

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 **March 25, 2016**

Commission File Number: 001-09249

GRACO INC.

(Exact name of registrant as specified in its charter)

Minnesota

(State of incorporation)

41-0285640

(I.R.S. Employer Identification Number)

88 - 11th Avenue N.E.
Minneapolis, Minnesota

(Address of principal executive offices)

55413

(Zip Code)

(612) 623-6000

(Registrant's telephone number, including area code)

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

Yes ☒ No ☐

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

Yes ☒ No ☐

Indicate by check mark 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	<input checked="" type="checkbox"/>	Accelerated Filer	<input type="checkbox"/>
Non-accelerated Filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

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

Yes ☐ No ☒

55,614,000 shares of the Registrant's Common Stock, \$1.00 par value, were outstanding as of April 13, 2016.

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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	
	March 25, 2016	March 27, 2015
Net Sales	\$ 304,912	\$ 306,453
Cost of products sold	143,116	144,324
Gross Profit	161,796	162,129
Product development	14,686	15,290
Selling, marketing and distribution	52,701	51,424
General and administrative	33,460	30,184
Operating Earnings	60,949	65,231
Interest expense	4,493	5,303
Held separate investment (income), net	—	(29,523)
Other expense (income), net	(1,146)	710
Earnings Before Income Taxes	57,602	88,741
Income taxes	18,050	19,900
Net Earnings	\$ 39,552	\$ 68,841
Per Common Share		
Basic net earnings	\$ 0.71	\$ 1.17
Diluted net earnings	\$ 0.70	\$ 1.14
Cash dividends declared	\$ 0.33	\$ 0.30

See notes to consolidated financial statements.

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

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Net Earnings	\$ 39,552	\$ 68,841
Components of other comprehensive income (loss)		
Cumulative translation adjustment	(2,402)	(3,011)
Pension and postretirement medical liability adjustment	1,473	2,438
Income taxes - pension and postretirement medical liability adjustment	(569)	(902)
Other comprehensive income (loss)	(1,498)	(1,475)
Comprehensive Income	\$ 38,054	\$ 67,366

See notes to consolidated financial statements.

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

	March 25, 2016	December 25, 2015
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 36,490	\$ 52,295
Accounts receivable, less allowances of \$11,400 and \$10,400	226,030	225,509
Inventories	212,331	202,136
Other current assets	20,993	29,077
Total current assets	495,844	509,017
Property, Plant and Equipment		
Cost	469,381	461,173
Accumulated depreciation	(285,170)	(282,736)
Property, plant and equipment, net	184,211	178,437
Goodwill	419,447	394,488
Other Intangible Assets, net	248,827	227,987
Deferred Income Taxes	58,674	56,976
Other Assets	23,995	24,447
Total Assets	\$ 1,430,998	\$ 1,391,352
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Notes payable to banks	\$ 14,508	\$ 15,901
Trade accounts payable	40,329	40,505
Salaries and incentives	27,886	44,673
Dividends payable	18,150	18,447
Other current liabilities	60,884	75,090
Total current liabilities	161,757	194,616
Long-term Debt	457,670	392,695
Retirement Benefits and Deferred Compensation	137,356	137,457
Deferred Income Taxes	28,577	22,303
Other Non-current Liabilities	8,730	8,730
Shareholders' Equity		
Common stock	55,566	55,766
Additional paid-in-capital	422,436	398,774
Retained earnings	264,901	285,508
Accumulated other comprehensive income (loss)	(105,995)	(104,497)
Total shareholders' equity	636,908	635,551
Total Liabilities and Shareholders' Equity	\$ 1,430,998	\$ 1,391,352

See notes to consolidated financial statements.

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

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Cash Flows From Operating Activities		
Net Earnings	\$ 39,552	\$ 68,841
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	12,010	10,810
Deferred income taxes	(2,688)	(4,044)
Share-based compensation	6,093	5,033
Excess tax benefit related to share-based payment arrangements	(3,300)	(300)
Change in		
Accounts receivable	3,100	(26,632)
Inventories	(8,127)	(13,545)
Trade accounts payable	119	6,088
Salaries and incentives	(17,191)	(16,910)
Retirement benefits and deferred compensation	669	3,171
Other accrued liabilities	(3,233)	4,947
Other	(1,426)	9,762
Net cash provided by operating activities	25,578	47,221
Cash Flows From Investing Activities		
Property, plant and equipment additions	(13,121)	(9,796)
Acquisition of businesses, net of cash acquired	(48,881)	(182,904)
Investment in restricted assets	876	—
Other	320	38
Net cash provided by (used in) investing activities	(60,806)	(192,662)
Cash Flows From Financing Activities		
Borrowings (payments) on short-term lines of credit, net	(1,461)	47,605
Borrowings on long-term line of credit	298,709	379,095
Payments on long-term line of credit	(233,734)	(227,055)
Excess tax benefit related to share-based payment arrangements	3,300	300
Common stock issued	20,111	12,746
Common stock repurchased	(48,050)	(46,935)
Cash dividends paid	(18,332)	(17,730)
Net cash provided by (used in) financing activities	20,543	148,026
Effect of exchange rate changes on cash	(1,120)	1,437
Net increase (decrease) in cash and cash equivalents	(15,805)	4,022
Cash and cash equivalents		
Beginning of year	52,295	23,656
End of period	\$ 36,490	\$ 27,678

See notes to consolidated financial statements.

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

1. Basis of Presentation

The consolidated balance sheet of Graco Inc. and Subsidiaries (the "Company") as of March 25, 2016 and the related statements of earnings for the thirteen weeks ended March 25, 2016 and March 27, 2015, and cash flows for the thirteen weeks ended March 25, 2016 and March 27, 2015 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 March 25, 2016, 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 2015 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. Earnings per Share

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

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Net earnings available to common shareholders	\$ 39,552	\$ 68,841
Weighted average shares outstanding for basic earnings per share	55,394	58,981
Dilutive effect of stock options computed using the treasury stock method and the average market price	1,315	1,484
Weighted average shares outstanding for diluted earnings per share	56,709	60,465
Basic earnings per share	\$ 0.71	\$ 1.17
Diluted earnings per share	\$ 0.70	\$ 1.14

Stock options to purchase 1,909,000 and 1,186,000 shares were not included in the March 25, 2016 and March 27, 2015 computations of diluted earnings per share, respectively, because they would have been anti-dilutive.

3. Share-Based Awards

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

	Option Shares	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
Outstanding, December 25, 2015	5,165	\$ 48.16	3,583	\$ 38.49
Granted	642	71.54		
Exercised	(465)	37.78		
Canceled	(6)	67.46		
Outstanding, March 25, 2016	5,336	\$ 51.86	3,575	\$ 41.83

The Company recognized year-to-date share-based compensation of \$6.1 million in 2016 and \$5.0 million in 2015. As of March 25, 2016, there was \$17.0 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:

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Expected life in years	7.0	6.5
Interest rate	1.4%	1.7%
Volatility	30.3%	35.3%
Dividend yield	1.9%	1.6%
Weighted average fair value per share	\$ 18.89	\$ 23.42

Under the Company's Employee Stock Purchase Plan, the Company issued 170,000 shares in 2016 and 166,000 shares in 2015. 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:

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Expected life in years	1.0	1.0
Interest rate	0.7%	0.2%
Volatility	19.3%	18.9%
Dividend yield	1.7%	1.6%
Weighted average fair value per share	\$ 17.49	\$ 16.51

4. Retirement Benefits

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

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Pension Benefits		
Service cost	\$ 1,997	\$ 2,096
Interest cost	4,017	3,775
Expected return on assets	(4,637)	(4,917)
Amortization and other	2,300	2,353
Net periodic benefit cost	<u>\$ 3,677</u>	<u>\$ 3,307</u>
Postretirement Medical		
Service cost	\$ 150	\$ 150
Interest cost	262	226
Amortization	(138)	(101)
Net periodic benefit cost	<u>\$ 274</u>	<u>\$ 275</u>

5. Shareholders' Equity

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

	Pension and Post- retirement Medical	Cumulative Translation Adjustment	Total
Balance, December 26, 2014	\$ (76,584)	\$ (24,152)	\$ (100,736)
Other comprehensive income before reclassifications	—	(3,011)	(3,011)
Amounts reclassified from accumulated other comprehensive income	1,536	—	1,536
Balance, March 27, 2015	<u>\$ (75,048)</u>	<u>\$ (27,163)</u>	<u>\$ (102,211)</u>
Balance, December 25, 2015	\$ (69,922)	\$ (34,575)	\$ (104,497)
Other comprehensive income before reclassifications	—	(2,402)	(2,402)
Amounts reclassified from accumulated other comprehensive income	904	—	904
Balance, March 25, 2016	<u>\$ (69,018)</u>	<u>\$ (36,977)</u>	<u>\$ (105,995)</u>

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

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Cost of products sold	\$ 528	\$ 938
Product development	204	383
Selling, marketing and distribution	486	703
General and administrative	255	414
Total before tax	\$ 1,473	\$ 2,438
Income tax (benefit)	(569)	(902)
Total after tax	<u>\$ 904</u>	<u>\$ 1,536</u>

6. Segment Information

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

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Net Sales		
Industrial	\$ 147,088	\$ 143,266
Process	64,285	67,681
Contractor	93,539	95,506
Total	<u>\$ 304,912</u>	<u>\$ 306,453</u>
Operating Earnings		
Industrial	\$ 45,794	\$ 42,940
Process	7,277	10,498
Contractor	16,743	19,375
Unallocated corporate (expense)	(8,865)	(7,582)
Total	<u>\$ 60,949</u>	<u>\$ 65,231</u>

Assets by segment were as follows (in thousands):

	March 25, 2016	December 25, 2015
Industrial	\$ 562,702	\$ 558,799
Process	532,447	481,677
Contractor	216,170	205,632
Unallocated corporate	119,679	145,244
Total	<u>\$ 1,430,998</u>	<u>\$ 1,391,352</u>

Geographic information follows (in thousands):

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Net sales <i>(based on customer location)</i>		
United States	\$ 153,001	\$ 159,328
Other countries	151,911	147,125
Total	<u>\$ 304,912</u>	<u>\$ 306,453</u>
	March 25, 2016	December 25, 2015
Long-lived assets		
United States	\$ 148,058	\$ 144,571
Other countries	36,153	33,866
Total	<u>\$ 184,211</u>	<u>\$ 178,437</u>

7. Inventories

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

	March 25, 2016	December 25, 2015
Finished products and components	\$ 117,180	\$ 112,267
Products and components in various stages of completion	55,136	51,033
Raw materials and purchased components	84,556	82,894
	256,872	246,194
Reduction to LIFO cost	(44,541)	(44,058)
Total	<u>\$ 212,331</u>	<u>\$ 202,136</u>

8. Intangible Assets

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

	Estimated Life (years)	Cost	Accumulated Amortization	Foreign Currency Translation	Book Value
March 25, 2016					
Customer relationships	3 - 14	\$ 218,227	\$ (41,010)	\$ (9,306)	\$ 167,911
Patents, proprietary technology and product documentation	3 - 11	22,222	(9,514)	(576)	12,132
Trademarks, trade names and other	5	595	(156)	(79)	360
		241,044	(50,680)	(9,961)	180,403
Not Subject to Amortization:					
Brand names		72,128	—	(3,704)	68,424
Total		<u>\$ 313,172</u>	<u>\$ (50,680)</u>	<u>\$ (13,665)</u>	<u>\$ 248,827</u>
December 25, 2015					
Customer relationships	3 - 14	\$ 197,900	\$ (36,852)	\$ (9,738)	\$ 151,310
Patents, proprietary technology and product documentation	3 - 11	20,400	(8,952)	(658)	10,790
Trademarks, trade names and other	5	495	(132)	(94)	269
		218,795	(45,936)	(10,490)	162,369
Not Subject to Amortization:					
Brand names		69,514	—	(3,896)	65,618
Total		<u>\$ 288,309</u>	<u>\$ (45,936)</u>	<u>\$ (14,386)</u>	<u>\$ 227,987</u>

Amortization of intangibles for the quarter was \$4.8 million in 2016 and \$4.1 million in 2015. Estimated annual amortization expense is as follows: \$19.0 million in 2016, \$18.8 million in 2017 \$18.5 million in 2018, \$18.3 million in 2019, \$18.2 million in 2020, and \$92.4 million thereafter.

Changes in the carrying amount of goodwill in 2016 were as follows (in thousands):

	Industrial	Process	Contractor	Total
Balance, December 25, 2015	\$ 153,283	\$ 228,473	\$ 12,732	\$ 394,488
Additions from business acquisitions	—	27,049	—	27,049
Foreign currency translation	1,585	(3,675)	—	(2,090)
Balance, March 25, 2016	<u>\$ 154,868</u>	<u>\$ 251,847</u>	<u>\$ 12,732</u>	<u>\$ 419,447</u>

Goodwill is reviewed for impairment annually in the fourth quarter and whenever events or changes in business circumstances indicate the carrying value of the goodwill may not be recoverable. In completing the goodwill impairment analysis for 2015, the estimated fair value of all reporting units substantially exceeded carrying value except for our Oil and Natural Gas reporting unit, which exceeded its carrying value by 14 percent. In the first quarter of 2016, the Company considered the impact of continuing weakness in the oil and natural gas markets and concluded that further impairment analysis was not required, however prolonged or deepened weakness could subject assets to impairment in the future.

9. Other Current Liabilities

Components of other current liabilities were (in thousands):

	March 25, 2016	December 25, 2015
Accrued self-insurance retentions	\$ 6,953	\$ 6,908
Accrued warranty and service liabilities	7,913	7,870
Accrued trade promotions	5,869	8,522
Payable for employee stock purchases	1,845	8,825
Customer advances and deferred revenue	8,393	9,449
Income taxes payable	4,770	1,308
Other	25,141	32,208
Total	<u>\$ 60,884</u>	<u>\$ 75,090</u>

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

Balance, December 25, 2015	\$ 7,870
Charged to expense	1,655
Margin on parts sales reversed	120
Reductions for claims settled	(1,732)
Balance, March 25, 2016	<u>\$ 7,913</u>

The Company manages certain self-insured loss exposures through a wholly-owned captive insurance subsidiary established in 2015. At March 25, 2016, cash balances of \$9 million were restricted to funding of the captive's loss reserves. Restricted cash is included within other current assets on the Company's Consolidated Balance Sheet.

10. Fair Value

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

	Level	March 25, 2016	December 25, 2015
Assets			
Cash surrender value of life insurance	2	\$ 12,749	\$ 12,856
Forward exchange contracts	2	—	107
Total assets at fair value		<u>\$ 12,749</u>	<u>\$ 12,963</u>
Liabilities			
Contingent consideration	3	\$ 4,081	\$ 9,600
Deferred compensation	2	2,991	2,958
Forward exchange contracts	2	603	—
Total liabilities at fair value		<u>\$ 7,675</u>	<u>\$ 12,558</u>

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

Contingent consideration liability represents the estimated value (using a probability-weighted expected return approach) of future payments to be made to previous owners of an acquired business based on future revenues.

Long-term notes payable with fixed interest rates have a carrying amount of \$300 million and an estimated fair value of \$330 million as of March 25, 2016 and \$320 million as of December 25, 2015. 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. Divestiture in 2015

Net earnings in the first quarter of 2015 included \$30 million of net investment income from the Liquid Finishing businesses sold in the second quarter of 2015. The Liquid Finishing businesses were held as a cost method investment, and prior to the sale, income was recognized on dividends received from post-tax earnings of Liquid Finishing.

12. Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued a final standard on accounting for leases. The new standard is effective for the Company in fiscal 2019 and requires most leases to be recorded on the balance sheet. The Company is evaluating the effect of the new standard on its consolidated financial statements and related disclosures and accounting systems.

In March 2016, FASB issued a new standard that changes the accounting for share-based payments. The standard is effective for the Company in fiscal 2017 and early adoption is permitted. It simplifies several aspects of accounting for share-based payments, including the accounting for income taxes, forfeitures, and classification in the statement of cash flows. Under the new standard, excess tax benefits on the exercise of stock options currently credited to equity will reduce the current tax provision, potentially creating volatility in the Company's effective tax rate. The Company is evaluating the effect of the new standard on its consolidated financial statements and related disclosures and is considering whether or not to early adopt.

Item 2. GRACO INC. AND SUBSIDIARIES

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

Overview

The Company designs, manufactures and markets systems and equipment to move, measure, control, dispense and spray fluid and coating materials. Management classifies the Company's business into three reportable segments: Industrial, Process and Contractor. Key strategies include developing and marketing new products, leveraging products and technologies into additional, growing end-user markets, expanding distribution globally and completing strategic acquisitions that provide additional channel and technologies. The following Management's Discussion and Analysis reviews significant factors affecting the Company's results of operations and financial condition. This discussion should be read in conjunction with the financial statements and the accompanying notes to the financial statements.

Consolidated Results

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

	Thirteen Weeks Ended		
	March 25, 2016	March 27, 2015	% Change
Net Sales	\$ 304.9	\$ 306.5	(1)%
Operating Earnings	60.9	65.2	(7)%
Net Earnings	\$ 39.6	\$ 68.8	(43)%
Diluted Net Earnings per Common Share	\$ 0.70	\$ 1.14	(39)%

Net earnings in the first quarter of 2015 included \$30 million (\$0.49 per diluted share) of net investment income from the Liquid Finishing businesses sold in the second quarter of 2015. Results excluding Liquid Finishing investment income and expense provide a more consistent base of comparison to future results. A calculation of the non-GAAP measurement of net earnings excluding investment income and expense follows (in millions except per share amounts):

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Net Earnings, as reported	\$ 39.6	\$ 68.8
Held separate investment (income), net	—	(29.5)
Income tax effect	—	(0.2)
Net Earnings, adjusted	\$ 39.6	\$ 39.1
Diluted earnings per share		
As reported	\$ 0.70	\$ 1.14
Adjusted	\$ 0.70	\$ 0.65

The following table presents components of changes in sales:

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

⁽¹⁾ North and South America, including the United States

⁽²⁾ Europe, Middle East and Africa

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

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Americas	\$ 173.4	\$ 184.8
EMEA	75.7	68.8
Asia Pacific	55.8	52.9
Consolidated	\$ 304.9	\$ 306.5

Sales decreased 1 percent, though at consistent translation rates they increased 1 percent. Increases of 10 percent in EMEA (13 percent at consistent translation rates) and 6 percent in Asia Pacific (9 percent at consistent translation rates) were largely offset by a 6 percent decrease in the Americas. Incremental sales from operations acquired within the last 12 months totaled \$7 million, contributing 2 percentage points of growth. Organic sales at consistent translation rates decreased 1 percent, with increases of 10 percent in EMEA, 6 percent in Asia Pacific and a decrease of 7 percent in the Americas.

Gross profit margin rates were consistent with the rates in the first quarter of last year. Favorable effects of realized pricing and reduced acquisition related purchase accounting effects offset the impact of lower factory volume and product mix.

Total operating expenses were \$4 million (4 percent) higher than the first quarter last year. The increase included expenses of acquired operations totaling \$3 million. Unallocated corporate expenses increased \$1 million, mostly from increases in stock compensation and pension, partially offset by a decrease in divestiture costs.

The effective income tax rate was 31 percent, up from 22 percent last year. Post-tax dividend income reduced the effective rate in the first quarter of 2015. The effective rate in the first quarter of 2016 benefited from foreign earnings taxed at lower rates than the U.S. rate and the federal R&D credit that was not reinstated in the first quarter of 2015.

Segment Results

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

Industrial

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Net sales (in millions)		
Americas	\$ 65.1	\$ 67.8
EMEA	44.2	41.0
Asia Pacific	37.8	34.5
Total	<u>\$ 147.1</u>	<u>\$ 143.3</u>
Operating earnings as a percentage of net sales	<u>31%</u>	<u>30%</u>

Industrial segment sales increased 3 percent (5 percent at consistent translation rates). A 4 percent decrease in the Americas was more than offset by increases of 8 percent in EMEA (11 percent at consistent translation rates) and 10 percent in Asia Pacific (12 percent at consistent translation rates). Operating margin rates for the Industrial segment were slightly higher than last year due to improved gross margin rates and expense leverage on higher sales volume.

Process

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Net sales (in millions)		
Americas	\$ 40.0	\$ 42.9
EMEA	13.9	13.9
Asia Pacific	10.4	10.9
Total	<u>\$ 64.3</u>	<u>\$ 67.7</u>
Operating earnings as a percentage of net sales	<u>11%</u>	<u>16%</u>

Process segment sales decreased 5 percent (3 percent at consistent translation rates), including decreases of 7 percent in the Americas and 5 percent in Asia Pacific (2 percent at consistent translation rates). Sales in EMEA were flat, and increased 4 percent at consistent translation rates. Operating margin rate decreased compared to last year with improvements in gross margin offset by unfavorable expense leverage.

Contractor

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Net sales (in millions)		
Americas	\$ 68.3	\$ 74.2
EMEA	17.6	13.9
Asia Pacific	7.6	7.4
Total	<u>\$ 93.5</u>	<u>\$ 95.5</u>
Operating earnings as a percentage of net sales	<u>18%</u>	<u>20%</u>

Contractor segment sales decreased 2 percent (1 percent at consistent translation rates), with an 8 percent decrease in the Americas partially offset by increases of 26 percent in EMEA (29 percent at consistent translation rates) and 3 percent in Asia Pacific (8 percent at consistent translation rates). Operating margin rate decreased due to unfavorable expense leverage on lower sales volume.

Liquidity and Capital Resources

Net cash provided by operating activities of \$26 million decreased \$22 million from the comparable period of 2015, mostly due to a decrease in net earnings. Net earnings in the first quarter of 2015 included \$30 million of post-tax dividends from the Liquid Finishing businesses that were sold in the second quarter of 2015. In the first quarter of 2016, the Company used proceeds from borrowings under its revolving line of credit to complete acquisitions of two related businesses that were not material to the consolidated financial statements. Other significant uses of cash in the first quarter of 2016 included share repurchases of \$48 million and cash dividends of \$18 million.

At March 25, 2016, cash balances of \$9 million were restricted to funding of certain self-insured loss reserves. Restricted cash is included within other current assets on the Company's Consolidated Balance Sheets.

At March 25, 2016, the Company had various lines of credit totaling \$546 million, of which \$376 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 2016.

Outlook

We maintain our outlook for the full year of low to mid single-digit organic constant currency growth for Graco worldwide and expect growth in every region and reportable segment. We expect the Americas to generate mid single-digit growth, and the EMEA and Asia Pacific regions to generate low single-digit growth. There is some risk in our Process segment outlook, reflecting continued headwinds in the oil and natural gas market, however we continue to believe this segment will achieve organic constant currency growth in 2016. While we are mindful of opportunities to reduce discretionary spending, our intent is to press forward with investments in our growth initiatives and we are confident these initiatives will provide a solid long-term return to our shareholders.

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, Form 10-Qs and Form 8-Ks, and other disclosures, including our 2015 Overview report, press releases, earnings releases, analyst briefings, conference calls and other written documents or oral statements released by our Company, may contain forward-looking statements. Forward-looking statements generally use words such as "expect," "foresee," "anticipate," "believe," "project," "should," "estimate," "will," and similar expressions, and reflect our Company's expectations concerning the future. All forecasts and projections are forward-looking statements. Forward-looking statements are based upon currently available information, but various risks and uncertainties may cause our Company's actual results to differ materially from those expressed in these statements. The Company undertakes no obligation to update these statements in light of new information or future events.

Future results could differ materially from those expressed due to the impact of changes in various factors. These risk factors include, but are not limited to: our Company's growth strategies, which include making acquisitions, investing in new products, expanding geographically and targeting new industries; economic conditions in the United States and other major world economies; changes in currency translation rates; changes in laws and regulations; compliance with anti-corruption laws; new entrants who copy our products or infringe on our intellectual property; risks incident to conducting business internationally; the ability to meet our customers' needs and changes in product demand; supply interruptions or delays; security breaches; the possibility of asset impairments if acquired businesses do not meet performance expectations; political instability; results of and costs associated with, litigation, administrative proceedings and regulatory reviews incident to our business as well as indemnification claims under our asset purchase agreement with Carlisle Companies Incorporated, Carlisle Fluid Technologies, Inc., and Finishing Brands Holdings Inc.; the possibility of decline in purchases from few large customers of the Contractor segment; variations in activity in the construction, automotive, mining and oil and natural gas industries; our ability to attract, develop and retain qualified personnel; and catastrophic events. Please refer to Item 1A of our Annual Report on Form 10-K for fiscal year 2015 for a more comprehensive discussion of these and other risk

factors. These reports are available on the Company's website at www.graco.com and the Securities and Exchange Commission's website at www.sec.gov. Shareholders, potential investors and other readers are urged to consider these factors in evaluating forward-looking statements and are cautioned not to place undue reliance on such forward-looking statements.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes related to market risk from the disclosures made in the Company's 2015 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 and Treasurer, the Vice President, Controller and Information Systems, and the Vice President, General Counsel and Secretary. Based upon that evaluation, they concluded that the Company's disclosure controls and procedures are effective.

Changes in internal controls

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

PART II OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes to the Company's risk factors from those disclosed in the Company's 2015 Annual Report on Form 10-K.

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

Issuer Purchases of Equity Securities

On April 24, 2015, 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 is for an indefinite period of time or until terminated by the Board.

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

Information on issuer purchases of equity securities follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (at end of period)
December 26, 2015 - January 22, 2016	538,624	\$ 65.62	538,624	4,040,800
January 23, 2016 - February 19, 2016	188,433	\$ 67.42	188,433	3,852,367
February 20, 2016 - March 25, 2016	—	—	—	—

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 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to Chief Executive Officer under the Graco Inc. 2015 Stock Incentive Plan in 2016 .
- 10.2 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to executive officers under the Graco Inc. 2015 Stock Incentive Plan in 2016.
- 31.1 Certification of President and Chief Executive Officer pursuant to Rule 13a-14(a).
- 31.2 Certification of Chief Financial Officer and Treasurer pursuant to Rule 13a-14(a).
- 32 Certification of President and Chief Executive Officer and Chief Financial Officer and Treasurer pursuant to Section 1350 of Title 18, U.S.C.
- 99.1 Press Release Reporting First Quarter Earnings dated April 20, 2016.
- 101 Interactive Data File.

SIGNATURES

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

GRACO INC.

Date:	<u>April 20, 2016</u>	By:	<u>/s/ Patrick J. McHale</u> Patrick J. McHale President and Chief Executive Officer <i>(Principal Executive Officer)</i>
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Date:	<u>April 20, 2016</u>	By:	<u>/s/ Christian E. Rothe</u> Christian E. Rothe Chief Financial Officer and Treasurer <i>(Principal Financial Officer)</i>
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Date:	<u>April 20, 2016</u>	By:	<u>/s/ Caroline M. Chambers</u> Caroline M. Chambers Vice President, Corporate Controller and Information Systems <i>(Principal Accounting Officer)</i>
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Graco Inc. Non-Qualified Stock Option Agreement

[Grant Plan Long Name]

Graco Inc., a Minnesota corporation, (the "Company"), pursuant to the terms of the Graco Inc. 2015 Stock Incentive Plan (the "Plan"), wishes to grant this Option (as defined in the Terms and Conditions below) to you ("Employee").

You must carefully read the Terms and Conditions governing this Option, as well as the Prospectus and any other documents provided in connection with the Option grant. Be sure you understand these documents and what your responsibilities and obligations are before acknowledging receipt of the Option. If you are not willing to agree to the Option Terms and Conditions, you must not accept the Option and you should not sign the Option Grant Acknowledgment and Agreement. If you accept the Option, you are accepting all of the Terms and Conditions that are applicable to your receipt of the Option. If you do not accept the Option, you are forfeiting your right to receive any potential benefits from the Option.

Employee: XXXX

Global ID: XXXXXXXX

Award Type: XXXXXXXX

Date of Grant: XXXX

Award Expiration Date: XXXXXX

Shares Granted: XXXXXXXX

Award Price: XX.XXUSD

Note: The statements above are qualified in their entirety by the Terms and Conditions below, and should be read in conjunction with such Terms and Conditions.

CEO Grant

TERMS AND CONDITIONS

1. Grant of Option

The Company grants to Employee, the right and option (the "Option") to purchase all or any part of an aggregate of the Shares Granted of Common Stock of the Company, par value USD 1.00 per share, at the Award Price per share on the terms and conditions set forth below.

2. Duration and Exercisability

- A. No portion of this Option may be exercised by Employee until the first anniversary of the Date of Grant and then only in accordance with the Vesting Schedule set forth below. In no event shall this Option or any portion of this Option be exercisable following the tenth anniversary of the Date of Grant.

Vesting Schedule

<u>Vesting Date</u>	<u>Portion of Option Exercisable</u>
First Anniversary of Date of Grant	25%
Second Anniversary of Date of Grant	50%
Third Anniversary of Date of Grant	75%
Fourth Anniversary of Date of Grant	100%

If Employee does not purchase in any one year the full number of shares of Common Stock of the Company to which Employee is entitled under this Option, Employee may, subject to the terms and conditions of Section 3, purchase such shares of Common Stock in any subsequent year during the term of this Option. This Option shall expire as of the close of trading at the national securities exchange on which the Common Stock is traded ("Exchange") on the tenth anniversary of the Date of Grant or if the Exchange is closed on the anniversary date or the Common Stock of the Company is not trading on said anniversary date, such earlier business day on which the Common Stock is trading on the Exchange.

- B. During the lifetime of Employee, the Option shall be exercisable only by Employee and shall not be assignable or transferable by Employee otherwise than (i) by will or the laws of descent and distribution, or (ii) by designating a beneficiary or beneficiaries (in a manner established by the Management Organization and Compensation Committee of the Board of Directors of the Company (the "Committee")) to exercise the rights of Employee and receive any property distributable with respect to the Option upon the death of the Employee (any person to whom the Option has been transferred pursuant to this Section 2B, a "Transferee"). The Transferee shall be subject to the provision of the Agreement, and, as a condition to the transfer of the Option becoming effective, the Transferee shall agree to be bound by the provision of this Agreement.

CEO Grant

- C. Under no circumstances may the Option or any portion of the Option granted by this Agreement be exercised after the term of the Option expires.

3. Effect of Termination of Employment

- A. If Employee's employment terminates for any reason other than Employee's gross and willful misconduct, death, retirement (as defined in Section 3D), or disability (as defined in Section 3D), any portion of the Option that was exercisable as of the date of termination of employment shall be exercisable at any time within the period beginning on the day after termination of Employee's employment and ending at the close of trading on the Exchange ninety (90) days later.
- B. If Employee's employment terminates by reason of Employee's gross and willful misconduct during employment, including, but not limited to, wrongful appropriation of Company or affiliate funds, serious violations of Company policy, breach of fiduciary duty or the conviction of a felony, the unexercised portion of the Option shall terminate as of the time of the misconduct. If the Company determines subsequent to the termination of Employee's employment for whatever reason, that Employee engaged in conduct during employment that would constitute gross and willful misconduct justifying termination, the Option shall terminate as of the time of such misconduct. Furthermore, if the Option is exercised in whole or in part and the Company thereafter determines that Employee engaged in gross and willful misconduct during employment which would have justified termination at any time prior to the date of such exercise, the Option shall be deemed to have terminated as of the time of the misconduct and the Company may elect to rescind the Option exercise. Gross and willful misconduct shall not include any action or inaction by the Employee contrary to the direction of the Board with respect to any initiative, strategy or action of the Company, which action or inaction the Employee believes is in the best interest of the Company.
- C. If Employee shall die while employed by the Company or an affiliate and shall not have fully exercised the Option, all shares remaining under the Option shall become immediately exercisable. If Employee shall die within ninety (90) days after a termination of employment which meets the criteria of Section 3A above, only the portion of the Option for those shares that are vested as of the date of termination shall be exercisable. The executor or administrator of Employee's estate or any Transferee may exercise the portion of such exercisable Option at any time during a period beginning on the day after the date of Employee's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant.
- D. If Employee's termination of employment is due to retirement or disability, all shares remaining under the Option shall become immediately exercisable. Employee shall be deemed to have retired if the termination of employment occurs for reasons other than the Employee's gross and willful misconduct, death, or disability after Employee (i) has attained age 55 and 10 years of service with the Company or an affiliate, or (ii) has attained age 65. Employee shall be deemed to be disabled if the termination of employment occurs because Employee is unable to work due to an impairment which would qualify as a disability under the Company's long term disability program. Employee may exercise the portion of the Option remaining unexercised at any time during a period beginning on the day after the date of Employee's termination of employment and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant. If Employee should die during the period between the date of Employee's retirement or disability and the expiration of the Option, the unexercised portion of the Option shall be exercisable at any time during a period beginning the

CEO Grant

day after the date of Employee's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant.

- E. Notwithstanding anything to the contrary contained in this Section 3, if Employee's employment is terminated by retirement (as defined in Section 3D) and Employee has not given written notice to the Chair of the Committee, of Employee's intention to retire not less than six (6) months prior to the date of Employee's retirement, then in such event, for purposes of this Agreement only, said termination of employment shall be deemed to be not a retirement but a termination subject to the provisions of Section 3A, *provided, however*, that in the event that the Committee determines that said termination of employment without six (6) months prior written notice is in the best interests of the Company, such termination shall be deemed to be a retirement and shall be subject to Section 3D.
- F. If the Option is exercised by a Transferee or the executors or administrators of the estate of a deceased optionee, the Company shall be under no obligation to issue stock hereunder unless and until the Company is satisfied that the person(s) exercising the Option is the validly designated beneficiary or the duly appointed legal representative of the deceased optionee's estate or the proper legatee or distributee thereof.
- G. For purposes of this Section 3, if the last day of the relevant period is a day upon which the Exchange is not open for trading or the Common Stock is not trading on that day, the relevant period will expire at the close of trading on such earlier business day on which the Exchange is open and the Common Stock is trading.

4. Manner of Exercise

- A. Employee or other proper party may exercise the Option only by delivering within the term of the Option written notice to the Company at its principal office in Minneapolis, Minnesota, stating the number of shares as to which the Option is being exercised and, except as provided in Sections 4B(2), 4B(3) and 4B(4), accompanied by payment-in-full of the Option price for all shares designated in the notice.
- B. The Employee may, at Employee's election, pay the Option price as follows:
 - (1) by cash or check (bank check, certified check, or personal check);
 - (2) by delivering to the Company for cancellation, shares of Common Stock of the Company which have a fair market value equal to the Option price;
 - (3) if the Employee is still serving as an executive officer of the Company on the date of exercise, by a reduction in the number of shares of Common Stock to be delivered upon exercise, which number of shares to be withheld shall have an aggregate fair market value on the date of exercise equal to the exercise price; or
 - (4) by delivering to the Company a properly executed exercise notice, together with irrevocable instructions to a broker to promptly deliver to the Company from sale or loan proceeds the amount required to pay the exercise price.

CEO Grant

For purposes of Sections 4B(2) and 4B(3), the fair market value per share of the Company's Common Stock shall be the closing price of the Common Stock on the day immediately preceding the date of exercise on the Exchange. If there is not a quotation available for such day, then the closing price on the next preceding day for which such a quotation exists shall be determinative of fair market value. If the Common Stock is not then traded on the Exchange, then the fair market value shall be determined in such manner as the Company shall deem reasonable.

5. Payment of Withholding Taxes

Upon exercise of any portion of this Option, Employee shall pay to the Company an amount sufficient to satisfy any federal, state, or local withholding tax requirements which arise as a result of the exercise of the Option or provide the Company with satisfactory indemnification for such payment. Employee may pay such amount by delivering to the Company for cancellation shares of Common Stock of the Company with a fair market value equal to the minimum amount of such withholding tax requirement by (i) electing to have the Company withhold shares otherwise to be delivered with a fair market value equal to the minimum statutory amount of such taxes required to be withheld by the Company, or (ii) electing to surrender to the Company previously owned shares with a fair market value equal to the amount of such minimum tax obligation.

6. Change of Control

A. Notwithstanding Section 2A hereof, the entire Option shall become immediately and fully exercisable upon a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:

- (1) an acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "1934 Act")), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) which, together with other acquisitions by such Person, results in the aggregate beneficial ownership by such Person of 30% or more of either
 - (a) the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or
 - (b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

- (i) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
- (ii) an acquisition by the Employee or any group that includes the Employee, or

CEO Grant

- (iii) an acquisition by any entity pursuant to a transaction that complies with clauses (a), (b) and (c) of Section 6A(3) below; or
- (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies by or on behalf of a Person other than the Board; or
- (3) Consummation of a reorganization, merger or consolidation of the Company with or into another entity or a statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination"); excluding, however, such a Business Combination pursuant to which
 - (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, a majority of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors (or comparable equity interests), as the case may be, of the surviving or acquiring entity resulting from such Business Combination (including, without limitation, an entity that as a result of such transaction beneficially owns 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly) in substantially the same proportions (as compared to the other holders of the Company's common stock and voting securities prior to the Business Combination) as their respective ownership, immediately prior to such Business Combination, of the Outstanding Company Common Stock and Outstanding Company Voting Securities,
 - (b) no Person (excluding (i) any employee benefit plan (or related trust) sponsored or maintained by the Company or such entity resulting from such Business Combination or any entity controlled by the Company or the entity resulting from such Business Combination, (ii) any entity beneficially owning 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly and (iii) the Employee and any group that includes the Employee) beneficially owns, directly or indirectly, 30% or more of the then outstanding shares of common stock (or comparable equity interests) of the entity resulting from such Business Combination or the combined voting power of the then outstanding voting securities (or comparable equity interests) of such entity, and
 - (c) immediately after the Business Combination, a majority of the members of the board of directors (or comparable governors) of the entity resulting from such Business Combination were members of the Incumbent Board at the

CEO Grant

time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

- (4) approval by the shareholders of the Company of a complete liquidation or dissolution of the Company.

7. Adjustments; Fundamental Change

- A. If there shall be any change in the number or character of the Common Stock of the Company through merger, consolidation, reorganization, recapitalization, dividend in the form of stock (of whatever amount), stock split or other change in the corporate structure of the Company, and all or any portion of the Option shall then be unexercised and not yet expired, appropriate adjustments in the outstanding Option shall be made by the Company, in order to prevent dilution or enlargement of Employee's Option rights. Such adjustments shall include, where appropriate, changes in the number of shares of Common Stock and the price per share subject to the outstanding Option.
- B. In the event of a proposed (i) dissolution or liquidation of the Company, (ii) a sale of substantially all of the assets of the Company, (iii) a merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, or (iv) a statutory share exchange involving the capital stock of the Company (each, a "Fundamental Change"), the Committee may, but shall not be obligated to:
- (1) with respect to a Fundamental Change that involves a merger, consolidation or statutory share exchange, make appropriate provision for the protection of the Option by the substitution of options and appropriate voting common stock of the corporation surviving any such merger or consolidation or, if appropriate, the "parent corporation" (as defined in Section 424(e) of the Internal Revenue Code of 1986, as amended from time to time, and any regulations promulgated thereunder, or any successor provision) of the Company or such surviving corporation, in lieu of the Option and shares of Common Stock of the Company, or
- (2) with respect to any Fundamental Change, including, without limitation, a merger, consolidation or statutory share exchange, declare, prior to the occurrence of the Fundamental Change, and provide written notice to the holder of the Option of the declaration, that the Option, whether or not then exercisable, shall be canceled at the time of, or immediately prior to the occurrence of, the Fundamental Change in exchange for payment to the holder of the Option, within 20 days after the Fundamental Change, of cash (or, if the Committee so elects in lieu of solely cash, of such form(s) of consideration, including cash and/or property, singly or in such combination as the Committee shall determine, that the holder of the Option would have received as a result of the Fundamental Change if the holder of the Option had exercised the Option immediately prior to the Fundamental Change) equal to, for each share of Common Stock covered by the canceled Option, the amount, if any, by which the Fair Market Value (as defined in this Section 7B) per share of Common Stock exceeds the exercise price per share of Common Stock covered by the Option. At the time of the declaration provided for in the immediately preceding sentence, the Option shall immediately become exercisable in full and the holder of the Option shall have the right, during the period preceding the time of cancellation of the Option, to exercise the Option as to all or any part of the shares of Common Stock covered thereby in whole or in part, as the case may be. In the event of a declaration pursuant to this Section 7B, the

Option, to the extent that it shall not have been exercised prior to the Fundamental Change, shall be canceled at the time of, or immediately prior to, the Fundamental Change, as provided in the declaration. Notwithstanding the foregoing, the holder of the Option shall not be entitled to the payment provided for in this Section 7B if such Option shall have expired or been forfeited. For purposes of this Section 7B only, "Fair Market Value" per share of Common Stock means the fair market value, as determined in good faith by the Committee, of the consideration to be received per share of Common Stock by the shareholders of the Company upon the occurrence of the Fundamental Change, notwithstanding anything to the contrary provided in this Agreement.

8. Miscellaneous

- A. This Option is issued pursuant to the Plan and is subject to its terms. The terms of the Plan are available for inspection during business hours at the principal offices of the Company.
- B. This Agreement shall not confer on Employee any right with respect to continuance of employment by the Company or any of its subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time.
- C. Neither Employee, the Employee's legal representative, a Transferee, nor the executor(s) or administrator(s) of the Employee's estate shall be, or have any of the rights or privileges of, a shareholder of the Company in respect of any shares of Common Stock receivable upon the exercise of this Option, in whole or in part, unless and until such shares shall have been issued upon exercise of this Option.
- D. The Company shall at all times during the term of the Option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.
- E. The internal law, and not the law of conflicts, of the State of Minnesota, USA, shall govern all questions concerning the validity, construction and effect of this Agreement, the Plan and any rules and regulations relating to the Plan or this Option.
- F. Employee hereby consents to the transfer by Employee's employer or the Company of information relating to Employee's participation in the Plan, including the personal data set forth in this Agreement, between them or to other related parties in the United States or elsewhere, or to any financial institution or other third party engaged by the Company, but solely for the purpose of administering the Plan and this Option. Employee also consents to the storage and processing of such data by such persons for this purpose.

Graco Inc. Non-Qualified Stock Option Agreement

[Grant Plan Long Name]

Graco Inc., a Minnesota corporation, (the "Company"), pursuant to the terms of the Graco Inc. 2015 Stock Incentive Plan (the "Plan"), wishes to grant this Option (as defined in the Terms and Conditions below) to you ("Employee").

You must carefully read the Terms and Conditions governing this Option, as well as the Prospectus and any other documents provided in connection with the Option grant. Be sure you understand these documents and what your responsibilities and obligations are before acknowledging receipt of the Option. If you are not willing to agree to the Option Terms and Conditions, you must not accept the Option and you should not sign the Option Grant Acknowledgment and Agreement. If you accept the Option, you are accepting all of the Terms and Conditions that are applicable to your receipt of the Option. If you do not accept the Option, you are forfeiting your right to receive any potential benefits from the Option.

Employee: XXXX

Global ID: XXXXXXXX

Award Type: XXXXXXXX

Date of Grant: XXXX

Award Expiration Date: XXXXX

Shares Granted: XXXXXXXX

Award Price: XX.XXUSD

Note: The statements above are qualified in their entirety by the Terms and Conditions below, and should be read in conjunction with such Terms and Conditions.

Executive Officer Grant

TERMS AND CONDITIONS

1. Grant of Option

The Company grants to Employee, the right and option (the "Option") to purchase all or any part of an aggregate of the Shares Granted of Common Stock of the Company, par value USD 1.00 per share, at the Award Price per share on the terms and conditions set forth below.

2. Duration and Exercisability

- A. No portion of this Option may be exercised by Employee until the first anniversary of the Date of Grant and then only in accordance with the Vesting Schedule set forth below. In no event shall this Option or any portion of this Option be exercisable following the tenth anniversary of the Date of Grant.

Vesting Schedule

<u>Vesting Date</u>	<u>Portion of Option Exercisable</u>
First Anniversary of Date of Grant	25%
Second Anniversary of Date of Grant	50%
Third Anniversary of Date of Grant	75%
Fourth Anniversary of Date of Grant	100%

If Employee does not purchase in any one year the full number of shares of Common Stock of the Company to which Employee is entitled under this Option, Employee may, subject to the terms and conditions of Section 3, purchase such shares of Common Stock in any subsequent year during the term of this Option. This Option shall expire as of the close of trading at the national securities exchange on which the Common Stock is traded ("Exchange") on the tenth anniversary of the Date of Grant or if the Exchange is closed on the anniversary date or the Common Stock of the Company is not trading on said anniversary date, such earlier business day on which the Common Stock is trading on the Exchange.

Executive Officer Grant

- B. During the lifetime of Employee, the Option shall be exercisable only by Employee and shall not be assignable or transferable by Employee otherwise than (i) by will or the laws of descent and distribution, or (ii) by designating a beneficiary or beneficiaries (in a manner established by the Management Organization and Compensation Committee of the Board of Directors of the Company (the "Committee")) to exercise the rights of Employee and receive any property distributable with respect to the Option upon the death of the Employee (any person to whom the Option has been transferred pursuant to this Section 2B, a "Transferee"). The Transferee shall be subject to the provision of the Agreement, and, as a condition to the transfer of the Option becoming effective, the Transferee shall agree to be bound by the provision of this Agreement.
- C. Under no circumstances may the Option or any portion of the Option granted by this Agreement be exercised after the term of the Option expires.

3. Effect of Termination of Employment

- A. If Employee's employment terminates for any reason other than Employee's gross and willful misconduct, death, retirement (as defined in Section 3D), or disability (as defined in Section 3D), any portion of the Option that was exercisable as of the date of termination of employment shall be exercisable at any time within the period beginning on the day after termination of Employee's employment and ending at the close of trading on the Exchange ninety (90) days later.
- B. If Employee's employment terminates by reason of Employee's gross and willful misconduct during employment, including, but not limited to, wrongful appropriation of Company or affiliate funds, serious violations of Company policy, breach of fiduciary duty or the conviction of a felony, the unexercised portion of the Option shall terminate as of the time of the misconduct. If the Company determines subsequent to the termination of Employee's employment for whatever reason, that Employee engaged in conduct during employment that would constitute gross and willful misconduct justifying termination, the Option shall terminate as of the time of such misconduct. Furthermore, if the Option is exercised in whole or in part and the Company thereafter determines that Employee engaged in gross and willful misconduct during employment which would have justified termination at any time prior to the date of such exercise, the Option shall be deemed to have terminated as of the time of the misconduct and the Company may elect to rescind the Option exercise.
- C. If Employee shall die while employed by the Company or an affiliate and shall not have fully exercised the Option, all shares remaining under the Option shall become immediately exercisable. If Employee shall die within ninety (90) days after a termination of employment which meets the criteria of Section 3A above, only the portion of the Option for those shares that are vested as of the date of termination shall be exercisable. The executor or administrator of Employee's estate or any Transferee may exercise the portion of such exercisable Option at any time during a period beginning on the day after the date of Employee's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant.
- D. If Employee's termination of employment is due to retirement or disability, all shares remaining under the Option shall become immediately exercisable. Employee shall be deemed to have retired if the termination of employment occurs for reasons other than the Employee's gross and willful misconduct, death, or disability after Employee (i) has attained age 55 and 10 years of service with the Company or an affiliate, or (ii) has attained age 65. Employee shall be deemed to be disabled if the termination of employment

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occurs because Employee is unable to work due to an impairment which would qualify as a disability under the Company's long term disability program. Employee may exercise the portion of the Option remaining unexercised at any time during a period beginning on the day after the date of Employee's termination of employment and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant. If Employee should die during the period between the date of Employee's retirement or disability and the expiration of the Option, the unexercised portion of the Option shall be exercisable at any time during a period beginning the day after the date of Employee's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant.

- E. Notwithstanding anything to the contrary contained in this Section 3, if Employee's employment is terminated by retirement (as defined in Section 3D) and Employee has not given the Company written notice to Employee's immediate supervisor and the Chief Executive Officer, of Employee's intention to retire not less than six (6) months prior to the date of Employee's retirement, then in such event, for purposes of this Agreement only, said termination of employment shall be deemed to be not a retirement but a termination subject to the provisions of Section 3A, provided, however, that in the event that the Chief Executive Officer determines that said termination of employment without six (6) months prior written notice is in the best interests of the Company, such termination shall be deemed to be a retirement and shall be subject to Section 3D.
- F. If the Option is exercised by a Transferee or the executors or administrators of the estate of a deceased optionee, the Company shall be under no obligation to issue stock hereunder unless and until the Company is satisfied that the person(s) exercising the Option is the validly designated beneficiary or the duly appointed legal representative of the deceased optionee's estate or the proper legatee or distributee thereof.
- G. For purposes of this Section 3, if the last day of the relevant period is a day upon which the Exchange is not open for trading or the Common Stock is not trading on that day, the relevant period will expire at the close of trading on such earlier business day on which the Exchange is open and the Common Stock is trading.

4. Manner of Exercise

- A. Employee or other proper party may exercise the Option only by delivering within the term of the Option written notice to the Company at its principal office in Minneapolis, Minnesota, stating the number of shares as to which the Option is being exercised and, except as provided in Sections 4B(2), 4B(3) and 4B(4), accompanied by payment-in-full of the Option price for all shares designated in the notice.
- B. The Employee may, at Employee's election, pay the Option price as follows:
 - (1) by cash or check (bank check, certified check, or personal check);
 - (2) by delivering to the Company for cancellation, shares of Common Stock of the Company which have a fair market value equal to the Option price;

Executive Officer Grant

(3) if the Employee is still serving as an executive officer of the Company on the date of exercise, by a reduction in the number of shares of Common Stock to be delivered upon exercise, which number of shares to be withheld shall have an aggregate fair market value on the date of exercise equal to the exercise price; or

(4) by delivering to the Company a properly executed exercise notice, together with irrevocable instructions to a broker to promptly deliver to the Company from sale or loan proceeds the amount required to pay the exercise price.

For purposes of Sections 4B(2) and 4B(3), the fair market value per share of the Company's Common Stock shall be the closing price of the Common Stock on the day immediately preceding the date of exercise on the Exchange. If there is not a quotation available for such day, then the closing price on the next preceding day for which such a quotation exists shall be determinative of fair market value. If the Common Stock is not then traded on the Exchange, then the fair market value shall be determined in such manner as the Company shall deem reasonable.

5. Payment of Withholding Taxes

Upon exercise of any portion of this Option, Employee shall pay to the Company an amount sufficient to satisfy any federal, state, or local withholding tax requirements which arise as a result of the exercise of the Option or provide the Company with satisfactory indemnification for such payment. Employee may pay such amount by delivering to the Company for cancellation shares of Common Stock of the Company with a fair market value equal to the minimum amount of such withholding tax requirement by (i) electing to have the Company withhold shares otherwise to be delivered with a fair market value equal to the minimum statutory amount of such taxes required to be withheld by the Company, or (ii) electing to surrender to the Company previously owned shares with a fair market value equal to the amount of such minimum tax obligation.

6. Change of Control

A. Notwithstanding Section 2A hereof, the entire Option shall become immediately and fully exercisable upon a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:

(1) an acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "1934 Act")), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) which, together with other acquisitions by such Person, results in the aggregate beneficial ownership by such Person of 30% or more of either

(a) the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or

(b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

Executive Officer Grant

- (i) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
 - (ii) an acquisition by the Employee or any group that includes the Employee, or
 - (iii) an acquisition by any entity pursuant to a transaction that complies with clauses (a), (b) and (c) of Section 6A(3) below; or
- (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies by or on behalf of a Person other than the Board; or
- (3) Consummation of a reorganization, merger or consolidation of the Company with or into another entity or a statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination"); excluding, however, such a Business Combination pursuant to which
 - (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, a majority of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors (or comparable equity interests), as the case may be, of the surviving or acquiring entity resulting from such Business Combination (including, without limitation, an entity that as a result of such transaction beneficially owns 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly) in substantially the same proportions (as compared to the other holders of the Company's common stock and voting securities prior to the Business Combination) as their respective ownership, immediately prior to such Business Combination, of the Outstanding Company Common Stock and Outstanding Company Voting Securities,
 - (b) no Person (excluding (i) any employee benefit plan (or related trust) sponsored or maintained by the Company or such entity resulting from such Business Combination or any entity controlled by the Company or the entity resulting from such Business Combination, (ii) any entity beneficially owning 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly and (iii) the Employee and any group that includes the Employee) beneficially owns, directly or indirectly, 30% or more of the then outstanding shares of common stock

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(or comparable equity interests) of the entity resulting from such Business Combination or the combined voting power of the then outstanding voting securities (or comparable equity interests) of such entity, and

- (c) immediately after the Business Combination, a majority of the members of the board of directors (or comparable governors) of the entity resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or
- (4) approval by the shareholders of the Company of a complete liquidation or dissolution of the Company.

7. Adjustments; Fundamental Change

- A. If there shall be any change in the number or character of the Common Stock of the Company through merger, consolidation, reorganization, recapitalization, dividend in the form of stock (of whatever amount), stock split or other change in the corporate structure of the Company, and all or any portion of the Option shall then be unexercised and not yet expired, appropriate adjustments in the outstanding Option shall be made by the Company, in order to prevent dilution or enlargement of Employee's Option rights. Such adjustments shall include, where appropriate, changes in the number of shares of Common Stock and the price per share subject to the outstanding Option.
- B. In the event of a proposed (i) dissolution or liquidation of the Company, (ii) a sale of substantially all of the assets of the Company, (iii) a merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, or (iv) a statutory share exchange involving the capital stock of the Company (each, a "Fundamental Change"), the Committee may, but shall not be obligated to:
 - (1) with respect to a Fundamental Change that involves a merger, consolidation or statutory share exchange, make appropriate provision for the protection of the Option by the substitution of options and appropriate voting common stock of the corporation surviving any such merger or consolidation or, if appropriate, the "parent corporation" (as defined in Section 424(e) of the Internal Revenue Code of 1986, as amended from time to time, and any regulations promulgated thereunder, or any successor provision) of the Company or such surviving corporation, in lieu of the Option and shares of Common Stock of the Company, or
 - (2) with respect to any Fundamental Change, including, without limitation, a merger, consolidation or statutory share exchange, declare, prior to the occurrence of the Fundamental Change, and provide written notice to the holder of the Option of the declaration, that the Option, whether or not then exercisable, shall be canceled at the time of, or immediately prior to the occurrence of, the Fundamental Change in exchange for payment to the holder of the Option, within 20 days after the Fundamental Change, of cash (or, if the Committee so elects in lieu of solely cash, of such form(s) of consideration, including cash and/or property, singly or in such combination as the Committee shall determine, that the holder of the Option would have received as a result of the Fundamental Change if the holder of the Option had exercised the Option immediately prior to the Fundamental Change) equal to, for each share of Common Stock covered by the canceled Option, the amount, if any,

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by which the Fair Market Value (as defined in this Section 7B) per share of Common Stock exceeds the exercise price per share of Common Stock covered by the Option. At the time of the declaration provided for in the immediately preceding sentence, the Option shall immediately become exercisable in full and the holder of the Option shall have the right, during the period preceding the time of cancellation of the Option, to exercise the Option as to all or any part of the shares of Common Stock covered thereby in whole or in part, as the case may be. In the event of a declaration pursuant to this Section 7B, the Option, to the extent that it shall not have been exercised prior to the Fundamental Change, shall be canceled at the time of, or immediately prior to, the Fundamental Change, as provided in the declaration. Notwithstanding the foregoing, the holder of the Option shall not be entitled to the payment provided for in this Section 7B if such Option shall have expired or been forfeited. For purposes of this Section 7B only, "Fair Market Value" per share of Common Stock means the fair market value, as determined in good faith by the Committee, of the consideration to be received per share of Common Stock by the shareholders of the Company upon the occurrence of the Fundamental Change, notwithstanding anything to the contrary provided in this Agreement.

8. Miscellaneous

- A. This Option is issued pursuant to the Plan and is subject to its terms. The terms of the Plan are available for inspection during business hours at the principal offices of the Company.
- B. This Agreement shall not create an employment relationship between Employee and the Company and shall not confer on Employee any right with respect to continuance of employment by the Company or any of its affiliates or subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time.
- C. Neither Employee, the Employee's legal representative, a Transferee, nor the executor(s) or administrator(s) of the Employee's estate shall be, or have any of the rights or privileges of, a shareholder of the Company in respect of any shares of Common Stock receivable upon the exercise of this Option, in whole or in part, unless and until such shares shall have been issued upon exercise of this Option.
- D. This Option has been granted to Employee as a purely discretionary benefit and shall not form part of Employee's salary or entitle Employee to receive similar option grants in the future. Benefits received under the Plan shall not be used in calculating severance payments, if any.
- E. The Company shall at all times during the term of the Option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.
- F. The internal law, and not the law of conflicts, of the State of Minnesota, USA, shall govern all questions concerning the validity, construction and effect of this Agreement, the Plan and any rules and regulations relating to the Plan or this Option.
- G. Employee hereby consents to the transfer by Employee's employer or the Company of information relating to Employee's participation in the Plan, including the personal data set forth in this Agreement, between them or to other related parties in the United States or

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elsewhere, or to any financial institution or other third party engaged by the Company, but solely for the purpose of administering the Plan and this Option. Employee also consents to the storage and processing of such data by such persons for this purpose.

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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: April 20, 2016

/s/ Patrick J. McHale

Patrick J. McHale

President and Chief Executive Officer

CERTIFICATION

I, Christian E. Rothe, 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: April 20, 2016

/s/ Christian E. Rothe

Christian E. Rothe

Chief Financial Officer and Treasurer

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: April 20, 2016

/s/ Patrick J. McHale

Patrick J. McHale

President and Chief Executive Officer

Date: April 20, 2016

/s/ Christian E. Rothe

Christian E. Rothe

Chief Financial Officer and Treasurer

News Release

FOR IMMEDIATE RELEASE:

Wednesday, April 20, 2016

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



FOR FURTHER INFORMATION:

Financial Contact: Christian Rothe, 612-623-6205
Media Contact: Charlotte Boyd, 612-623-6153
Charlotte_M_Boyd@graco.com

Graco Reports First Quarter Results Solid Sales Growth in EMEA and Asia Pacific Offset by Decrease in Americas Currency Headwinds Continue

MINNEAPOLIS (April 20, 2016) - Graco Inc. (NYSE: GGG) today announced results for the first quarter ended March 25, 2016.

Summary

\$ in millions except per share amounts

	Thirteen Weeks Ended		
	March 25, 2016	March 27, 2015	% Change
Net Sales	\$ 304.9	\$ 306.5	(1) %
Operating Earnings	60.9	65.2	(7) %
Net Earnings	39.6	68.8	(43) %
Diluted Net Earnings per Common Share	0.70	1.14	(39) %
Diluted Net Earnings per Common Share, adjusted (1)	\$ 0.70	\$ 0.65	8 %

(1) Excludes effect of \$30 million of net investment income from the Liquid Finishing businesses sold in the second quarter of 2015. See Consolidated Results below for reconciliation of the adjusted non-GAAP financial measure to GAAP.

- At consistent translation rates, sales increased 1 percent. Incremental sales from acquired operations contributed 2 percentage points of growth.
- Changes in currency translation rates decreased sales and net earnings by approximately \$5 million and \$2 million, respectively.
- Operating expenses increased by \$4 million, including \$3 million from acquired operations and a \$1 million increase in unallocated corporate expenses driven by higher stock compensation and non-divisional pension cost.

"First quarter sales continued to show variability between regions and product lines, similar with the quarter to quarter variability we have experienced during the last couple of years," said Patrick J. McHale, Graco's President and CEO. "February was notably weak, particularly in the Americas, with double-digit declines in incoming order rates across most product categories. Order rates normalized in March and have continued to hold through the beginning of the second quarter. Contractor Americas performance was weaker than expected in the first quarter against a tough comparable from the same period of 2015. Out the door sales of our channel partners remained solid, however, and we expect Contractor Americas to make up ground in the second quarter. We continue to anticipate Contractor Americas will grow high single digits for the full year 2016."

More . . .

Consolidated Results

Sales decreased 1 percent, though at consistent translation rates they increased 1 percent. Increases of 10 percent in EMEA (13 percent at consistent translation rates) and 6 percent in Asia Pacific (9 percent at consistent translation rates) were largely offset by a 6 percent decrease in the Americas. Incremental sales from operations acquired within the last 12 months totaled \$7 million, contributing 2 percentage points of growth. Organic sales at consistent translation rates decreased 1 percent, with increases of 10 percent in EMEA, 6 percent in Asia Pacific and a decrease of 7 percent in the Americas.

Gross profit margin rates were consistent with the rates in the first quarter of last year. Favorable effects of realized pricing and reduced acquisition related purchase accounting effects offset the impact of lower factory volume and product mix.

Total operating expenses were \$4 million (4 percent) higher than the first quarter last year. The increase included expenses of acquired operations totaling \$3 million. Unallocated corporate expenses increased \$1 million, mostly from increases in stock compensation and pension, partially offset by a decrease in divestiture costs.

The effective income tax rate was 31 percent, up from 22 percent last year. Post-tax dividend income reduced the effective rate in the first quarter of 2015. The effective rate in the first quarter of 2016 benefited from foreign earnings taxed at lower rates than the U.S. rate and the federal R&D credit that was not reinstated in the first quarter of 2015.

Net earnings in the first quarter of 2015 included \$30 million (\$0.49 per diluted share) of net investment income from the Liquid Finishing businesses sold in the second quarter of 2015. Results excluding Liquid Finishing investment income and expense provide a more consistent base of comparison of on-going financial results. Excluding net investment income from 2015 results, net earnings increased by \$0.5 million and diluted earnings per share increased by \$0.05. A calculation of the non-GAAP measurement of net earnings excluding investment income and expense follows (in millions except per share amounts):

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Net Earnings, as reported	\$ 39.6	\$ 68.8
Held separate investment (income), net	0.0	(29.5)
Income tax effect	0.0	(0.2)
Net Earnings, adjusted	\$ 39.6	\$ 39.1
Diluted earnings per share		
As reported	\$ 0.70	\$ 1.14
Adjusted	\$ 0.70	\$ 0.65

More . . .

Segment Results

Certain measurements of segment operations are summarized below:

	Thirteen Weeks		
	Industrial	Process	Contractor
Net sales (in millions)	\$ 147.1	\$ 64.3	\$ 93.5
Percentage change from last year			
Sales	3%	(5)%	(2)%
Operating earnings	7%	(31)%	(14)%
Operating earnings as a percentage of sales			
2016	31%	11 %	18 %
2015	30%	16 %	20 %

Industrial segment sales increased 3 percent (5 percent at consistent translation rates). A 4 percent decrease in the Americas was more than offset by increases of 8 percent in EMEA (11 percent at consistent translation rates) and 10 percent in Asia Pacific (12 percent increase at consistent translation rates). Operating margin rates for the Industrial segment were slightly higher than last year due to improved gross margin rates and expense leverage on higher sales volume.

Process segment sales decreased 5 percent (3 percent at consistent translation rates), including decreases of 7 percent in the Americas and 5 percent in Asia Pacific (2 percent at consistent translation rates). Sales in EMEA were flat, and increased 4 percent at consistent translation rates. Operating margin rate decreased compared to last year with improvements in gross margin offset by unfavorable expense leverage.

Contractor segment sales decreased 2 percent (1 percent at consistent translation rates), with an 8 percent decrease in the Americas partially offset by increases of 26 percent in EMEA (29 percent at consistent translation rates) and 3 percent in Asia Pacific (8 percent at consistent translation rates). Operating margin rate decreased due to unfavorable expense leverage on lower sales volume.

Outlook

"Despite softness in the first quarter, we maintain our outlook for the full year of low to mid single-digit organic constant currency growth for Graco worldwide and expect growth in every region and reportable segment," said McHale. "We expect the Americas to generate mid single-digit growth, and the EMEA and Asia Pacific regions to generate low single-digit growth. There is some risk in our Process segment outlook, reflecting continued headwinds in the oil and natural gas market, however we continue to believe this segment will achieve organic constant currency growth in 2016. While we are mindful of opportunities to reduce discretionary spending, our intent is to press forward with investments in our growth initiatives and we are confident these initiatives will provide a solid long-term return to our shareholders."

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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, Form 10-Qs and Form 8-Ks, and other disclosures, including our 2015 Overview report, press releases, earnings releases, analyst briefings, conference calls and other written documents or oral statements released by our Company, may contain forward-looking statements. Forward-looking statements generally use words such as “expect,” “foresee,” “anticipate,” “believe,” “project,” “should,” “estimate,” “will,” and similar expressions, and reflect our Company’s expectations concerning the future. All forecasts and projections are forward-looking statements. Forward-looking statements are based upon currently available information, but various risks and uncertainties may cause our Company’s actual results to differ materially from those expressed in these statements. The Company undertakes no obligation to update these statements in light of new information or future events.

Future results could differ materially from those expressed due to the impact of changes in various factors. These risk factors include, but are not limited to: our Company’s growth strategies, which include making acquisitions, investing in new products, expanding geographically and targeting new industries; economic conditions in the United States and other major world economies; changes in currency translation rates; changes in laws and regulations; compliance with anti-corruption laws; new entrants who copy our products or infringe on our intellectual property; risks incident to conducting business internationally; the ability to meet our customers’ needs and changes in product demand; supply interruptions or delays; security breaches; the possibility of asset impairments if acquired businesses do not meet performance expectations; political instability; results of and costs associated with, litigation, administrative proceedings and regulatory reviews incident to our business as well as indemnification claims under our asset purchase agreement with Carlisle Companies Incorporated, Carlisle Fluid Technologies, Inc., and Finishing Brands Holdings Inc.; the possibility of decline in purchases from few large customers of the Contractor segment; variations in activity in the construction, automotive, mining and oil and natural gas industries; our ability to attract, develop and retain qualified personnel; and catastrophic events. Please refer to Item 1A of our Annual Report on Form 10-K for fiscal year 2015 (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 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, April 21, 2016, at 10 a.m. CT, 11 a.m. ET, to discuss Graco's first 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. 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 p.m. CT on April 21, 2016, by dialing 888-203-1112, Conference ID #4595390, 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 April 25, 2016.

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

More . . .

GRACO INC. AND SUBSIDIARIES
Consolidated Statement of Earnings
(Unaudited) (In thousands except per share amounts)

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Net Sales	\$ 304,912	\$ 306,453
Cost of products sold	143,116	144,324
Gross Profit	161,796	162,129
Product development	14,686	15,290
Selling, marketing and distribution	52,701	51,424
General and administrative	33,460	30,184
Operating Earnings	60,949	65,231
Interest expense	4,493	5,303
Held separate investment (income), net	—	(29,523)
Other expense (income), net	(1,146)	710
Earnings Before Income Taxes	57,602	88,741
Income taxes	18,050	19,900
Net Earnings	\$ 39,552	\$ 68,841
Net Earnings per Common Share		
Basic	\$ 0.71	\$ 1.17
Diluted	\$ 0.70	\$ 1.14
Weighted Average Number of Shares		
Basic	55,394	58,981
Diluted	56,709	60,465

Segment Information
(Unaudited) (In thousands)

	Thirteen Weeks Ended	
	March 25, 2016	March 27, 2015
Net Sales		
Industrial	\$ 147,088	\$ 143,266
Process	64,285	67,681
Contractor	93,539	95,506
Total	\$ 304,912	\$ 306,453
Operating Earnings		
Industrial	\$ 45,794	\$ 42,940
Process	7,277	10,498
Contractor	16,743	19,375
Unallocated corporate (expense)	(8,865)	(7,582)
Total	\$ 60,949	\$ 65,231

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

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