These instruments are recorded at current market values and the gains and losses are included in other expense (income), net. The notional amount of contracts outstanding as of September 27, 2013 totaled $23 million. The Company believes it uses strong financial counterparts in these transactions and that the resulting credit risk under these hedging strategies is not significant.

The Company uses significant other observable inputs (level 2 in the fair value hierarchy) to value the derivative instruments used to hedge and net monetary positions, including reference to market prices and financial models that incorporate relevant market assumptions. The fair market value and balance sheet classification of such instruments follows (in thousands):

	Balance Sheet Classification	Sep 27, 2013	Dec 28, 2012
Gain (loss) on foreign currency forward contracts			
Gains		$ 38	$ 553
Losses		(314)	(62)
Net	Other current liabilities	$ (276)	
	Accounts receivable		$ 491

12. On April 2, 2012, the Company completed the purchase of the finishing businesses of Illinois Tool Works Inc. (“ITW”). The acquisition included powder finishing and liquid finishing equipment operations, technologies and brands (separately, the “Powder Finishing” and “Liquid Finishing” businesses). Results of the Powder Finishing businesses have been included in the Industrial segment since the date of acquisition, including $96 million of sales and $14 million of operating earnings in the first nine months of 2013 and $62 million of sales and $4 million of operating earnings in the comparable period of 2012 (starting in the second quarter).

In May 2012, the United States Federal Trade Commission (“FTC”) issued a proposed decision and order which requires Graco to sell the Liquid Finishing business assets 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. While it seeks a buyer, Graco must hold the Liquid Finishing business assets separate from its other businesses and maintain them as viable and competitive.

The Company does not have a controlling interest in the Liquid Finishing businesses, nor is it able to exert significant influence over those businesses. Consequently, the Company’s investment in the shares of the Liquid Finishing businesses has been reflected as a cost-method investment on the Consolidated Balance Sheets, and its results of operations have not been consolidated with those of the Company.

As a cost-method investment, income is recognized based on dividends received from after-tax earnings of Liquid Finishing and included in other expense (income) on the Consolidated Statements of Earnings. Dividends received in 2013 totaled $9 million in the third quarter and $24 million year-to-date. Dividends received in 2012 totaled $4 million in the third quarter and $8 million year-to-date (starting in the second quarter). Once the FTC issues its final decision and order, and the Company completes the sale of its investment, there will be no further dividends from Liquid Finishing.

Also in 2013, ITW reimbursed Graco approximately $4.5 million for payments of pre-acquisition tax liabilities paid by Liquid Finishing businesses after the acquisition date. This reimbursement was recorded as a reduction of the cost-method investment on the Consolidated Balance Sheet.

The Company evaluates its cost-method investment for other-than-temporary impairment at each reporting period. As of September 27, 2013, the Company evaluated its investment in Liquid Finishing and determined that there was no impairment.

Sales and operating earnings of the Liquid Finishing businesses were as follows (in thousands):

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012	Sep 27, 2013	Sep 28, 2012
Net Sales	$ 75,879	$ 69,554	$ 210,922	$ 206,061
Operating Earnings	16,734	15,379	46,712	40,314

The following pro forma information reflects the combined results of Graco and Powder Finishing operations as if the acquisition had occurred at the beginning of 2011 (in thousands, except per share amounts):

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012	Sep 27, 2013	Sep 28, 2012
Net Sales	$ 277,035	$ 256,472	$ 832,101	$ 789,023
Operating Earnings	69,726	59,916	216,440	191,005
Net Earnings	56,101	39,425	166,074	122,193
Basic earnings per share	0.91	0.65	2.71	2.02
Diluted earnings per share	0.89	0.64	2.65	1.98

Pro forma results for the 2012 year-to-date period reflect additional depreciation and amortization of $2 million, as if the acquisition of Powder Finishing had occurred at the beginning of 2011. Non-recurring acquisition expenses of $4 million for the third quarter and $15 million year-to-date were eliminated from the 2012 pro forma results. Purchase accounting effects of $7 million related to inventory were removed from the year-to-date 2012 pro forma results.

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, Contractor and Lubrication. 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.

Acquisition

On April 2, 2012, the Company completed the purchase of the finishing businesses of ITW. The acquisition included Powder Finishing and Liquid Finishing equipment operations, technologies and brands. Results of the Powder Finishing business have been included in the Industrial segment since the date of acquisition.

Pursuant to a March 2012 order, the Liquid Finishing businesses were to be held separate from the rest of Graco's businesses while the United States Federal Trade Commission ("FTC") considered a settlement with Graco and determined which portions of the Liquid Finishing businesses Graco must divest.

In May 2012, the FTC issued a proposed decision and order which requires Graco to sell the Liquid Finishing business assets, including certain business activities related to the development, manufacture, and sale of 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. While it seeks a buyer, Graco must continue to hold the Liquid Finishing business assets separate from its other businesses and maintain them as viable and competitive.

The Company does not control the Liquid Finishing businesses, nor is it able to exert influence over those businesses. Consequently, the Company's investment in the shares of the Liquid Finishing businesses has been reflected as a cost-method investment, and its financial results have not been consolidated with those of the Company.

As a cost-method investment, income is recognized based on dividends received from after-tax earnings of Liquid Finishing and included in other expense (income) on the Consolidated Statements of Earnings. Dividends received in 2013 totaled $9 million in the third quarter and $24 million year-to-date. Dividends received in 2012 totaled $4 million in the third quarter and $8 million year-to-date (starting in the second quarter). Once the FTC issues its final decision and order, and the Company completes the sale of its investment, there will be no further dividends from Liquid Finishing.

Also in 2013, ITW reimbursed Graco approximately $4.5 million for payments of pre-acquisition tax liabilities paid by Liquid Finishing businesses after the acquisition date. This reimbursement was recorded as a reduction of the cost-method investment on the Consolidated Balance Sheet.

The Company evaluates its cost-method investment for other-than-temporary impairment at each reporting period. As of September 27, 2013, the Company evaluated its investment in Liquid Finishing and determined that there was no impairment.

Consolidated Results

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

	Thirteen Weeks Ended			Thirty-nine Weeks Ended		
	Sep 27, 2013	Sep 28, 2012	% Change	Sep 27, 2013	Sep 28, 2012	% Change
Net Sales	$ 277.0	$ 256.5	8%	$ 832.1	$ 758.8	10%
Net Earnings	$ 56.1	$ 37.1	51%	$ 166.1	$ 106.9	55%
Diluted Net Earnings per Common Share	$ 0.89	$ 0.60	48%	$ 2.65	$ 1.73	53%

Sales for the quarter increased 8 percent from last year, driven by strong sales in the Contractor segment, along with modest increases in the Industrial and Lubrication segments. Year-to-date sales increased 10 percent, including 4 percentage points from the full-year impact of the Powder Finishing operations acquired in April 2012, and strong growth in Contractor segment sales.

Higher sales and strong gross margin rates, decreases in acquisition-related expenses, higher investment income from Liquid Finishing businesses held separate, and favorable changes in the income tax provision all contributed to significant growth in net earnings for both the quarter and the year-to-date.

Changes in currency translation rates did not have a significant effect on consolidated operating results, but had a more notable impact on regional results. Favorable effects of rate changes in EMEA were offset by unfavorable effects in Asia Pacific.

Table of Contents

The following table presents components of changes in sales:

	Quarter						
	Segment			Region			
	Industrial	Contractor	Lubrication	Americas	EMEA	Asia Pacific	Total
Volume and Price	1 %	24 %	3 %	15 %	4 %	(6)%	8 %
Currency	- %	- %	(1) %	- %	4 %	(3)%	- %
Total	1 %	24 %	2 %	15 %	8 %	(9)%	8 %

	Year-to-Date						
	Segment			Region			
	Industrial	Contractor	Lubrication	Americas	EMEA	Asia Pacific	Total
Volume and Price	- %	17 %	- %	11 %	1 %	(3)%	6 %
Acquisitions	8 %	- %	- %	2 %	8 %	5%	4 %
Currency	(1)%	1 %	- %	- %	2 %	(2)%	- %
Total	7 %	18 %	- %	13 %	11 %	- %	10%

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

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012	Sep 27, 2013	Sep 28, 2012
Americas[1]	$ 156.1	$ 135.8	$ 455.0	$ 402.4
EMEA[2]	70.3	65.2	210.1	189.3
Asia Pacific	50.6	55.5	167.0	167.1
Consolidated	$ 277.0	$ 256.5	$ 832.1	$ 758.8

[1] North and South America, including the U.S.
[2] Europe, Middle East and Africa

Sales for the quarter increased 8 percent, including increases of 15 percent in the Americas and 8 percent in EMEA (4 percent at consistent translation rates). Sales for the quarter decreased 9 percent in Asia Pacific (6 percent at consistent translation rates). Year-to-date sales increased 10 percent, including increases of 13 percent in the Americas and 11 percent in EMEA (9 percent at consistent translation rates). Year-to-date sales were flat in Asia Pacific (up 2 percent at consistent translation rates). The first quarter impact of the Powder Finishing operations acquired in April 2012 contributed approximately 4 percentage points of the total year-to-date growth and accounted for most of the growth in EMEA (at consistent translation rates).

Gross profit margin, expressed as a percentage of sales, was 54 ½ percent for the quarter, consistent with the comparable period last year. Year-to-date gross profit margin rate was 55 percent, up 1 percentage point from last year. Non-recurring inventory-related purchase accounting effects totaling $7 million reduced last year’s year-to-date gross margin rate by approximately 1 percentage point.

Total operating expenses for the quarter and year-to-date were slightly lower than the comparable periods last year. Volume-related increases in selling, marketing and distribution expenses were more than offset by decreases in general and administrative expenses, including acquisition and divestiture cost decreases of $3 million for the quarter and $14 million year-to-date.

Other expense (income) included after-tax dividends received from the Liquid Finishing businesses that are held separate from the Company's other businesses. Such dividends totaled $9 million for the quarter and $24 million year-to-date, up from $4 million for the quarter and $8 million year-to-date received in the comparable periods last year. On a fully-diluted per share basis, dividends in 2013 were $0.14 for the quarter and $0.38 year-to-date, compared to $0.06 for the quarter and $0.13 year-to-date last year.

The effective income tax rates of 24 percent for the quarter and 27 percent year-to-date were lower than the comparable periods last year. This year's rates included the impact of the federal R&D credit that was renewed in the first quarter, effective retroactive to the beginning of 2012. There was no R&D credit recognized in 2012. The effective rates in 2013 also reflected the effect of higher after-tax dividend income received from the Liquid Finishing businesses held separate, and the effect of more foreign earnings that are taxed at lower rates than in the United States. The effective rate for the quarter also included the impact of additional benefit from U.S. business credits and deductions.

Segment Results

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

Industrial

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012	Sep 27, 2013	Sep 28, 2012
Net sales (in millions)				
Americas	$ 69.0	$ 67.0	$ 205.4	$ 192.0
EMEA	51.5	47.0	151.6	133.7
Asia Pacific	36.2	40.7	123.5	121.3
Total	$ 156.7	$ 154.7	$ 480.5	$ 447.0
Operating earnings as a percentage of net sales	32 %	30 %	33 %	31 %

Industrial segment sales for the quarter increased 1 percent, with increases of 3 percent in the Americas and 10 percent in EMEA (6 percent at consistent translation rates), mostly offset by an 11 percent decrease in Asia Pacific (9 percent at consistent translation rates). Year-to-date sales increased 7 percent, mostly from Powder Finishing operations acquired in April 2012. Operating margin rate for the Industrial segment increased compared to last year, driven by improved gross margin rates. The effects of purchase accounting related to inventory reduced the 2012 year-to-date operating margin rate by approximately 2 percentage points.

Table of Contents

Contractor

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012	Sep 27, 2013	Sep 28, 2012
Net sales (in millions)				
Americas	$ 67.1	$ 48.7	$ 188.5	$ 149.5
EMEA	16.6	16.1	50.8	49.2
Asia Pacific	9.2	10.1	29.8	30.2
Total	$ 92.9	$ 74.9	$ 269.1	$ 228.9
Operating earnings as a percentage of net sales	23 %	17 %	23 %	19 %

Contractor segment sales for the quarter increased 24 percent, including increases of 38 percent in the Americas and 4 percent in EMEA (flat at consistent translation rates) and a decrease of 8 percent in Asia Pacific. Year-to-date sales were up 18 percent, driven by increases in the Americas. Higher sales volume and expense leverage led to higher operating margin rates in the Contractor segment.

Lubrication

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 27, 2013	Sep 28, 2012	Sep 27, 2013	Sep 28, 2012
Net sales (in millions)				
Americas	$ 20.0	$ 20.0	$ 61.1	$ 60.8
EMEA	2.1	2.2	7.6	6.4
Asia Pacific	5.3	4.7	13.8	15.6
Total	$ 27.4	$ 26.9	$ 82.5	$ 82.8
Operating earnings as a percentage of net sales	20 %	20 %	21 %	21 %

Lubrication segment sales for the quarter increased 2 percent, mostly from increases in Asia Pacific. Year-to-date sales were flat, with increases in Europe offset by decreases in Asia Pacific. Operating margin rates were steady in this segment.

Liquidity and Capital Resources

Net cash provided by operating activities was $181 million in 2013 and $132 million in 2012. The increase mostly reflects the increase in net earnings. Accounts receivable and inventory balances have increased since the end of 2012 due to increases in business activity.

In May 2012, the FTC issued a proposed decision and order which requires Graco to sell the Liquid Finishing business assets, including certain business activities related to the development, manufacture, and sale of 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. The Company believes its investment in the Liquid Finishing businesses, carried at a cost of $422 million, is not impaired.

Under terms of the FTC's hold separate order, the Company is required 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. To the extent that the Liquid Finishing businesses generate funds in excess of financial resources needed, the Company has access to such funds consistent with practices in place prior to the acquisition. In the first nine months of 2013, the Company received $24 million of dividends from current earnings of the Liquid Finishing businesses.

At September 27, 2013, the Company had various lines of credit totaling $502 million, of which $389 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 2013, including the needs of the Powder Finishing and Liquid Finishing businesses acquired in April 2012.

Outlook

We expect to achieve growth in every region in the fourth quarter of 2013. The housing recovery and a marginally favorable economic environment in the U.S. should continue to provide a tailwind for growth in our Contractor and Industrial segments in the Americas. We don't see a catalyst to advance the weak macroeconomic environments in Asia Pacific or EMEA in the near term, but we expect modest growth in the fourth quarter. As we finish out 2013 and look toward 2014, Graco's global team remains focused on our strategic growth initiatives of expanding our distribution channels, developing innovative new products, conversion of end users from manual painting techniques to using spray equipment, and continuing our efforts to expand into adjacent new markets.

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 our Form 10-K, our Form 10-Qs and Form 8-Ks, and other disclosures, including our 2012 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: changes in laws and regulations; economic conditions in the United States and other major world economies; whether we are able to locate, complete and effectively integrate acquisitions; whether we are able to effectively and timely complete a divestiture of the acquired Liquid Finishing businesses, which has not been completed and remains subject to FTC approval; risks incident to conducting business internationally, including currency fluctuations and political instability; supply interruptions or delays; the ability to meet our customers’ needs, and changes in product demand; new entrants who copy our products or infringe on our intellectual property; results of and costs associated with, litigation, administrative proceedings and regulatory reviews incident to our business; compliance with anti-corruption laws; the possibility of decline in purchases from few large customers of the Contractor segment; fluctuations in new construction and remodeling activity; natural disasters; and security breaches. Please refer to Item 1A of our Annual Report on Form 10-K for fiscal year 2012 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.

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 2012 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 and Controller, 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.

Table of Contents

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 2012 Annual Report on Form 10-K.

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.

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 withholding on option exercises.

Information on issuer purchases of equity securities follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (at end of period)
Jun 29, 2013 – Jul 26, 2013	95,108	$ 66.95	94,901	5,789,771
Jul 27, 2013 – Aug 23, 2013	100,932	$ 71.75	99,853	5,689,918
Aug 24, 2013 – Sep 27, 2013	120,000	$ 72.15	120,000	5,569,918

Item 6. Exhibits

3.1	Restated Articles of Incorporation as amended April 26, 2013. (Incorporated by reference to Exhibit 3.1 to the Company's Report on Form 8-K filed April 30, 2013.)
3.2	Restated Bylaws as amended June 13, 2002. (Incorporated by reference to Exhibit 3 to the Company's Report on Form 10-Q for the thirteen weeks ended June 28, 2002.)
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 Third Quarter Earnings dated October 23, 2013.
101	Interactive Data File.

Table of Contents

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:	October 23, 2013	By:	/s/ Patrick J. McHale Patrick J. McHale President and Chief Executive Officer *(Principal Executive Officer)*
Date:	October 23, 2013	By:	/s/ James A. Graner James A. Graner Chief Financial Officer *(Principal Financial Officer)*
Date:	October 23, 2013	By:	/s/ Caroline M. Chambers Caroline M. Chambers Vice President and Corporate Controller *(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: October 23, 2013

/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: October 23, 2013

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

Exhibit 32

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: October 23, 2013

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

Date: October 23, 2013

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

GRACO INC.
P.O. Box 1441
Minneapolis, MN
55440-1441
NYSE: GGG

News Release

FOR IMMEDIATE RELEASE:
Wednesday, October 23, 2013

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

Graco Reports Record Third Quarter Sales and Earnings

MINNEAPOLIS, MN (October 23, 2013) - Graco Inc. **(NYSE: GGG)** today announced results for the quarter and nine months ended September 27, 2013.

Summary
$ in millions except per share amounts

	Thirteen Weeks Ended			Thirty-nine Weeks Ended		
	Sep 27, 2013	**Sep 28, 2012**	**% Change**	**Sep 27, 2013**	**Sep 28, 2012**	**% Change**
Net Sales	$ 277.0	$ 256.5	8 %	$ 832.1	$ 758.8	10 %
Net Earnings	56.1	37.1	51 %	166.1	106.9	55 %
Diluted Net Earnings per Common Share	$ 0.89	$ 0.60	48 %	$ 2.65	$ 1.73	53 %

- Sales for the quarter increased 8 percent over last year, driven by a 24 percent increase in the Contractor segment, along with modest increases in Industrial and Lubrication. Year-to-date sales increased 10 percent, including 4 percentage points from the first quarter impact of the Powder Finishing operations (acquired in April 2012) and strong Contractor segment sales.
- Gross margin rate for the quarter was consistent with last year's third quarter. Year-to-date gross margin rate was one percentage point higher than last year, which included non-recurring inventory charges in the second quarter related to the acquisition of Powder Finishing.
- Acquisition and divestiture costs for the quarter decreased by $3 million. Year-to-date operating expenses included acquisition and divestiture costs of $1 million, a decrease of $14 million compared to the comparable period last year.
- Other expense (income) included dividend income received from the Liquid Finishing businesses held as a cost-method investment. Dividends were $9 million for the quarter, up from $4 million last year and $24 million year-to-date, up from $8 million last year.
- Lower effective income tax rates in 2013 reflected the effects of higher after-tax dividend income, the renewal of the federal R&D credit, additional benefit from business credits and deductions and foreign earnings taxed at lower rates than in the United States.
- Changes in currency translation rates did not have a significant effect on consolidated operating results. Favorable effects of rate changes in EMEA were offset by unfavorable effects in Asia Pacific.
- Cash flow from operations remained strong through the first nine months of 2013, with $152 million applied to reduction of long-term debt and $74 million returned to investors through dividends and Company stock repurchases.

More . . .

“This was the ninth consecutive quarter Graco posted sales that set a new quarterly record, an achievement that reflects the commitment of our employees and distributors to executing our strategic growth initiatives,” said Patrick J. McHale, Graco’s President and Chief Executive Officer. “The Company’s rates of growth throughout the world remained diverged in the third quarter of 2013, with strong year-over-year growth in the Americas, moderate growth in EMEA and a sales decline in Asia Pacific. Our overall sales growth for the quarter was strong, as we continue to benefit from the U.S. housing market recovery.”

Consolidated Results

Sales for the quarter increased 8 percent, including increases of 15 percent in the Americas and 8 percent in EMEA (4 percent at consistent translation rates). Sales for the quarter decreased 9 percent in Asia Pacific (6 percent at consistent translation rates). Year-to-date sales increased 10 percent, including increases of 13 percent in the Americas and 11 percent in EMEA (9 percent at consistent translation rates). Year-to-date sales were flat in Asia Pacific (up 2 percent at consistent translation rates). The first quarter impact of the Powder Finishing operations acquired in April 2012 contributed approximately 4 percentage points of the total year-to-date growth and accounted for most of the growth in EMEA (at consistent translation rates).

Gross profit margin, expressed as a percentage of sales, was 54 ½ percent for the quarter, consistent with the comparable period last year. Year-to-date gross profit margin rate was 55 percent, up 1 percentage point from last year. Non-recurring inventory-related purchase accounting effects totaling $7 million reduced last year’s year-to-date gross margin rate by approximately 1 percentage point.

Total operating expenses for the quarter and year-to-date were slightly lower than the comparable periods last year. Volume-related increases in selling, marketing and distribution expenses were more than offset by decreases in general and administrative expenses, including acquisition and divestiture cost decreases of $3 million for the quarter and $14 million year-to-date.

Other expense (income) included dividends received from the Liquid Finishing businesses that are held separate from the Company’s other businesses. Such dividends totaled $9 million for the quarter and $24 million year-to-date, up from $4 million for the quarter and $8 million year-to-date received in the comparable periods last year.

The effective income tax rates of 24 percent for the quarter and 27 percent year-to-date were lower than the comparable periods last year. This year’s rates included the impact of the federal R&D credit that was renewed in the first quarter, effective retroactive to the beginning of 2012. There was no R&D credit recognized in 2012. The effective rates in 2013 also reflected the effect of higher after-tax dividend income received from the Liquid Finishing businesses held separate, and the effect of more foreign earnings that are taxed at lower rates than in the United States. The effective rate for the quarter also included the impact of additional benefit from U.S. business credits and deductions.

More . . .

Segment Results

Certain measurements of segment operations are summarized below:

	Thirteen Weeks			Thirty-nine Weeks		
	Industrial	Contractor	Lubrication	Industrial	Contractor	Lubrication
Net sales (in millions)	$ 156.7	$ 92.9	$ 27.4	$ 480.5	$ 269.1	$ 82.5
Percentage change from last year						
Sales	1 %	24 %	2 %	7 %	18 %	(0)%
Operating earnings	5 %	67 %	3 %	13 %	44 %	2 %
Operating earnings as a percentage of net sales						
2013	32 %	23 %	20 %	33 %	23 %	21 %
2012	30 %	17 %	20 %	31 %	19 %	21 %

Industrial segment sales for the quarter increased 1 percent, with increases of 3 percent in the Americas and 10 percent in EMEA (6 percent at consistent translation rates), mostly offset by an 11 percent decrease in Asia Pacific (9 percent at consistent translation rates). Year-to-date sales increased 7 percent, mostly from Powder Finishing operations acquired in April 2012. Operating margin rate for the Industrial segment increased compared to last year, driven by improved gross margin rates. The effects of purchase accounting related to inventory reduced the 2012 year-to-date operating margin rate by approximately 2 percentage points.

Contractor segment sales for the quarter increased 24 percent, including increases of 38 percent in the Americas and 4 percent in EMEA (flat at consistent translation rates) and a decrease of 8 percent in Asia Pacific. Year-to-date sales were up 18 percent, driven by increases in the Americas. Higher sales volume and expense leverage led to higher operating margin rates in the Contractor segment.

Lubrication segment sales for the quarter increased 2 percent, mostly from increases in Asia Pacific. Year-to-date sales were flat, with increases in Europe offset by decreases in Asia Pacific. Operating margin rates were steady in this segment.

Acquisition in 2012

On April 2, 2012, the Company completed the purchase of the finishing businesses of Illinois Tool Works Inc. The acquisition included Powder Finishing and Liquid Finishing equipment operations, technologies and brands. Results of the Powder Finishing business have been included in the Industrial segment since the date of acquisition.

Pursuant to a March 2012 order, the Liquid Finishing businesses were to be held separate from the rest of Graco's businesses while the United States Federal Trade Commission ("FTC") considered a settlement with Graco and determined which portions of the Liquid Finishing business Graco must divest.

In May 2012, the FTC issued a proposed decision and order which requires Graco to sell the Liquid Finishing business assets, including certain business activities related to the development, manufacture, and sale of 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. While it seeks a buyer, Graco must continue to hold the Liquid

More . . .

Finishing business assets separate from its other businesses and maintain them as viable and competitive.

The Company does not control the Liquid Finishing businesses, nor is it able to exert influence over those businesses. Consequently, the Company's investment in the shares of the Liquid Finishing businesses has been reflected as a cost-method investment, and its financial results have not been consolidated with those of the Company. Income is recognized based on dividends received from current earnings and is included in other income.

The Liquid Finishing businesses generated sales of $76 million and EBITDA of $16 million in the third quarter.

Outlook

"We expect to achieve growth in every region in the fourth quarter of 2013," said McHale. "The housing recovery and a marginally favorable economic environment in the U.S. should continue to provide a tailwind for growth in our Contractor and Industrial segments in the Americas. We don't see a catalyst to advance the weak macroeconomic environments in Asia Pacific or EMEA in the near term, but we expect modest growth in the fourth quarter. As we finish out 2013 and look toward 2014, Graco's global team remains focused on our strategic growth initiatives of expanding our distribution channels, developing innovative new products, conversion of end users from manual painting techniques to using spray equipment, and continuing our efforts to expand into adjacent new markets."

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 our Form 10-K, our Form 10-Qs and Form 8-Ks, and other disclosures, including our 2012 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: changes in laws and regulations; economic conditions in the United States and other major world economies; whether we are able to locate, complete and effectively integrate acquisitions; whether we are able to effectively and timely complete a divestiture of the acquired Liquid Finishing businesses, which has not been completed and remains subject to FTC approval; risks incident to conducting business internationally, including currency fluctuations and political instability; supply interruptions or delays; the ability to meet our customers' needs, and changes in product demand; new entrants who copy our products or infringe on our intellectual property; results of and costs associated with, litigation, administrative proceedings and regulatory reviews incident to our business; compliance with anti-corruption laws; the possibility of decline in purchases from few large customers of the Contractor segment; fluctuations in new construction and remodeling activity; natural disasters; and security breaches. Please refer to Item 1A of our Annual Report on Form 10-K for fiscal year 2012 (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.

More . . .

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.

Conference Call

Graco management will hold a conference call, including slides via webcast, with analysts and institutional investors on Thursday, October 24, 2013, at 11:00 a.m. ET, to discuss Graco's third 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 2:00 p.m. ET on October 24, 2013, by dialing 800-406-7325, Conference ID #4643781, if calling within the U.S. or Canada. The dial-in number for international participants is 303-590-3030, with the same Conference ID #. The replay by telephone will be available through October 27, 2013.

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 coating 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/ir.

More . . .

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

(in thousands, except per share amounts)	Thirteen Weeks Ended Sep 27, 2013	Thirteen Weeks Ended Sep 28, 2012	Thirty-nine Weeks Ended Sep 27, 2013	Thirty-nine Weeks Ended Sep 28, 2012
Net Sales	$ 277,035	$ 256,472	$ 832,101	$ 758,778
Cost of products sold	126,162	116,539	371,845	347,136
Gross Profit	150,873	139,933	460,256	411,642
Product development	12,508	12,485	37,396	36,625
Selling, marketing and distribution	44,297	41,230	132,207	121,803
General and administrative	24,342	29,887	74,213	86,439
Operating Earnings	69,726	56,331	216,440	166,775
Interest expense	4,450	5,233	13,837	14,281
Other expense (income), net	(8,425)	(3,233)	(23,671)	(6,170)
Earnings Before Income Taxes	73,701	54,331	226,274	158,664
Income taxes	17,600	17,200	60,200	51,800
Net Earnings	$ 56,101	$ 37,131	$ 166,074	$ 106,864
Net Earnings per Common Share				
Basic	$ 0.91	$ 0.61	$ 2.71	$ 1.77
Diluted	$ 0.89	$ 0.60	$ 2.65	$ 1.73
Weighted Average Number of Shares				
Basic	61,333	60,570	61,222	60,369
Diluted	62,996	61,778	62,748	61,640

Segment Information (Unaudited)

	Thirteen Weeks Ended Sep 27, 2013	Thirteen Weeks Ended Sep 28, 2012	Thirty-nine Weeks Ended Sep 27, 2013	Thirty-nine Weeks Ended Sep 28, 2012
Net Sales				
Industrial	$ 156,654	$ 154,704	$ 480,500	$ 447,027
Contractor	92,942	74,851	269,068	228,943
Lubrication	27,439	26,917	82,533	82,808
Total	$ 277,035	$ 256,472	$ 832,101	$ 758,778
Operating Earnings				
Industrial	$ 49,429	$ 47,162	$ 156,178	$ 138,646
Contractor	21,459	12,835	62,370	43,339
Lubrication	5,497	5,356	17,285	16,988
Unallocated corporate (expense)	(6,659)	(9,022)	(19,393)	(32,198)
Total	$ 69,726	$ 56,331	$ 216,440	$ 166,775

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/ir.

# # #