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 27, 2014**

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

60,083,000 shares of the Registrant's Common Stock, $1.00 par value, were outstanding as of July 16, 2014.

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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 27, 2014	June 28, 2013	June 27, 2014	June 28, 2013
Net Sales	$ 322,549	$ 286,020	$ 612,511	$ 555,066
Cost of products sold	145,699	127,281	276,349	245,683
Gross Profit	176,850	158,739	336,162	309,383
Product development	13,405	12,467	26,564	24,888
Selling, marketing and distribution	49,503	44,556	95,845	87,910
General and administrative	28,094	26,499	53,200	49,871
Operating Earnings	85,848	75,217	160,553	146,714
Interest expense	4,676	4,625	9,264	9,387
Other expense (income), net	(10,764)	(10,851)	(14,192)	(15,246)
Earnings Before Income Taxes	91,936	81,443	165,481	152,573
Income taxes	25,700	23,600	48,500	42,600
Net Earnings	$ 66,236	$ 57,843	$ 116,981	$ 109,973
Per Common Share				
Basic net earnings	$ 1.10	$ 0.94	$ 1.93	$ 1.80
Diluted net earnings	$ 1.07	$ 0.92	$ 1.88	$ 1.76
Cash dividends declared	$ 0.28	$ 0.25	$ 0.55	$ 0.50

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited) (In thousands)

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 27, 2014	June 28, 2013	June 27, 2014	June 28, 2013
Net Earnings	$ 66,236	$ 57,843	$ 116,981	$ 109,973
Other comprehensive income (loss)				
Cumulative translation adjustment	(1,908)	2,632	(1,994)	(5,855)
Pension and postretirement medical liability adjustment	1,225	2,330	2,413	4,786
Income taxes				
Pension and postretirement medical liability adjustment	(436)	(842)	(864)	(1,720)
Other comprehensive income (loss)	(1,119)	4,120	(445)	(2,789)
Comprehensive Income	$ 65,117	$ 61,963	$ 116,536	$ 107,184

See notes to consolidated financial statements.

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GRACO INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Unaudited)
(In thousands)

	June 27, 2014	Dec 27, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	$ 29,568	$ 19,756
Accounts receivable, less allowances of $6,600 and $6,300	229,224	183,293
Inventories	147,060	133,787
Deferred income taxes	21,096	18,827
Investment in businesses held separate	421,767	422,297
Other current assets	10,745	14,633
Total current assets	859,460	792,593
Property, Plant and Equipment		
Cost	424,822	407,887
Accumulated depreciation	(265,769)	(256,170)
Property, plant and equipment, net	159,053	151,717
Goodwill	226,537	189,967
Other Intangible Assets, net	162,898	147,940
Deferred Income Taxes	22,632	20,366
Other Assets	26,297	24,645
Total Assets	$ 1,456,877	$ 1,327,228
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Notes payable to banks	$ 12,599	$ 9,584
Trade accounts payable	42,740	34,282
Salaries and incentives	30,205	38,939
Dividends payable	16,583	16,881
Other current liabilities	63,039	69,167
Total current liabilities	165,166	168,853
Long-term Debt	522,760	408,370
Retirement Benefits and Deferred Compensation	94,863	94,705
Deferred Income Taxes	20,776	20,935
Shareholders' Equity		
Common stock	60,181	61,003
Additional paid-in-capital	368,865	347,058
Retained earnings	271,060	272,653
Accumulated other comprehensive income (loss)	(46,794)	(46,349)
Total shareholders' equity	653,312	634,365
Total Liabilities and Shareholders' Equity	$ 1,456,877	$ 1,327,228

See notes to consolidated financial statements.

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

	Twenty-six Weeks Ended	
	June 27, 2014	June 28, 2013
Cash Flows From Operating Activities		
Net Earnings	$ 116,981	$ 109,973
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	18,327	18,637
Deferred income taxes	(5,710)	(5,073)
Share-based compensation	9,818	7,762
Excess tax benefit related to share-based payment arrangements	(2,300)	(3,300)
Change in		
Accounts receivable	(42,019)	(27,349)
Inventories	(9,806)	(12,393)
Trade accounts payable	6,219	4,541
Salaries and incentives	(9,670)	(5,635)
Retirement benefits and deferred compensation	2,749	6,113
Other accrued liabilities	3,916	7,646
Other	(4,476)	(761)
Net cash provided by operating activities	84,029	100,161
Cash Flows From Investing Activities		
Property, plant and equipment additions	(17,062)	(9,423)
Acquisition of businesses, net of cash acquired	(65,219)	-
Proceeds from sale of assets	-	1,600
Investment in businesses held separate	530	835
Other	(599)	(112)
Net cash used in investing activities	(82,350)	(7,100)
Cash Flows From Financing Activities		
Borrowings (payments) on short-term lines of credit, net	2,659	(172)
Borrowings on long-term line of credit	325,665	198,645
Payments on long-term line of credit	(211,275)	(289,335)
Payments of debt issuance costs	(890)	-
Excess tax benefit related to share-based payment arrangements	2,300	3,300
Common stock issued	17,792	25,975
Common stock repurchased	(93,820)	(6,334)
Cash dividends paid	(33,485)	(30,504)
Net cash provided by (used in) financing activities	8,946	(98,425)
Effect of exchange rate changes on cash	(813)	1,813
Net increase (decrease) in cash and cash equivalents	9,812	(3,551)
Cash and cash equivalents		
Beginning of year	19,756	31,120
End of period	$ 29,568	$ 27,569

See notes to consolidated financial statements.

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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 27, 2014 and the related statements of earnings for the thirteen and twenty-six weeks ended June 27, 2014 and June 28, 2013, and cash flows for the twenty-six weeks ended June 27, 2014 and June 28, 2013 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 27, 2014, 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 2013 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 27, 2014	June 28, 2013	June 27, 2014	June 28, 2013
Net earnings available to common shareholders	$ 66,236	$ 57,843	$ 116,981	$ 109,973
Weighted average shares outstanding for basic earnings per share	60,453	61,371	60,637	61,166
Dilutive effect of stock options computed using the treasury stock method and the average market price	1,575	1,470	1,596	1,458
Weighted average shares outstanding for diluted earnings per share	62,028	62,841	62,233	62,624
Basic earnings per share	$ 1.10	$ 0.94	$ 1.93	$ 1.80
Diluted earnings per share	$ 1.07	$ 0.92	$ 1.88	$ 1.76

Stock options to purchase 876,000 and 568,000 shares were not included in the June 27, 2014 and June 28, 2013 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 twenty-six weeks ended June 27, 2014 is shown below (in thousands, except per share amounts):

	Option Shares	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
Outstanding, December 27, 2013	5,149	$ 41.03	3,311	$ 33.20
Granted	475	74.62		
Exercised	(238)	34.09		
Canceled	(14)	68.03		
Outstanding, June 27, 2014	5,372	$ 44.25	3,667	$ 34.89

The Company recognized year-to-date share-based compensation of $9.8 million in 2014 and $7.8 million in 2013. As of June 27, 2014, there was $19.1 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:

	Twenty-six Weeks Ended	
	June 27, 2014	June 28, 2013
Expected life in years	6.5	6.5
Interest rate	2.0 %	1.2 %
Volatility	36.1 %	36.3 %
Dividend yield	1.5 %	1.7 %
Weighted average fair value per share	$ 24.83	$ 18.29

Under the Company's Employee Stock Purchase Plan, the Company issued 193,000 shares in 2014 and 197,000 shares in 2013. 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 27, 2014	June 28, 2013
Expected life in years	1.0	1.0
Interest rate	0.1 %	0.2 %
Volatility	21.4 %	26.0 %
Dividend yield	1.4 %	1.7 %
Weighted average fair value per share	$ 17.81	$ 14.16

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 27, 2014	June 28, 2013	June 27, 2014	June 28, 2013
Pension Benefits				
Service cost	$ 1,697	$ 1,789	$ 3,439	$ 3,590
Interest cost	3,940	3,429	8,076	6,998
Expected return on assets	(5,211)	(4,535)	(10,630)	(9,249)
Amortization and other	1,355	2,789	2,688	5,292
Net periodic benefit cost	$ 1,781	$ 3,472	$ 3,573	$ 6,631
Postretirement Medical				
Service cost	$ 125	$ 155	$ 250	$ 310
Interest cost	278	247	555	493
Amortization	(126)	(50)	(254)	(102)
Net periodic benefit cost	$ 277	$ 352	$ 551	$ 701

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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 28, 2013			
Beginning balance	$ (78,138)	$ (12,516)	$ (90,654)
Other comprehensive income before reclassifications	-	2,632	2,632
Amounts reclassified from accumulated other comprehensive income	1,488	-	1,488
Ending balance	$ (76,650)	$ (9,884)	$ (86,534)
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	$ (48,583)	$ 1,789	$ (46,794)
Twenty-six Weeks Ended June 28, 2013			
Beginning balance	$ (79,716)	$ (4,029)	$ (83,745)
Other comprehensive income before reclassifications	-	(5,855)	(5,855)
Amounts reclassified from accumulated other comprehensive income	3,066	-	3,066
Ending balance	$ (76,650)	$ (9,884)	$ (86,534)
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	$ (48,583)	$ 1,789	$ (46,794)

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 27, 2014	June 28, 2013	June 27, 2014	June 28, 2013
Cost of products sold	$ 440	$ 844	$ 876	$ 1,753
Product development	195	370	382	763
Selling, marketing and distribution	354	658	689	1,324
General and administrative	236	458	466	946
Total before tax	$ 1,225	$ 2,330	$ 2,413	$ 4,786
Income tax (benefit)	(436)	(842)	(864)	(1,720)
Total after tax	$ 789	$ 1,488	$ 1,549	$ 3,066

6. The Company has three reportable segments: Industrial (which aggregates five operating segments), Contractor and Lubrication. Sales and operating earnings by segment were as follows (in thousands):

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 27, 2014	June 28, 2013	June 27, 2014	June 28, 2013
Net Sales				
Industrial	$ 181,763	$ 159,671	$ 358,189	$ 323,846
Contractor	111,121	98,498	196,027	176,126
Lubrication	29,665	27,851	58,295	55,094
Total	$ 322,549	$ 286,020	$ 612,511	$ 555,066
Operating Earnings				
Industrial	$ 57,563	$ 51,530	$ 112,778	$ 106,749
Contractor	28,289	24,479	46,539	40,911
Lubrication	6,901	6,647	13,434	11,788
Unallocated corporate (expense)	(6,905)	(7,439)	(12,198)	(12,734)
Total	$ 85,848	$ 75,217	$ 160,553	$ 146,714

Assets by segment were as follows (in thousands):

	June 27, 2014	Dec 27, 2013
Industrial	$ 673,111	$ 591,135
Contractor	187,750	152,300
Lubrication	81,839	82,503
Unallocated corporate	514,177	501,290
Total	$ 1,456,877	$ 1,327,228

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Geographic information follows (in thousands):

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 27, 2014	June 28, 2013	June 27, 2014	June 28, 2013
Net sales				
(based on customer location)				
United States	$ 156,160	$ 135,173	$ 290,082	$ 251,254
Other countries	166,389	150,847	322,429	303,812
Total	$ 322,549	$ 286,020	$ 612,511	$ 555,066

	June 27, 2014	Dec 27, 2013
Long-lived assets		
United States	$ 128,264	$ 120,262
Other countries	30,789	31,455
Total	$ 159,053	$ 151,717

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

	June 27, 2014	Dec 27, 2013
Finished products and components	$ 72,945	$ 65,963
Products and components in various stages of completion	43,550	41,458
Raw materials and purchased components	73,897	69,051
	190,392	176,472
Reduction to LIFO cost	(43,332)	(42,685)
Total	$ 147,060	$ 133,787

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

June 27, 2014	Estimated Life (years)	Cost	Accumulated Amortization	Foreign Currency Translation	Book Value
Customer relationships	3 - 14	$ 118,975	$ (17,088)	$ 730	$ 102,617
Patents, proprietary technology and product documentation	5 - 11	18,125	(6,232)	49	11,942
Trademarks, trade names and other	5	175	(27)	-	148
		137,275	(23,347)	779	114,707
Not Subject to Amortization:					
Brand names		47,800	-	391	48,191
Total		$ 185,075	$ (23,347)	$ 1,170	$ 162,898
December 27, 2013					
Customer relationships	3 - 14	$ 121,205	$ (26,377)	$ 1,458	$ 96,286
Patents, proprietary technology and product documentation	3 - 11	16,125	(5,869)	118	10,374
Trademarks, trade names and other	5	175	(9)	-	166
		137,505	(32,255)	1,576	106,826
Not Subject to Amortization:					
Brand names		40,400	-	714	41,114
Total		$ 177,905	$ (32,255)	$ 2,290	$ 147,940

Amortization of intangibles for the quarter was $2.7 million in 2014 and $3.2 million in 2013, and for the year-to-date was $5.8 million in 2014 and $6.6 million in 2013. Estimated annual amortization expense is as follows: $11.2 million in 2014, $10.7 million in 2015, $10.4 million in 2016, $10.2 million in 2017, $10.1 million in 2018 and $67.9 million thereafter.

Changes in the carrying amount of goodwill in 2014 were as follows (in thousands):

	Industrial	Contractor	Lubrication	Total
Beginning balance	$ 157,738	$ 12,732	$ 19,497	$ 189,967
Additions from business acquisitions	37,340	-	-	37,340
Foreign currency translation	(770)	-	-	(770)
Ending balance	$ 194,308	$ 12,732	$ 19,497	$ 226,537

In the first quarter of 2014, the Company paid $65 million cash to acquire a manufacturer of fluid management solutions for environmental monitoring and remediation, markets where Graco had little or no previous exposure. The acquired business will expand and complement the Company's Industrial segment. The purchase price was allocated based on estimated fair values, including $37 million of goodwill, $22 million of other identifiable intangible assets and $6 million of net tangible assets.

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

	June 27, 2014	Dec 27, 2013
Accrued self-insurance retentions	$ 6,755	$ 6,381
Accrued warranty and service liabilities	7,749	7,771
Accrued trade promotions	5,154	7,245
Payable for employee stock purchases	4,399	7,908
Customer advances and deferred revenue	11,209	11,693
Income taxes payable	4,227	4,561
Other	23,546	23,608
Total other current liabilities	$ 63,039	$ 69,167

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 27, 2014	Year Ended Dec 27, 2013
Balance, beginning of year	$ 7,771	$ 7,943
Assumed in business acquisition	12	-
Charged to expense	3,038	6,119
Margin on parts sales reversed	1,178	3,819
Reductions for claims settled	(4,250)	(10,110)
Balance, end of period	$ 7,749	$ 7,771

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

	Level	June 27, 2014	Dec 27, 2013
Assets			
Cash surrender value of life insurance	2	$ 13,331	$ 12,611
Forward exchange contracts	2	-	291
Total assets at fair value		$ 13,331	$ 12,902
Liabilities			
Deferred compensation	2	$ 2,580	$ 2,296
Forward exchange contracts	2	302	-
Total liabilities at fair value		$ 2,882	$ 2,296

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 June 27, 2014 and $320 million as of December 27, 2013. 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 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.

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 continues to work on resolving issues related to a proposed 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 2014 totaled $11 million in the second quarter and $15 million year-to-date. Dividends received in 2013 totaled $11 million in the second quarter and $15 million year-to-date. 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.

The Company evaluates its cost-method investment for other-than-temporary impairment at each reporting period. As of June 27, 2014, 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		Twenty-six Weeks Ended	
	June 27, 2014	June 28, 2013	June 27, 2014	June 28, 2013
Net Sales	$ 68,953	$ 71,845	$ 139,462	$ 135,043
Operating Earnings	14,608	16,398	29,894	29,978

12. On June 26, 2014, the Company executed an amendment to its revolving credit agreement, extending the expiration date to June 26, 2019, and increasing the amount of credit available to $500 million, a $50 million increase.

Under the amended agreement, the base rate applied to borrowings is an annual rate equal to a margin ranging from zero percent to 0.875 percent (down from zero to 1 percent under the prior agreement), depending on the Company’s cash flow leverage ratio, plus the highest of (i) the bank’s prime rate, (ii) the federal funds rate plus 0.5 percent or (iii) one-month LIBOR plus 1.5 percent. In general, LIBOR-based loans bear interest at LIBOR plus 1 percent to 1.875 percent (down from 1 to 2 percent), depending on the Company’s cash flow leverage ratio.

Fees on the undrawn amount of the loan commitment decreased to a range of 0.15 percent to 0.30 percent (down from 0.15 percent to 0.40 percent), depending on the Company’s cash flow leverage ratio.

13. In May 2014, the Financial Accounting Standards Board issued a final standard on revenue from contracts with customers. The new standard sets forth a single comprehensive model for recognizing and reporting revenue. The new standard is effective for the Company in its fiscal year 2017, and permits the use of either a retrospective or a cumulative effect transition method. The Company is evaluating the effect of the new standard on its consolidated financial statements and related disclosures, and has not yet selected a transition method.

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 in 2012

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 continues to work on resolving issues related to a proposed 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 2014 totaled $11 million in the second quarter and $15 million year-to-date, consistent with the amounts received in comparable periods of

2013. 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.

The Company evaluates its cost-method investment for other-than-temporary impairment at each reporting period. As of June 27, 2014, 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			Twenty-six Weeks Ended		
	June 27, 2014	June 28, 2013	% Change	June 27, 2014	June 28, 2013	% Change
Net Sales	$ 322.5	$ 286.0	13%	$ 612.5	$ 555.1	10%
Operating Earnings	$ 85.8	$ 75.2	14%	$ 160.6	$ 146.7	9%
Net Earnings	$ 66.2	$ 57.8	15%	$ 117.0	$ 110.0	6%
Diluted Net Earnings per Common Share	$ 1.07	$ 0.92	16%	$ 1.88	$ 1.76	7%

Sales for the second quarter increased in all reportable segments and regions, with double-digit percentage growth in Industrial and Contractor segments. Year-to-date sales increased in all segments and regions except for Asia Pacific, where sales were flat compared to last year.

Changes in product mix and lower margins from acquired operations contributed to a decrease in gross margin rate for both the quarter and the year-to-date.

Expense leverage offset the effects of lower gross margin rates on operating earnings. Year-to-date operating earnings increased 9 percent, but a higher effective income tax rate led to a smaller increase in net earnings.

The following table presents components of changes in sales:

	Quarter						
	Segment			Region			
	Industrial	Contractor	Lubrication	Americas	EMEA	Asia Pacific	Total
Volume and Price	6 %	12 %	7 %	10 %	7 %	4 %	8 %
Acquisitions	6 %	- %	- %	6 %	1 %	2 %	4 %
Currency	2 %	1 %	- %	(1)%	4 %	1 %	1 %
Total	14 %	13 %	7 %	15 %	12 %	7 %	13 %

	Year-to-Date						
	Segment			Region			
	Industrial	Contractor	Lubrication	Americas	EMEA	Asia Pacific	Total
Volume and Price	5 %	11 %	7 %	11 %	5 %	(2)%	7 %
Acquisitions	5 %	- %	- %	5 %	1 %	1 %	3 %
Currency	1 %	- %	(1)%	(1)%	4 %	- %	- %
Total	11 %	11 %	6 %	15 %	10 %	(1)%	10 %

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

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 27, 2014	June 28, 2013	June 27, 2014	June 28, 2013
Americas[1]	$ 184.8	$ 160.7	$ 343.6	$ 298.9
EMEA[2]	79.7	70.9	153.1	139.8
Asia Pacific	58.0	54.4	115.8	116.4
Consolidated	$ 322.5	$ 286.0	$ 612.5	$ 555.1

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

Sales for the quarter increased 13 percent, including increases of 15 percent in the Americas, 12 percent in EMEA (8 percent at consistent translation rates) and 7 percent in Asia Pacific. Year-to-date sales increased 10 percent, including increases of 15 percent in the Americas and 10 percent in EMEA (6 percent at consistent translation rates). Sales were flat in Asia Pacific. Sales from operations acquired in the fourth quarter of 2013 and the first quarter of 2014 totaled $10 million for the quarter (contributing 4 percentage points of growth) and $17 million year-to-date (3 percentage points of growth).

Gross profit margin, expressed as a percentage of sales, was 55 percent for both the quarter and year-to-date, down less than one percentage point from the comparable periods last year. Changes in product mix and lower margins in acquired operations contributed to the decrease in both the quarter and year-to-date. Non-recurring inventory-related purchase accounting effects of $1 million and lower margins in acquired operations accounted for nearly half of the year-to-date decrease.

Total operating expenses for the quarter were $7 ½ million (9 percent) higher than second quarter last year. Year-to-date operating expenses were $13 million (8 percent) higher than last year. Expenses of acquired operations and spending on regional and product growth initiatives accounted for more than half of the increase for both the quarter and year-to-date. As a percentage of sales, total operating expenses for the quarter were 28 percent, down 1 percentage point from the second quarter last year and year-to-date operating expenses were down by one-half percentage point.

Other expense (income) included dividends received from the Liquid Finishing businesses that are held separate from the Company's other businesses. Such dividends totaled $11 million for the quarter and $15 million year-to-date, consistent with the comparable periods of last year.

The effective income tax rate of 28 percent for the quarter was 1 percentage point lower than the comparable period last year. The decrease resulted from higher foreign earnings that are taxed at lower rates than in the U.S., partially offset by the impact of the federal R&D credit not being renewed for 2014. The effective year-to-date income tax rate of 29 percent was 1 percentage point higher than last year. Last year's rate included the favorable impact of the R&D credit that was renewed in 2013 retroactive to the beginning of 2012. The increase in the effective rate as a result of the expiration of the R&D credit for 2014 was partially offset by the impacts of higher foreign earnings taxed at lower rates than in the U.S. and additional benefit from U.S. business deductions.

Segment Results

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

Industrial

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 27, 2014	June 28, 2013	June 27, 2014	June 28, 2013
Net sales (in millions)				
Americas	$ 83.0	$ 70.2	$ 161.5	$ 136.4
EMEA	55.9	49.8	110.3	100.1
Asia Pacific	42.9	39.7	86.4	87.3
Total	$ 181.8	$ 159.7	$ 358.2	$ 323.8
Operating earnings as a percentage of net sales	32 %	32 %	31 %	33 %

Industrial segment sales for the quarter increased 14 percent, with increases of 18 percent in the Americas, 12 percent in EMEA (7 percent at consistent translation rates) and 8 percent in Asia Pacific. Year-to-date sales increased 11 percent with increases in the Americas and EMEA and a small decrease in Asia Pacific. First half results included the operations of QED Environmental Systems, acquired at the beginning of fiscal 2014, and EcoQuip, acquired at the end of fiscal 2013. Acquired operations contributed $10 million to sales in this segment for the quarter and $17 million year-to-date (6 percentage points of growth for the quarter and 5 percentage points for the year-to-date). Year-to-date operating margin rate for the Industrial segment decreased compared to last year due to lower margins on acquired operations, including the impact of non-recurring acquisition-related inventory valuation adjustments, and other investments in regional and product expansion.

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Contractor

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 27, 2014	June 28, 2013	June 27, 2014	June 28, 2013
Net sales (in millions)				
Americas	$ 79.2	$ 69.9	$ 137.7	$ 121.4
EMEA	21.3	18.0	37.7	34.1
Asia Pacific	10.6	10.6	20.6	20.6
Total	$ 111.1	$ 98.5	$ 196.0	$ 176.1
Operating earnings as a percentage of net sales	25 %	25 %	24 %	23 %

Contractor segment sales for the quarter increased 13 percent, including increases of 13 percent in the Americas, 18 percent in EMEA (14 percent at consistent translation rates) and 1 percent in Asia Pacific. Year-to-date sales increased 11 percent with strong increases in the Americas and EMEA. Operating margin rates in the Contractor segment were slightly higher than the rates for the comparable periods last year. The favorable effects of higher sales volume and expense leverage were partially offset by unfavorable effects of product mix.

Lubrication

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 27, 2014	June 28, 2013	June 27, 2014	June 28, 2013
Net sales (in millions)				
Americas	$ 22.7	$ 20.6	$ 44.4	$ 41.1
EMEA	2.6	3.0	5.1	5.5
Asia Pacific	4.4	4.3	8.8	8.5
Total	$ 29.7	$ 27.9	$ 58.3	$ 55.1
Operating earnings as a percentage of net sales	23 %	24 %	23 %	21 %

Lubrication segment sales increased 7 percent for the quarter and 6 percent year-to-date, mostly from increases in the Americas. Higher sales volume, improved gross margin rate and expense leverage led to a higher year-to-date operating margin rate in the Lubrication segment.

Liquidity and Capital Resources

Net cash provided by operating activities was $84 million in 2014 and $100 million in 2013. The first half increase in accounts receivable was $15 million higher in 2014 than the increase in 2013. Accounts receivable and inventory balances have increased since the end of 2013 due to increases in business activity. Significant uses of cash in the first half of 2014 included $65 million for a business acquisition, $94 million for purchases of Company common stock and $33 million of dividends paid to shareholders.

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 continues to work on resolving issues related to a proposed 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. Since the date of acquisition, the Company received $55 million of dividends from current earnings of the Liquid Finishing businesses, including $15 million in the first half of 2014.

On June 26, 2014, the Company executed an amendment to its revolving credit agreement, extending the expiration date to June 26, 2019, and increasing the amount of credit available to $500 million, a $50 million increase.

Under the amended agreement, the base rate applied to borrowings is an annual rate equal to a margin ranging from zero percent to 0.875 percent (down from zero to 1 percent under the prior agreement), depending on the Company's cash flow leverage ratio, plus the highest of (i) the bank's prime rate, (ii) the federal funds rate plus 0.5 percent or (iii) one-month LIBOR plus 1.5 percent. In general, LIBOR-based loans bear interest at LIBOR plus 1 percent to 1.875 percent (down from 1 to 2 percent), depending on the Company's cash flow leverage ratio.
Fees on the undrawn amount of the loan commitment decreased to a range of 0.15 percent to 0.30 percent (down from 0.15 percent to 0.40 percent), depending on the Company's cash flow leverage ratio.

At June 27, 2014, the Company had various lines of credit totaling $552 million, of which $317 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 2014, including the needs of the Liquid Finishing businesses acquired in April 2012.

Outlook

After a solid first half of 2014, we are well positioned to achieve full-year growth in all segments and geographies. Our Contractor segment is poised to continue low double-digit growth in the Americas, benefitting from the recovery in the U.S. construction market. Stable macroeconomic conditions in developed economies and firming demand levels in the emerging markets of EMEA and China may provide upside to our outlook for mid-single-digit organic growth for the second half of the year.

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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 2013 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; our Company's growth strategies, which include making acquisitions, investing in new products, expanding geographically and targeting new industries; whether we are able to effectively complete a divestiture of the acquired Liquid Finishing businesses, which has not been completed and remains subject to FTC approval; political instability; new entrants who copy our products or infringe on our intellectual property; supply interruptions or delays; risks incident to conducting business internationally; the ability to meet our customers' needs and changes in product demand; 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; variations in activity in the construction and automotive industries; security breaches and natural disasters. Please refer to Item 1A of our Annual Report on Form 10-K for fiscal year 2013 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 2013 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.

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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 2013 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 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 29, 2014 – Apr 25, 2014	190,000	$ 73.98	190,000	4,230,623
Apr 26, 2014 – May 23, 2014	200,000	$ 72.62	200,000	4,030,623
May 24, 2014 – Jun 27, 2014	236,463	$ 75.20	236,463	3,794,160

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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	Amendment No. 2 dated as of June 26, 2014 to Note Agreement dated as of March 11, 2011.
10.2	Omnibus Amendment, dated June 26, 2014, amending and restating the Credit Agreement among Graco Inc., the borrowing subsidiaries from time to time party thereto, the banks from time to time party thereto and U.S. Bank National Association, as administrative agent. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K filed July 1, 2014.)
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 Second Quarter Earnings dated July 23, 2014.
101	Interactive Data File.

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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:	July 23, 2014	By:	/s/ Patrick J. McHale Patrick J. McHale President and Chief Executive Officer *(Principal Executive Officer)*
Date:	July 23, 2014	By:	/s/ James A. Graner James A. Graner Chief Financial Officer *(Principal Financial Officer)*
Date:	July 23, 2014	By:	/s/ Caroline M. Chambers Caroline M. Chambers Vice President, Corporate Controller and Information Systems *(Principal Accounting Officer)*

Exhibit 10.1

June 26, 2014

Graco Inc.
88 11th Avenue NE
Minneapolis, Minnesota 55413

Re: Amendment No. 2 to Note Agreement

Ladies and Gentlemen:

Reference is made to that certain Note Agreement, dated as of March 11, 2011 (as amended by the Amendment and Restatement of Amendment No. 1 to Note Agreement, dated March 27, 2012, the **"Note Agreement"**), between Graco Inc., a Minnesota corporation (the **"Company"**), on the one hand, and The Prudential Insurance Company of America, Gibraltar Life Insurance Co., Ltd., The Prudential Life Insurance Company, Ltd., Forethought Life Insurance Company, RGA Reinsurance Company, MTL Insurance Company and Zurich American Insurance Company, on the other hand. Capitalized terms used herein and not otherwise defined herein shall have the meanings assigned to such terms in the Note Agreement.

The Company has requested certain amendments to the Note Agreement set forth below. Subject to the terms and conditions hereof, the undersigned holders of the Notes are willing to agree to such request. Accordingly, and in accordance with the provisions of paragraph 11C of the Note Agreement, the parties hereto agree as follows:

SECTION 1. Amendments to the Note Agreement. Effective upon the Effective Date (as defined in Section 2 below), the parties hereto agree that the Note Agreement is amended as follows:

1.1. Clause (xiii) of paragraph 7A of the Note Agreement is amended in its entirety to read as follows:

"(xiii) occurrence of any ERISA Event that alone or together with any other ERISA Events that have occurred, could reasonably be expected to result in a Material Adverse Effect or the imposition of a Lien under Title IV of ERISA; or"

1.2. Clause (i) of paragraph 6I of the Note Agreement is amended in its entirety to read as follows:

"(i) Investments outstanding on the Second Amendment Effective Date and listed on Schedule 6I."

1.3. Paragraph 10B of the Note Agreement is hereby amended by amending and restating, or inserting in the appropriate alphabetical sequence, as the case may be, the following definitions:

"EBITDA" shall mean, for any period of determination, the consolidated net income of the Company and its Subsidiaries, plus, to the extent subtracted in determining consolidated net income and without duplication, (i) Interest Expense, (ii) depreciation, (iii) amortization, (iv) income tax expense, (v) extraordinary, non-operating or noncash charges and expenses (including but not limited to non-cash stock compensation expense, non-cash pension expense, workforce reduction or other restructuring charges, and transaction costs, fees and charges incurred in connection with the acquisition of any substantial portion of the Ownership Interests or assets of, or a line of business or division of, another Person, including any merger or consolidation with such other Person), minus (a) the aggregate amount of extraordinary, non-operating or non-cash gains and income (including, without limitation, extraordinary or nonrecurring gains, gains from the discontinuance of operations and gains arising from the sale of assets other than inventory) and (b) required cash contributions to pension plans, all as determined in accordance with GAAP. For purposes of calculating EBITDA, with respect to any period of determination, (i) Permitted Acquisitions that have been made by the Company and its Subsidiaries, including through mergers or consolidations and including any related financing transactions, during the period of determination shall be deemed to have occurred on the first day of the period of determination; provided that only the actual historical results of operations of the Persons so acquired, without adjustment for pro forma expense savings or revenue increases, shall be used for such calculation; and provided, further, that the EBITDA of the Person so acquired attributable to discontinued operations, as determined in accordance with GAAP, and operations or businesses disposed of prior to the end of such period of determination, shall be excluded, and (ii) dispositions that have been made by the Company and its Subsidiaries during the period of determination shall be deemed to have occurred on the first day of the period of determination; provided that the EBITDA for such period shall be reduced by an amount equal to the EBITDA (if positive) attributable to the property that is the subject of such disposition for such period or increased by an amount equal to the EBITDA (if negative) attributable thereto for such period.

"ERISA Event" shall mean one of the following that, alone or together with any other event described in clauses (i) through (vii) that have occurred, could reasonably be expected to result in a Material Adverse Effect or the imposition of a Lien under Title IV of ERISA: (i) the institution by the Company or any ERISA Affiliate of steps to terminate any Plan if in order to effectuate such termination, the Company or any ERISA Affiliate would be required to make a contribution to such Plan, or would incur a liability or obligation to such Plan, if such contribution or such liability or obligation would constitute a Material Adverse Effect, (ii) the institution by the PBGC of steps to terminate any Plan, (iii) the Company or any ERISA Affiliate fails to make a contribution payment to a Plan on or before the applicable due date which could result in the imposition of a Lien under Section 430(k) of the Code or Section 303(k) of ERISA, (iv) the occurrence of any Reportable Event, (v) the failure of any Plan to satisfy the “minimum funding standard”, as defined in Section 412(a) of the Code or Section 302(a) of ERISA for a plan year, whether or not waived, (vi) the filing pursuant to Section 412(c) of the Code or Section 302(c) of ERISA of an application for a waiver of the minimum funding standard with respect to any Plan, or (vii) the incurrence by the Company or any ERISA Affiliates of any withdrawal liability under ERISA, or the receipt by the Company or any ERISA Affiliate of any notice that a multiemployer plan is, or is expected to be, insolvent or in reorganization, within the meaning of Title IV of ERISA.

“Indebtedness” shall mean, with respect to any Person at the time of any determination, without duplication: (i) all obligations of such Person for borrowed money, (ii) all obligations of such Person evidenced by bonds, debentures, notes or other similar instruments, (iii) all obligations of such Person upon which interest charges are customarily paid or accrued, (iv) all obligations of such Person under conditional sale or other title retention agreements relating to property purchased by such Person, (v) all obligations of such Person issued or assumed as the deferred purchase price of property or services, except trade accounts payable and accrued expenses arising in the ordinary course of business and except earn-outs and similar obligations, (vi) all Indebtedness of others secured by any Lien on property owned or acquired by such Person, whether or not the obligations secured thereby have been assumed, (vii) all Capitalized Lease Obligations of such Person, (viii) all Rate Hedging Obligations of such Person, (ix) all obligations of such Person, actual or contingent, as an account party in respect of letters of credit or bankers’ acceptances, except for letters of credit or bankers’ acceptances supporting the purchase or sale of goods in the ordinary course of business, (x) all Indebtedness of any partnership or joint venture as to which such Person is or may become personally liable, (xi) all obligations of such Person under any Ownership Interests issued by such Person which cease to be considered Ownership Interests in such Person, and (1) all Contingent Obligations (except for letters of credit, bankers’ acceptances, performance bonds and similar instruments supporting the purchase or sale of goods in the ordinary course of business) of such Person. Non-recourse Indebtedness of such Person shall be deemed Indebtedness, but only to the extent of the lower of the book value of such Indebtedness or the fair market value of the property securing such Indebtedness. In no event shall obligations under operating leases (as determined by GAAP as in effect on the date hereof, without regard to any change to FASB ASC 840) be deemed Indebtedness.

“Second Amendment Effective Date” shall mean the “Effective Date”, as defined in Amendment No. 2 to this Agreement.

1.4. Schedules 6I and 8A(1) to the Note Agreement are replaced by Schedules 6I and 8A(1) attached to this letter agreement.

SECTION 2. Effectiveness. The amendments in Section 1 of this letter agreement shall become effective on the date (the "**Effective Date"**) that each of the following conditions has been satisfied:

2.1. Documents. Each holder of a Note shall have received original counterparts of this letter agreement executed by the holders of the Notes, the Company and each Guarantor.

2.2. Credit Agreement Amendment. Each holder of a Note shall have received copies of an executed amendment to or restatement of the Credit Agreement in form and substance satisfactory to each holder of a Note and such amendment or restatement shall be in full force and effect.

2.3. Representations. All representations set forth in Section 3 shall be true and correct as of the Effective Date, except for such representations and warranties that speak of an earlier date, in which case such representations and warranties shall be true and correct as of such earlier date.

2.4. Proceedings**.** All corporate and other proceedings taken or to be taken in connection with the transactions contemplated by this letter agreement shall be satisfactory to each holder of a Note and its counsel, and each holder of a Note shall have received all such counterpart originals or certified or other copies of such documents as they may reasonably request.

SECTION 3. Representations and Warranties. The Company represents and warrants to each holder of Note that (i) the execution and delivery of this letter agreement has been duly authorized by all necessary corporate action on behalf of the Company and each Guarantor, this letter agreement has been executed and delivered by a duly authorized officer of the Company and each Guarantor, and all necessary or required consents to and approvals of this letter have been obtained and are in full force and effect, and (ii) immediately before and after giving effect to the amendments to the Note Agreement in Section 1 hereof, (a) each representation and warranty set forth in paragraph 8 of the Note Agreement is true and correct other than those representations and warranties that speak as of a certain date, in which case such representation and warranty was true and correct as of such earlier date and (b) no Event of Default or Default exists.

SECTION 4. Reference to and Effect on Note Agreement. Upon the effectiveness of the amendments made in this letter agreement, each reference to the Note Agreement in any other document, instrument or agreement shall mean and be a reference to the Note Agreement as modified by this letter agreement. Except as specifically set forth in Section 1 hereof, the Note Agreement and the Notes shall remain in full force and effect and are hereby ratified and confirmed in all respects. Except as specifically stated in Section 1 of this letter agreement, the execution, delivery and effectiveness of this letter agreement shall not (a) amend the Note Agreement, any Note or any other Transaction Document, (b) operate as a waiver of any right, power or remedy of the holder of any Note, or (c) constitute a waiver of, or consent to any departure from, any provision of the Note Agreement, any Note or any of the other Transaction Documents at any time. The execution, delivery and effectiveness of this letter agreement shall not be construed as a course of dealing or other implication that any holder of Notes has agreed to or is prepared to grant any amendment to, waiver of or consent under the Note Agreement, any Note or any other Transaction Document in the future, whether or not under similar circumstances.

SECTION 5. Expenses. The Company hereby confirms its obligations under the Note Agreement, whether or not the transactions hereby contemplated are consummated, to pay, promptly after request by the holders of the Notes, all reasonable out-of-pocket costs and expenses, including attorneys' fees and expenses, incurred by such holders in connection with this letter agreement or the transactions contemplated hereby, in enforcing any rights under this letter agreement, or in responding to any subpoena or other legal process or informal investigative demand issued in connection with this letter agreement or the transactions contemplated hereby. The obligations of the Company under this Section 5 shall survive transfer by any holder of any Note and payment of any Note.

SECTION 6. Reaffirmation. Each Guarantor hereby consents to the foregoing amendments to the Note Agreement and hereby ratifies and reaffirms all of its payment and performance obligations, contingent or otherwise, under the Guaranty Agreement after giving effect to such amendments. Each Guarantor hereby acknowledges that, notwithstanding the foregoing amendments, that the Guaranty Agreement remains in full force and effect and is hereby ratified and confirmed. Without limiting the generality of the foregoing, each Guarantor agrees and confirms that the Guaranty Agreement continues to guaranty the obligations arising under or in connection with the Note Agreement, as the same may be amended by this letter agreement.

SECTION 7. Governing Law. THIS LETTER AGREEMENT SHALL BE CONSTRUED AND ENFORCED IN ACCORDANCE WITH THE INTERNAL LAWS OF THE STATE OF ILLINOIS, WITHOUT REGARD TO PRINCIPLES OF CONFLICT OF LAWS OF SUCH STATE WHICH WOULD OTHERWISE CAUSE THIS LETTER TO BE CONSTRUED OR ENFORCED OTHER THAN IN ACCORDANCE WITH THE LAWS OF THE STATE OF ILLINOIS.

SECTION 8. Counterparts; Section Titles. This letter agreement may be executed in any number of counterparts and by different parties hereto in separate counterparts, each of which when so executed and delivered shall be deemed to be an original and all of which taken together shall constitute but one and the same instrument. Delivery of an executed counterpart of a signature page to this letter agreement by facsimile or electronic transmission shall be effective as delivery of a manually executed counterpart of this letter agreement. The section titles contained in this letter agreement are and shall be without substance, meaning or content of any kind whatsoever and are not a part of the agreement between the parties hereto.

Very truly yours,

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA

By: /s/ David Levine
Vice President

GIBRALTAR LIFE INSURANCE CO., LTD. THE PRUDENTIAL LIFE INSURANCE COMPANY, LTD.

By: Prudential Investment Management (Japan), Inc.,
as Investment Manager

By: Prudential Investment Management, Inc.,
as Sub-Adviser

By: /s/ David Levine
Vice President

FORETHOUGHT LIFE INSURANCE COMPANY
RGA REINSURANCE COMPANY
MTL INSURANCE COMPANY
ZURICH AMERICAN INSURANCE COMPANY

By: Prudential Private Placement Investors, L.P.
(as Investment Advisor)

By: Prudential Private Placement Investors, Inc.
(as its General Partner)

By: /s/ David Levine
Vice President

Accepted and Agreed to:

GRACO INC.

By: /s/ James A. Graner
Name: James A. Graner
Title: Chief Financial Officer

GRACO MINNESOTA INC.

By: /s/ James A. Graner
Name: James A. Graner
Title: Chief Financial Officer and Treasurer

GRACO OHIO INC.

By: /s/ James A. Graner
Name: James A. Graner
Title: Chief Financial Officer and Treasurer

GEMA USA INC. (formerly known as Graco Holdings Inc.)

By: /s/ James A. Graner
Name: James A. Graner
Title: President

Schedule 6I

Investments (Paragraph 6I)

Investment in Corporate Owned Life Insurance (COLI) through establishment of a Rabbi (Grantor) Trust ("Trust") with Wilmington Trust on June 27, 2007.

The Trust is intended to provide informal funding for the Company's deferred compensation and executive excess benefit retirement plans. The funding schedule anticipates the payment of a premium of $1,498,626 each year for a five year period beginning in 2007. An additional premium payment in the amount of $1,498,626 was approved and made in November 2013.

Schedule 8A(1)

Subsidiaries (Paragraph 8A(1))

Subsidiary	**Jurisdiction**	**Number of Shares**	**Percentage Owned**	**Material Subsidiary?**	**Part of Hold Separate Business?**
DeVilbiss Equipamentos para Pintura Ltda.	Brazil	4,417,465	99.9999773626% by Graco do Brasil Ltda. 0.0000226374% by the Company		Yes
DeVilbiss Europa Unterstützungskasse GmbH	Germany	50,000	100% by Finishing Brands Germany GmbH		Yes
DeVilbiss Ransburg de México, S. de R.L. de C.V.	Mexico	1 Series A, par value 400 pesos 1 Series B, par value 4,999,600 pesos	100% by Gema USA Inc. 100% by the Company		Yes
Ecoquip Inc.	Virginia	100	100% by the Company		
Finishing Brands Germany GmbH	Germany	531,950	100% by the Company		Yes
Finishing Brands Holdings Inc.	Minnesota	100	100% by the Company		Yes
Finishing Brands UK Limited	United Kingdom	2	100% by Graco Limited		Yes
Finishing Brands (Shanghai) Co., Ltd.	P.R. China	N/A**	100% by the Company		Yes
Fluid Automation, Inc.	Michigan	100	100% by Graco Ohio Inc.		
Gema Europe s.r.l.	Italy	51,000	100% owned by Graco International Holdings S.à r.l.		
Gema México Powder Finishing S. de R.L. de C.V.	Mexico	13,103,000	99.9999923682% by Gema USA Inc. 0.0000076318% by the Company		
Gema Switzerland GmbH*	Switzerland	2,500,000	100% owned by Graco International Holdings S.à r.l.		
Gema USA Inc.	Minnesota	100	100% by the Company	Yes	
Gema (Shanghai) Co., Ltd.	P.R. China	N/A**	100% by Graco BVBA		
GFEC Uruguay S.A.	Uruguay	250,000	100% owned by Graco Global Holdings S.à r.l.		
GG Manufacturing s.r.l.	Romania	10,000	99.99% by Gema Switzerland GmbH 0.01% by Gema Europe s.r.l.		
Graco Australia Pty Ltd.	Australia	248	100% owned by Graco Global Holdings S.à r.l.		
Graco BVBA	Belguim	1,008,157	99.9999008091% by Graco International		

			Holdings S.à r.l. 0.0000991909% by Graco Global Holdings S.à r.l.		
Graco Canada Inc.	Canada	10,000	100% owned by Graco Global Holdings S.à r.l.		
Graco Chile SpA	Chile	100	100% by the Company		
Graco Colombia S.A.S.	Colombia	20,000	100% by the Company		
Graco do Brasil Ltda.	Brazil	26,006,536	99.9999961548% by Graco Global Holdings S.à r.l. 0.0000038452% by Graco International Holdings S.à r.l.		
Graco Fluid Equipment (Shanghai) Co., Ltd.	People’s Republic of China	N/A**	100% by the Company		
Graco Fluid Equipment (Suzhou) Co., Ltd.	People’s Republic of China	N/A**	100% by Graco Minnesota Inc.		
Graco Global Holdings S.à r.l.	Luxembourg	20,000	100% by the Company	Yes	
Graco GmbH	Germany	500,000	100% owned by Graco International Holdings S.à r.l.		
Graco Hong Kong Ltd.	People’s Republic of China (Special Adm Region)	2,000	100% owned by Graco Global Holdings S.à r.l.		
Graco International Holding S.à r.l.	Luxembourg	17,000	100% owned by Graco Global Holdings S.à r.l.		
Graco K.K.	Japan	660,000	100% owned by Graco Global Holdings S.à r.l.		
Graco Korea Inc.	Korea	125,500	100% owned by Graco Global Holdings S.à r.l.		
Graco Limited	United Kingdom	100,001	100% owned by Graco International Holdings S.à r.l.		
Graco Minnesota Inc.	Minnesota	100	100% by the Company	Yes	
Graco Ohio Inc.	Ohio	95 Class A 9,405 Class B	100% by the Company	Yes	
Graco S.A.S.	France	24,499	100% owned by Graco International Holdings S.à r.l.		
Graco Trading (Suzhou) Co., Ltd.	People’s Republic of China	N/A**	100% by Graco Minnesota Inc.		
Gusmer Sudamerica S.A.	Argentina	12,000*	100% by the Company*		
Q.E.D. Environmental Systems, Inc.	Michigan	500	100% by the Company		
Ransburg Industrial Finishing K.K.	Japan/Delaware	1,463	100% by the Company		Yes

Rasgory S.A.	Uruguay	10,800	100% owned by Graco Global Holdings S.à r.l.		
Surfaces & Finitions S.A.S.	France	6,250	100% by the Company		Yes

* Shares held by two executive officers of the Company to satisfy the requirements of local law.\

**No shares are issued.

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 23, 2014

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

Exhibit 31.2

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 23, 2014

/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 23, 2014

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

Date: July 23, 2014

/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, July 23, 2014

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

Graco Reports Record Sales and Earnings
Sales Growth for the Quarter in All Segments and Regions

MINNEAPOLIS, MN (July 23, 2014) - Graco Inc. **(NYSE: GGG)** today announced results for the quarter and six months ended June 27, 2014.

Summary
$ in millions except per share amounts

	Thirteen Weeks Ended			Twenty-six Weeks Ended		
	June 27, 2014	June 28, 2013	% Change	June 27, 2014	June 28, 2013	% Change
Net Sales	$ 322.5	$ 286.0	13 %	$ 612.5	$ 555.1	10 %
Operating Earnings	85.8	75.2	14 %	160.6	146.7	9 %
Net Earnings	66.2	57.8	15 %	117.0	110.0	6 %
Diluted Net Earnings per Common Share	$ 1.07	$ 0.92	16 %	$ 1.88	$ 1.76	7 %

- Sales for the quarter increased in all reportable segments and regions, with double-digit percentage growth in Industrial and Contractor segments.
- Gross margin rates were slightly lower than last year due to changes in product mix and lower margins from acquired operations.
- Expense leverage offset the effects of lower gross margin rates on operating earnings.
- In the first 6 months of the year, the Company used $65 million cash to acquire a business and returned $127 million to investors through dividends and Company stock repurchases.

"Demand levels around the world firmed in the second quarter, as we experienced solid growth in all segments and geographies," said Patrick J. McHale, Graco's President and CEO. "Contractor segment sales increased double-digits, led by the continued recovery in the U.S. construction sector and an improved professional painting market throughout the EMEA region. The Industrial segment posted organic sales growth in the mid-single digits in all regions and showed growth in every product category, reflecting a broad base of activity levels. Industrial lubrication product demand was the primary driver of the Lubrication segment's high single-digit sales growth in the second quarter. Recent acquisitions and strategic investments in regional and product expansion had a slightly dilutive impact on operating margins, but we believe returns on these investments will contribute to Graco's growth in the quarters and years to come."

More . . .

Consolidated Results

Sales for the quarter increased 13 percent, including increases of 15 percent in the Americas, 12 percent in EMEA (8 percent at consistent translation rates) and 7 percent in Asia Pacific. Year-to-date sales increased 10 percent, including increases of 15 percent in the Americas and 10 percent in EMEA (6 percent at consistent translation rates). Sales were flat in Asia Pacific. Sales from operations acquired in the fourth quarter of 2013 and the first quarter of 2014 totaled $10 million for the quarter (contributing 4 percentage points of growth) and $17 million year-to-date (3 percentage points of growth).

Gross profit margin, expressed as a percentage of sales, was 55 percent for both the quarter and year-to-date, down less than one percentage point from the comparable periods last year. Changes in product mix and lower margins in acquired operations contributed to the decrease in both the quarter and year-to-date. Non-recurring inventory-related purchase accounting effects of $1 million and lower margins in acquired operations accounted for nearly half of the year-to-date decrease.

Total operating expenses for the quarter were $7 ½ million (9 percent) higher than second quarter last year. Year-to-date operating expenses were $13 million (8 percent) higher than last year. Expenses of acquired operations and spending on regional and product growth initiatives accounted for more than half of the increase for both the quarter and year-to-date. As a percentage of sales, total operating expenses for the quarter were 28 percent, down 1 percentage point from the second quarter last year and year-to-date operating expenses were down by one-half percentage point.

Other expense (income) included dividends received from the Liquid Finishing businesses that are held separate from the Company's other businesses. Such dividends totaled $11 million for the quarter and $15 million year-to-date, consistent with the comparable periods of last year.

The effective income tax rate of 28 percent for the quarter was 1 percentage point lower than the comparable period last year. The decrease resulted from higher foreign earnings that are taxed at lower rates than in the U.S., partially offset by the impact of the federal R&D credit not being renewed for 2014. The effective year-to-date income tax rate of 29 percent was 1 percentage point higher than last year. Last year's rate included the favorable impact of the R&D credit that was renewed in 2013 retroactive to the beginning of 2012. The increase in the effective rate as a result of the expiration of the R&D credit for 2014 was partially offset by the impacts of higher foreign earnings taxed at lower rates than in the U.S. and additional benefit from U.S. business deductions.

Segment Results

Certain measurements of segment operations are summarized below:

	Thirteen Weeks			Twenty-six Weeks		
	Industrial	Contractor	Lubrication	Industrial	Contractor	Lubrication
Net sales (in millions)	$ 181.8	$ 111.1	$ 29.7	$ 358.2	$ 196.0	$ 58.3
Percentage change from last year						
Sales	14 %	13 %	7 %	11 %	11 %	6 %
Operating earnings	12 %	16 %	4 %	6 %	14 %	14 %
Operating earnings as a percentage of sales						
2014	32 %	25 %	23 %	31 %	24 %	23 %
2013	32 %	25 %	24 %	33 %	23 %	21 %

More . . .

Industrial segment sales for the quarter increased 14 percent, with increases of 18 percent in the Americas, 12 percent in EMEA (7 percent at consistent translation rates) and 8 percent in Asia Pacific. Year-to-date sales increased 11 percent with increases in the Americas and EMEA and a small decrease in Asia Pacific. First half results included the operations of QED Environmental Systems, acquired at the beginning of fiscal 2014, and EcoQuip, acquired at the end of fiscal 2013. Acquired operations contributed $10 million to sales in this segment for the quarter and $17 million year-to-date (6 percentage points of growth for the quarter and 5 percentage points for the year-to-date). Year-to-date operating margin rate for the Industrial segment decreased compared to last year due to lower margins on acquired operations, including the impact of non-recurring acquisition-related inventory valuation adjustments, and other investments in regional and product expansion.

Contractor segment sales for the quarter increased 13 percent, including increases of 13 percent in the Americas, 18 percent in EMEA (14 percent at consistent translation rates) and 1 percent in Asia Pacific. Year-to-date sales increased 11 percent with strong increases in the Americas and EMEA. Operating margin rates in the Contractor segment were slightly higher than the rates for the comparable periods last year. The favorable effects of higher sales volume and expense leverage were partially offset by unfavorable effects of product mix.

Lubrication segment sales increased 7 percent for the quarter and 6 percent year-to-date, mostly from increases in the Americas. Higher sales volume, improved gross margin rate and expense leverage led to a higher year-to-date operating margin rate in the Lubrication 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 continues to work on resolving issues related to a proposed 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. Income is recognized based on dividends received from current earnings and is included in other income. 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.

The Liquid Finishing businesses generated sales of $69 million and EBITDA of $15 million in the second quarter of 2014.

More . . .

Outlook

“After a solid first half of 2014, we are well positioned to achieve full-year growth in all segments and geographies,” stated Mr. McHale. “Our Contractor segment is poised to continue low double-digit growth in the Americas, benefitting from the recovery in the U.S. construction market. Stable macroeconomic conditions in developed economies and firming demand levels in the emerging markets of EMEA and China may provide upside to our outlook for mid-single-digit organic growth for the second half of the year.”

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 2013 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; our Company’s growth strategies, which include making acquisitions, investing in new products, expanding geographically and targeting new industries; whether we are able to effectively complete a divestiture of the acquired Liquid Finishing businesses, which has not been completed and remains subject to FTC approval; political instability; new entrants who copy our products or infringe on our intellectual property; supply interruptions or delays; risks incident to conducting business internationally; the ability to meet our customers’ needs and changes in product demand; 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; variations in activity in the construction and automotive industries; security breaches and natural disasters. Please refer to Item 1A of our Annual Report on Form 10-K for fiscal year 2013 (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.

More . . .

Conference Call

Graco management will hold a conference call, including slides via webcast, with analysts and institutional investors on Thursday, July 24, 2014, 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 24, 2014, by dialing 888-203-1112, Conference ID #1832522, 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 28, 2014.

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 June 27, 2014	Thirteen Weeks Ended June 28, 2013	Twenty-six Weeks Ended June 27, 2014	Twenty-six Weeks Ended June 28, 2013
Net Sales	$ 322,549	$ 286,020	$ 612,511	$ 555,066
Cost of products sold	145,699	127,281	276,349	245,683
Gross Profit	176,850	158,739	336,162	309,383
Product development	13,405	12,467	26,564	24,888
Selling, marketing and distribution	49,503	44,556	95,845	87,910
General and administrative	28,094	26,499	53,200	49,871
Operating Earnings	85,848	75,217	160,553	146,714
Interest expense	4,676	4,625	9,264	9,387
Other expense (income), net	(10,764)	(10,851)	(14,192)	(15,246)
Earnings Before Income Taxes	91,936	81,443	165,481	152,573
Income taxes	25,700	23,600	48,500	42,600
Net Earnings	$ 66,236	$ 57,843	$ 116,981	$ 109,973
Net Earnings per Common Share				
Basic	$ 1.10	$ 0.94	$ 1.93	$ 1.80
Diluted	$ 1.07	$ 0.92	$ 1.88	$ 1.76
Weighted Average Number of Shares				
Basic	60,453	61,371	60,637	61,166
Diluted	62,028	62,841	62,233	62,624

Segment Information (Unaudited)

	Thirteen Weeks Ended June 27, 2014	Thirteen Weeks Ended June 28, 2013	Twenty-six Weeks Ended June 27, 2014	Twenty-six Weeks Ended June 28, 2013
Net Sales				
Industrial	$ 181,763	$ 159,671	$ 358,189	$ 323,846
Contractor	111,121	98,498	196,027	176,126
Lubrication	29,665	27,851	58,295	55,094
Total	$ 322,549	$ 286,020	$ 612,511	$ 555,066
Operating Earnings				
Industrial	$ 57,563	$ 51,530	$ 112,778	$ 106,749
Contractor	28,289	24,479	46,539	40,911
Lubrication	6,901	6,647	13,434	11,788
Unallocated corporate (expense)	(6,905)	(7,439)	(12,198)	(12,734)
Total	$ 85,848	$ 75,217	$ 160,553	$ 146,714

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.

# # #