

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

FORM 10-Q

☒ Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the quarterly period ended **September 30, 2022**

☐ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to

Commission File Number: 001-09249

GRACO INC.

(Exact name of registrant as specified in its charter)

Minnesota

(State or other jurisdiction of incorporation or organization)

41-0285640

(I.R.S. Employer Identification 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)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value \$1.00 per share	GCG	The New York Stock Exchange

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐
Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

Yes ☐ No ☒

168,529,015 shares of the Registrant's Common Stock, \$1.00 par value, were outstanding as of October 12, 2022.

TABLE OF CONTENTS

	<u>Page</u>
PART I - FINANCIAL INFORMATION	
Item 1. Financial Statements	
Consolidated Statements of Earnings	3
Consolidated Statements of Comprehensive Income	3
Consolidated Balance Sheets	4
Consolidated Statements of Cash Flows	5
Consolidated Statements of Shareholders' Equity	6
Notes to Consolidated Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3. Quantitative and Qualitative Disclosures About Market Risk	22
Item 4. Controls and Procedures	22
PART II - OTHER INFORMATION	
Item 1A. Risk Factors	23
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	24
Item 6. Exhibits	25
SIGNATURES	
EXHIBITS	

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

	Three Months Ended		Nine Months Ended	
	September 30, 2022	September 24, 2021	September 30, 2022	September 24, 2021
Net Sales	\$ 545,644	\$ 486,696	\$ 1,588,476	\$ 1,447,989
Cost of products sold	284,556	238,462	803,853	688,597
Gross Profit	261,088	248,234	784,623	759,392
Product development	19,704	19,762	58,749	60,739
Selling, marketing and distribution	61,386	66,078	186,457	197,432
General and administrative	36,849	37,795	119,225	114,493
Operating Earnings	143,149	124,599	420,192	386,728
Interest expense	1,542	2,500	8,555	7,456
Other expense (income), net	(866)	344	(106)	31
Earnings Before Income Taxes	142,473	121,755	411,743	379,241
Income taxes	26,241	17,926	77,290	59,607
Net Earnings	\$ 116,232	\$ 103,829	\$ 334,453	\$ 319,634
Net Earnings per Common Share				
Basic	\$ 0.69	\$ 0.61	\$ 1.97	\$ 1.89
Diluted	\$ 0.67	\$ 0.59	\$ 1.93	\$ 1.83

See notes to consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2022	September 24, 2021	September 30, 2022	September 24, 2021
Net Earnings	\$ 116,232	\$ 103,829	\$ 334,453	\$ 319,634
Components of other comprehensive income (loss)				
Cumulative translation adjustment	(13,335)	(3,537)	(29,827)	(8,314)
Pension and postretirement medical liability adjustment	1,340	2,559	3,602	8,240
Income taxes - pension and postretirement medical liability adjustment	(312)	(564)	(826)	(1,771)
Other comprehensive income (loss)	(12,307)	(1,542)	(27,051)	(1,845)
Comprehensive Income	\$ 103,925	\$ 102,287	\$ 307,402	\$ 317,789

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited) (In thousands)

	September 30, 2022	December 31, 2021
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 414,827	\$ 624,302
Accounts receivable, less allowances of \$6,600 and \$3,900	364,073	325,132
Inventories	462,220	382,301
Other current assets	44,783	31,886
Total current assets	1,285,903	1,363,621
Property, Plant and Equipment, net	562,807	451,061
Goodwill	359,645	356,255
Other Intangible Assets, net	136,948	149,740
Operating Lease Assets	30,996	30,046
Deferred Income Taxes	30,450	55,786
Other Assets	31,451	36,689
Total Assets	\$ 2,438,200	\$ 2,443,198
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Notes payable to banks	\$ 42,692	\$ 43,489
Current portion of long term debt	—	75,000
Trade accounts payable	99,025	78,432
Salaries and incentives	60,458	82,941
Dividends payable	35,836	35,771
Other current liabilities	192,757	191,159
Total current liabilities	430,768	506,792
Long-term Debt	75,000	75,000
Retirement Benefits and Deferred Compensation	101,626	106,897
Operating Lease Liabilities	22,107	23,527
Deferred Income Taxes	8,310	10,661
Other Non-current Liabilities	12,078	10,978
Shareholders' Equity		
Common stock	168,523	170,308
Additional paid-in-capital	776,594	742,288
Retained earnings	950,414	876,916
Accumulated other comprehensive income (loss)	(107,220)	(80,169)
Total shareholders' equity	1,788,311	1,709,343
Total Liabilities and Shareholders' Equity	\$ 2,438,200	\$ 2,443,198

See notes to consolidated financial statements.

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

	Nine Months Ended	
	September 30, 2022	September 24, 2021
Cash Flows From Operating Activities		
Net Earnings	\$ 334,453	\$ 319,634
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	48,223	44,846
Deferred income taxes	20,062	(10,219)
Share-based compensation	19,480	19,882
Change in		
Accounts receivable	(56,524)	(10,793)
Inventories	(86,455)	(77,531)
Trade accounts payable	8,456	14,033
Salaries and incentives	(20,841)	22,770
Retirement benefits and deferred compensation	473	6,676
Other accrued liabilities	411	27,307
Other	3,814	626
Net cash provided by operating activities	271,552	357,231
Cash Flows From Investing Activities		
Property, plant and equipment additions	(147,193)	(82,628)
Acquisition of businesses, net of cash acquired	(25,296)	(19,386)
Other	(477)	(102)
Net cash used in investing activities	(172,966)	(102,116)
Cash Flows From Financing Activities		
Borrowings on short-term lines of credit, net	4,110	27,880
Payments on long-term debt	(75,000)	(69)
Payments of debt issuance costs	—	(1,422)
Common stock issued	28,299	40,445
Common stock repurchased	(155,181)	—
Taxes paid related to net share settlement of equity awards	(1,219)	—
Cash dividends paid	(106,855)	(95,238)
Net cash used in financing activities	(305,846)	(28,404)
Effect of exchange rate changes on cash	(2,215)	(1,792)
Net increase (decrease) in cash and cash equivalents	(209,475)	224,919
Cash and Cash Equivalents		
Beginning of year	624,302	378,909
End of period	\$ 414,827	\$ 603,828

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited) (In thousands)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Three Months Ended September 30, 2022					
Balance, July 1, 2022	\$ 169,114	\$ 770,209	\$ 912,864	\$ (94,913)	\$ 1,757,274
Shares issued	182	4,707	—	—	4,889
Shares repurchased	(773)	(3,369)	(43,126)	—	(47,268)
Stock compensation cost	—	5,047	—	—	5,047
Net earnings	—	—	116,232	—	116,232
Dividends declared (\$0.210 per share)	—	—	(35,556)	—	(35,556)
Other comprehensive income (loss)	—	—	—	(12,307)	(12,307)
Balance, September 30, 2022	<u>\$ 168,523</u>	<u>\$ 776,594</u>	<u>\$ 950,414</u>	<u>\$ (107,220)</u>	<u>\$ 1,788,311</u>
Nine Months Ended September 30, 2022					
Balance, December 31, 2021	\$ 170,308	\$ 742,288	\$ 876,916	\$ (80,169)	\$ 1,709,343
Shares issued	689	26,392	—	—	27,081
Shares repurchased	(2,474)	(10,781)	(154,034)	—	(167,289)
Stock compensation cost	—	18,696	—	—	18,696
Restricted stock canceled (issued)	—	(1)	—	—	(1)
Net earnings	—	—	334,453	—	334,453
Dividends declared (\$0.630 per share)	—	—	(106,921)	—	(106,921)
Other comprehensive income (loss)	—	—	—	(27,051)	(27,051)
Balance, September 30, 2022	<u>\$ 168,523</u>	<u>\$ 776,594</u>	<u>\$ 950,414</u>	<u>\$ (107,220)</u>	<u>\$ 1,788,311</u>
Three Months Ended September 24, 2021					
Balance, June 25, 2021	\$ 169,667	\$ 715,635	\$ 720,429	\$ (124,468)	\$ 1,481,263
Shares issued	287	6,942	—	—	7,229
Stock compensation cost	—	5,438	—	—	5,438
Net earnings	—	—	103,829	—	103,829
Dividends declared (\$0.188 per share)	—	—	(31,868)	—	(31,868)
Other comprehensive income (loss)	—	—	—	(1,542)	(1,542)
Balance, September 24, 2021	<u>\$ 169,954</u>	<u>\$ 728,015</u>	<u>\$ 792,390</u>	<u>\$ (126,010)</u>	<u>\$ 1,564,349</u>
Nine Months Ended September 24, 2021					
Balance, December 25, 2020	\$ 168,568	\$ 671,206	\$ 568,295	\$ (124,165)	\$ 1,283,904
Shares issued	1,386	41,395	—	—	42,781
Stock compensation cost	—	17,750	—	—	17,750
Restricted stock canceled (issued)	—	(2,336)	—	—	(2,336)
Net earnings	—	—	319,634	—	319,634
Dividends declared (\$0.563 per share)	—	—	(95,539)	—	(95,539)
Other comprehensive income (loss)	—	—	—	(1,845)	(1,845)
Balance, September 24, 2021	<u>\$ 169,954</u>	<u>\$ 728,015</u>	<u>\$ 792,390</u>	<u>\$ (126,010)</u>	<u>\$ 1,564,349</u>

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 September 30, 2022 and the related statements of earnings, comprehensive income and shareholders' equity for the three and nine months ended September 30, 2022 and September 24, 2021, and cash flows for the nine months ended September 30, 2022 and September 24, 2021 have been prepared by the Company and have not been audited.

In the opinion of management, these consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of the Company as of September 30, 2022, 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 2021 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. Segment Information

Effective January 1, 2022, our high performance coatings and foam product offerings previously included within the Applied Fluid Technologies division of the Industrial segment were realigned and are now managed under the Contractor segment. This change aligns the types of products offered and markets served within the segments. Prior year segment information has been restated to conform to the current organizational structure.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2022	September 24, 2021	September 30, 2022	September 24, 2021
Net Sales				
Industrial	\$ 156,182	\$ 154,560	\$ 459,176	\$ 428,872
Process	125,376	96,185	364,883	284,790
Contractor	264,086	235,951	764,417	734,327
Total	\$ 545,644	\$ 486,696	\$ 1,588,476	\$ 1,447,989
Operating Earnings				
Industrial	\$ 53,964	\$ 50,812	\$ 161,795	\$ 138,879
Process	30,638	21,514	89,183	64,923
Contractor	65,123	58,659	192,314	203,366
Unallocated corporate (expense)	(6,576)	(6,386)	(23,100)	(20,440)
Total	\$ 143,149	\$ 124,599	\$ 420,192	\$ 386,728

Assets by segment were as follows (in thousands):

	September 30, 2022	December 31, 2021
Industrial	\$ 606,224	\$ 601,843
Process	543,701	436,203
Contractor	698,698	599,726
Unallocated corporate	589,577	805,426
Total	<u>\$ 2,438,200</u>	<u>\$ 2,443,198</u>

Geographic information follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2022	September 24, 2021	September 30, 2022	September 24, 2021
Net Sales (based on customer location)				
United States	\$ 289,831	\$ 244,086	\$ 840,922	\$ 739,309
Other countries	255,813	242,610	747,554	708,680
Total	<u>\$ 545,644</u>	<u>\$ 486,696</u>	<u>\$ 1,588,476</u>	<u>\$ 1,447,989</u>

	September 30, 2022	December 31, 2021
Long-lived Assets		
United States	\$ 498,780	\$ 388,835
Other countries	64,027	62,226
Total	<u>\$ 562,807</u>	<u>\$ 451,061</u>

3. Earnings per Share

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

	Three Months Ended		Nine Months Ended	
	September 30, 2022	September 24, 2021	September 30, 2022	September 24, 2021
Net earnings available to common shareholders	<u>\$ 116,232</u>	<u>\$ 103,829</u>	<u>\$ 334,453</u>	<u>\$ 319,634</u>
Weighted average shares outstanding for basic earnings per share	169,166	169,834	169,368	169,459
Dilutive effect of stock options computed using the treasury stock method and the average market price	<u>3,623</u>	<u>4,940</u>	<u>4,020</u>	<u>4,939</u>
Weighted average shares outstanding for diluted earnings per share	<u>172,789</u>	<u>174,774</u>	<u>173,388</u>	<u>174,398</u>
Basic earnings per share	\$ 0.69	\$ 0.61	\$ 1.97	\$ 1.89
Diluted earnings per share	\$ 0.67	\$ 0.59	\$ 1.93	\$ 1.83

Stock options to purchase 1,618,000 and 428,000 shares were not included in the September 30, 2022 and September 24, 2021 computations of diluted earnings per share, respectively, because they would have been anti-dilutive.

4. 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 31, 2021	9,575	\$ 39.31	7,296	\$ 33.75
Granted	831	71.73		
Exercised	(391)	24.00		
Canceled	(40)	49.17		
Outstanding, September 30, 2022	9,975	\$ 42.58	7,648	\$ 36.35

The Company recognized year-to-date share-based compensation of \$17.9 million in 2022 and \$19.9 million in 2021. As of September 30, 2022, there was \$11.0 million of unrecognized compensation cost related to unvested options, expected to be recognized over a weighted average period of 2.7 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:

	Nine Months Ended	
	September 30, 2022	September 24, 2021
Expected life in years	7.3	7.5
Interest rate	1.9 %	1.2 %
Volatility	25.5 %	25.3 %
Dividend yield	1.2 %	1.0 %
Weighted average fair value per share	\$ 19.06	\$ 18.91

Under the Company's Employee Stock Purchase Plan, the Company issued 316,000 shares in 2022 and 416,000 shares in 2021. 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:

	Nine Months Ended	
	September 30, 2022	September 24, 2021
Expected life in years	1.0	1.0
Interest rate	0.9 %	0.1 %
Volatility	20.5 %	40.1 %
Dividend yield	1.2 %	1.1 %
Weighted average fair value per share	\$ 16.01	\$ 21.50

5. Retirement Benefits

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

	Three Months Ended		Nine Months Ended	
	September 30, 2022	September 24, 2021	September 30, 2022	September 24, 2021
Pension Benefits				
Service cost	\$ 2,053	\$ 1,674	\$ 6,187	\$ 7,119
Interest cost	2,745	2,519	8,249	8,476
Expected return on assets	(5,237)	(5,412)	(14,816)	(15,673)
Amortization and other	1,200	2,148	3,695	7,254
Net periodic benefit cost	<u>\$ 761</u>	<u>\$ 929</u>	<u>\$ 3,315</u>	<u>\$ 7,176</u>
Postretirement Medical				
Service cost	\$ 129	\$ 153	\$ 387	\$ 503
Interest cost	209	124	629	624
Amortization	86	252	259	752
Net periodic benefit cost	<u>\$ 424</u>	<u>\$ 529</u>	<u>\$ 1,275</u>	<u>\$ 1,879</u>

6. Shareholders' Equity

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

	Pension and Postretirement Medical	Cumulative Translation Adjustment	Total
Three Months Ended September 30, 2022			
Balance, July 1, 2022	\$ (58,359)	\$ (36,554)	\$ (94,913)
Other comprehensive income (loss) before reclassifications	—	(13,335)	(13,335)
Reclassified to pension cost and deferred tax	1,028	—	1,028
Balance, September 30, 2022	<u>\$ (57,331)</u>	<u>\$ (49,889)</u>	<u>\$ (107,220)</u>
Nine Months Ended September 30, 2022			
Balance, December 31, 2021	\$ (60,107)	\$ (20,062)	\$ (80,169)
Other comprehensive income (loss) before reclassifications	—	(29,827)	(29,827)
Reclassified to pension cost and deferred tax	2,776	—	2,776
Balance, September 30, 2022	<u>\$ (57,331)</u>	<u>\$ (49,889)</u>	<u>\$ (107,220)</u>
Three Months Ended September 24, 2021			
Balance, June 25, 2021	\$ (109,655)	\$ (14,813)	\$ (124,468)
Other comprehensive income (loss) before reclassifications	—	(3,537)	(3,537)
Reclassified to pension cost and deferred tax	1,995	—	1,995
Balance, September 24, 2021	<u>\$ (107,660)</u>	<u>\$ (18,350)</u>	<u>\$ (126,010)</u>
Nine Months Ended September 24, 2021			
Balance, December 25, 2020	\$ (114,129)	\$ (10,036)	\$ (124,165)
Other comprehensive income (loss) before reclassifications	—	(8,314)	(8,314)
Reclassified to pension cost and deferred tax	6,469	—	6,469
Balance, September 24, 2021	<u>\$ (107,660)</u>	<u>\$ (18,350)</u>	<u>\$ (126,010)</u>

Amounts related to pension and postretirement medical adjustments are reclassified to non-service components of pension cost that are included within other non-operating expenses.

7. Receivables and Credit Losses

Accounts receivable includes trade receivables of \$350 million and other receivables of \$14 million as of September 30, 2022 and \$315 million and \$10 million, respectively, as of December 31, 2021.

Allowance for Credit Losses

Following is a summary of activity in the year to date allowance for credit losses (in thousands):

	September 30, 2022	September 24, 2021
Balance, beginning	\$ 3,254	\$ 3,745
Additions (reversals) charged to costs and expenses	3,262	164
Deductions from reserves ⁽¹⁾	(564)	(425)
Other additions (deductions) ⁽²⁾	(452)	68
Balance, ending	<u>\$ 5,500</u>	<u>\$ 3,552</u>

(1) Represents amounts determined to be uncollectible and charged against reserves, net of collections on accounts previously charged against reserves.

(2) Includes effects of foreign currency translation.

8. Inventories

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

	September 30, 2022	December 31, 2021
Finished products and components	\$ 211,195	\$ 166,922
Products and components in various stages of completion	140,892	117,063
Raw materials and purchased components	229,127	185,291
Subtotal	581,214	469,276
Reduction to LIFO cost	(118,994)	(86,975)
Total	<u>\$ 462,220</u>	<u>\$ 382,301</u>

9. Intangible Assets

Components of other intangible assets were as follows (dollars in thousands):

	Finite Life			Indefinite Life	
	Customer Relationships	Patents and Proprietary Technology	Trademarks, Trade Names and Other	Trade Names	Total
As of September 30, 2022					
Cost	\$ 202,103	\$ 26,574	\$ 1,700	\$ 62,633	\$ 293,010
Accumulated amortization	(119,529)	(17,519)	(659)	—	(137,707)
Foreign currency translation	(12,791)	(1,042)	—	(4,522)	(18,355)
Book value	\$ 69,783	\$ 8,013	\$ 1,041	\$ 58,111	\$ 136,948
Weighted average life in years	13	10	5	N/A	
As of December 31, 2021					
Cost	\$ 194,505	\$ 26,074	\$ 900	\$ 62,633	\$ 284,112
Accumulated amortization	(108,657)	(15,734)	(452)	—	(124,843)
Foreign currency translation	(7,710)	(707)	—	(1,112)	(9,529)
Book value	\$ 78,138	\$ 9,633	\$ 448	\$ 61,521	\$ 149,740
Weighted average life in years	13	10	5	N/A	

Amortization of intangibles for the quarter was \$4.8 million in 2022 and \$4.6 million in 2021 and for the year to date was \$14.1 million in 2022 and \$13.4 million in 2021. Estimated annual amortization expense based on the current carrying amount of other intangible assets is as follows (in thousands):

	2022 (Remainder)	2023	2024	2025	2026	Thereafter
Estimated Amortization Expense	\$ 4,556	\$ 16,860	\$ 15,639	\$ 15,071	\$ 8,660	\$ 18,051

Changes in the carrying amount of goodwill for each reportable segment were as follows (in thousands):

	Industrial	Process	Contractor	Total
Balance, December 31, 2021	\$ 185,733	\$ 141,304	\$ 29,218	\$ 356,255
Additions, adjustments from business acquisitions	—	16,994	—	16,994
Foreign currency translation	(10,162)	(3,442)	—	(13,604)
Balance, September 30, 2022	\$ 175,571	\$ 154,856	\$ 29,218	\$ 359,645

In the first quarter, the Company completed an acquisition of a business that is not material to the consolidated financial statements.

10. Other Current Liabilities

Components of other current liabilities were as follows (in thousands):

	September 30, 2022	December 31, 2021
Accrued self-insurance retentions	\$ 9,306	\$ 9,303
Accrued warranty and service liabilities	14,263	14,463
Accrued trade promotions	13,670	15,872
Payable for employee stock purchases	12,244	15,746
Customer advances and deferred revenue	60,657	60,554
Income taxes payable	13,652	5,200
Right of return refund liability	18,219	18,614
Operating lease liabilities, current	9,193	9,096
Other	41,553	42,311
Total	<u>\$ 192,757</u>	<u>\$ 191,159</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 31, 2021	\$ 14,463
Assumed in business acquisition	38
Charged to expense	6,251
Margin on parts sales reversed	1,811
Reductions for claims settled	(8,300)
Balance, September 30, 2022	<u>\$ 14,263</u>

Customer Advances and Deferred Revenue

Revenue is deferred when cash payments are received or due in advance of performance, including amounts which are refundable. This is also the case for services associated with certain product sales. During the three and nine months ended September 30, 2022, we recognized \$11.2 million and \$52.0 million, respectively, that was included in deferred revenue at December 31, 2021. During the three and nine months ended September 24, 2021, we recognized \$16.4 million and \$40.4 million, respectively, that was included in deferred revenue at December 25, 2020.

11. Fair Value

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

	Level	September 30, 2022	December 31, 2021
Assets			
Cash surrender value of life insurance	2	\$ 17,575	\$ 23,147
Forward exchange contracts	2	171	—
Total assets at fair value		<u>\$ 17,746</u>	<u>\$ 23,147</u>
Liabilities			
Contingent consideration	3	\$ 14,411	\$ 12,274
Deferred compensation	2	5,554	5,962
Forward exchange contracts	2	—	111
Total liabilities at fair value		<u>\$ 19,965</u>	<u>\$ 18,347</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 certain acquired businesses based on future revenues.

Long-term notes payable with fixed interest rates had a carrying amount of \$75 million and estimated fair value of \$75 million as of September 30, 2022. As of December 31, 2021, the long-term notes had a carrying amount of \$150 million and estimated fair value of \$165 million. 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.

Item 2. GRACO INC. AND SUBSIDIARIES

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

Overview

The Company supplies technology and expertise for the management of fluids and coatings in both industrial and commercial applications. It designs, manufactures and markets systems and equipment to move, measure, control, dispense and spray fluid and coating materials. 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 ongoing global COVID-19 pandemic and related governmental, business and societal responses continue to have an impact on our operations, supply chains, distribution channels, and end-user customers. The timing, duration, and extent of the impact from the pandemic in our major geographies is still uncertain and we cannot predict the magnitude of the impact to the results of our operations or financial position.

The Company continues to experience logistical and production constraints associated with raw materials and purchased components. These constraints were due to limited raw material and component availability, reduced freight capacity, shipping delays, and labor shortages as a result of responses to the COVID-19 pandemic and other supply chain disruptions. We also have experienced the effects of price inflation related to raw materials, purchased components, and freight and transportation costs. The supply chain disruptions and associated effects of inflation have adversely impacted profitability in the near-term and limited our ability to satisfy strengthening customer demand, especially within our high-volume Contractor segment. We expect these challenges to continue through the remainder of 2022.

The Company also has historically sold products to customers located in or associated with Russia and Belarus. In response to Russia's invasion of Ukraine, the United States, the United Kingdom, the European Union, Switzerland and others have implemented sanctions and export controls targeting Russia and Belarus and entities associated with those countries, which significantly limits our ability to sell certain products, serve certain customers and collect on our outstanding receivables in those countries. In the first quarter of 2022, we decided to suspend sales into Russia and Belarus for the time being. Sales to Russia and Belarus accounted for approximately 1.5% of our 2021 net sales and were not material for the first three quarters of 2022.

The duration and extent to which the pandemic and trade sanctions against Russia and Belarus affect the Company's business will depend on future developments which still remain uncertain.

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

A summary of financial results follows (in millions except per share amounts):

	Three Months Ended			Nine Months Ended		
	Sep 30, 2022	Sep 24, 2021	% Change	Sep 30, 2022	Sep 24, 2021	% Change
Net Sales	\$ 545.6	\$ 486.7	12 %	\$ 1,588.5	\$ 1,448.0	10 %
Operating Earnings	143.1	124.6	15 %	420.2	386.7	9 %
Net Earnings	116.2	103.8	12 %	334.5	319.6	5 %
Net Earnings, adjusted ⁽¹⁾	114.8	100.3	14 %	331.3	309.9	7 %
Diluted Net Earnings per Common Share	\$ 0.67	\$ 0.59	14 %	\$ 1.93	\$ 1.83	5 %
Diluted Net Earnings per Common Share, adjusted ⁽¹⁾	\$ 0.66	\$ 0.57	16 %	\$ 1.91	\$ 1.78	7 %

(1) See below for a reconciliation of adjusted non-GAAP financial measures to GAAP.

Sales increased 12 percent for the quarter and 10 percent year to date, with increases in all segments. Changes in currency translation rates reduced worldwide sales by \$20 million (5 percentage points) for the quarter and \$43 million (3 percentage points) for the year to date. Sales from acquired operations contributed approximately \$3 million (1 percentage point) for the quarter and \$8 million (1 percentage point) for the year to date.

Gross profit margin rates for the quarter and year to date decreased 3 percentage points as strong realized pricing was unable to offset higher product costs and unfavorable currency translation.

Total operating expenses decreased \$6 million (5 percentage points) for the quarter and \$8 million (2 percentage points) for the year to date primarily due to lower sales and earnings-based expenses. Expense leverage largely offset the effects of lower gross profit margin rates on operating earnings.

Excluding the impact of excess tax benefits related to stock option exercises and certain non-recurring tax provision adjustments presents a more consistent basis for comparison of financial results. A calculation of the non-GAAP measurements of adjusted income taxes, effective income tax rates, net earnings and diluted earnings per share follows (in millions except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 30, 2022	September 24, 2021	September 30, 2022	September 24, 2021
Earnings before income taxes	\$ 142.4	\$ 121.8	\$ 411.8	\$ 379.2
Income taxes, as reported	\$ 26.2	\$ 17.9	\$ 77.3	\$ 59.6
Excess tax benefit from option exercises	1.4	2.6	3.2	8.8
Other non-recurring tax benefit	—	0.9	—	0.9
Income taxes, adjusted	\$ 27.6	\$ 21.4	\$ 80.5	\$ 69.3
Effective income tax rate				
As reported	18.4 %	14.7 %	18.8 %	15.7 %
Adjusted	19.4 %	17.6 %	19.6 %	18.3 %
Net Earnings, as reported	\$ 116.2	\$ 103.8	\$ 334.5	\$ 319.6
Excess tax benefit from option exercises	(1.4)	(2.6)	(3.2)	(8.8)
Other non-recurring tax benefit	—	(0.9)	—	(0.9)
Net Earnings, adjusted	\$ 114.8	\$ 100.3	\$ 331.3	\$ 309.9
Weighted Average Diluted Shares	172.8	174.8	173.4	174.4
Diluted Earnings per Share				
As reported	\$ 0.67	\$ 0.59	\$ 1.93	\$ 1.83
Adjusted	\$ 0.66	\$ 0.57	\$ 1.91	\$ 1.78

The following table presents an overview of components of net earnings as a percentage of net sales:

	Three Months Ended		Nine Months Ended	
	September 30, 2022	September 24, 2021	September 30, 2022	September 24, 2021
Net Sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of products sold	52.2	49.0	50.6	47.6
Gross Profit	47.8	51.0	49.4	52.4
Product development	3.6	4.1	3.7	4.2
Selling, marketing and distribution	11.3	13.6	11.7	13.6
General and administrative	6.8	7.8	7.5	7.9
Operating Earnings	26.2	25.6	26.5	26.7
Interest expense	0.3	0.5	0.5	0.5
Other expense (income), net	(0.2)	0.1	—	—
Earnings Before Income Taxes	26.1	25.0	25.9	26.2
Income taxes	4.8	3.7	4.9	4.1
Net Earnings	21.3 %	21.3 %	21.1 %	22.1 %

Net Sales

The following table presents net sales by geographic region (in millions):

	Three Months Ended		Nine Months Ended	
	September 30, 2022	September 24, 2021	September 30, 2022	September 24, 2021
Americas ⁽¹⁾	\$ 333.4	\$ 280.4	\$ 964.8	\$ 847.3
EMEA ⁽²⁾	111.3	115.0	325.8	339.0
Asia Pacific	100.9	91.3	297.9	261.7
Consolidated	\$ 545.6	\$ 486.7	\$ 1,588.5	\$ 1,448.0

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

(2) Europe, Middle East and Africa

The following table presents the components of net sales change by geographic region:

	Three Months				Nine Months			
	Volume and Price	Acquisitions	Currency	Total	Volume and Price	Acquisitions	Currency	Total
Americas	18%	1%	0%	19%	13%	1%	0%	14%
EMEA	10%	0%	(13)%	(3)%	5%	1%	(10)%	(4)%
Asia Pacific	17%	1%	(8)%	10%	18%	1%	(5)%	14%
Consolidated	16%	1%	(5)%	12%	12%	1%	(3)%	10%

Gross Profit

Gross profit margin rates for the quarter and year to date decreased 3 percentage points from the comparable periods last year. Realized pricing was unable to offset continued increases in product costs and the adverse impacts of changes in currency translation rates.

Operating Expenses

Total operating expenses for the quarter decreased \$6 million (5 percent) compared to the third quarter last year. Reductions of \$5 million from the impact of currency translation and \$3 million from lower sales and earnings-based expenses were partially offset by volume and rate related increases. Year-to-date operating expenses decreased \$8 million compared to the same period last year. Reductions of \$10 million from the impact of currency translation and \$10 million from lower sales and earnings-based expenses were partially offset by \$3 million of allowances for credit losses on customer receivables in Russia and other volume and rate related increases.

Interest Expense

Interest expense increased \$1 million for the year to date and includes a \$3.5 million fee related to the prepayment of private placement debt in the first quarter of 2022.

Income Taxes

The effective income tax rate was 18 percent for the quarter and 19 percent for the year to date, up 3 percentage points, respectively, from the comparable periods last year. The increase was primarily due to decreases in excess tax benefits from stock option exercises and the unfavorable effects of foreign earnings taxed at higher rates than the U.S.

Segment Results

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

Industrial Segment

The following table presents net sales and operating earnings as a percentage of sales for the Industrial segment (dollars in millions):

	Three Months Ended		Nine Months Ended	
	September 30, 2022	September 24, 2021	September 30, 2022	September 24, 2021
Net Sales				
Americas	\$ 60.1	\$ 54.1	\$ 175.9	\$ 152.3
EMEA	48.1	53.9	141.6	144.5
Asia Pacific	47.9	46.4	141.7	132.0
Total	\$ 156.1	\$ 154.4	\$ 459.2	\$ 428.8
Operating earnings as a percentage of net sales	35 %	33 %	35 %	32 %

The following table presents the components of net sales change by geographic region for the Industrial segment:

	Three Months				Nine Months			
	Volume and Price	Acquisitions	Currency	Total	Volume and Price	Acquisitions	Currency	Total
Americas	11%	0%	0%	11%	16%	0%	(1)%	15%
EMEA	3%	0%	(14)%	(11)%	9%	0%	(11)%	(2)%
Asia Pacific	11%	0%	(8)%	3%	12%	0%	(5)%	7%
Segment Total	8%	0%	(7)%	1%	12%	0%	(5)%	7%

For both the quarter and year to date, strong Industrial segment sales growth in the Americas and Asia Pacific was partially offset by weakness in EMEA due to unfavorable macroeconomic conditions. The operating margin rate increased for both the quarter and year to date as strong realized pricing and expense leverage more than offset higher product costs and the adverse impacts of currency translation.

Process Segment

The following table presents net sales and operating earnings as a percentage of sales for the Process segment (dollars in millions):

	Three Months Ended		Nine Months Ended	
	September 30, 2022	September 24, 2021	September 30, 2022	September 24, 2021
Net Sales				
Americas	\$ 76.6	\$ 58.6	\$ 222.0	\$ 175.1
EMEA	16.6	13.8	51.4	44.4
Asia Pacific	32.2	23.8	91.5	65.3
Total	\$ 125.4	\$ 96.2	\$ 364.9	\$ 284.8
Operating earnings as a percentage of net sales	24 %	22 %	24 %	23 %

The following table presents the components of net sales change by geographic region for the Process segment:

	Three Months				Nine Months			
	Volume and Price	Acquisitions	Currency	Total	Volume and Price	Acquisitions	Currency	Total
Americas	27%	4%	0%	31%	24%	3%	0%	27%
EMEA	30%	1%	(11)%	20%	22%	1%	(7)%	16%
Asia Pacific	40%	1%	(7)%	34%	44%	1%	(5)%	40%
Segment Total	30%	4%	(4)%	30%	28%	2%	(2)%	28%

The Process segment had broad-based double-digit sales growth in all product applications and regions for the quarter and year to date. The operating margin rate for this segment increased 2 percentage points for the quarter and 1 percentage point for the year to date as increased volume and expense leverage offset higher product costs, unfavorable product and channel mix and the adverse impacts of currency translation.

Contractor Segment

The following table presents net sales and operating earnings as a percentage of sales for the Contractor segment (dollars in millions):

	Three Months Ended		Nine Months Ended	
	September 30, 2022	September 24, 2021	September 30, 2022	September 24, 2021
Net Sales				
Americas	\$ 196.7	\$ 167.6	\$ 566.9	\$ 519.9
EMEA	46.6	47.3	132.8	150.1
Asia Pacific	20.8	21.2	64.7	64.4
Total	\$ 264.1	\$ 236.1	\$ 764.4	\$ 734.4
Operating earnings as a percentage of net sales	25 %	25 %	25 %	28 %

The following table presents the components of net sales change by geographic region for the Contractor segment:

	Three Months				Nine Months			
	Volume and Price	Acquisitions	Currency	Total	Volume and Price	Acquisitions	Currency	Total
Americas	18%	0%	(1)%	17%	9%	0%	0%	9%
EMEA	12%	0%	(13)%	(1)%	(4)%	1%	(9)%	(12)%
Asia Pacific	7%	0%	(8)%	(1)%	6%	0%	(5)%	1%
Segment Total	16%	0%	(4)%	12%	6%	1%	(3)%	4%

Contractor segment sales increased 12 percent for the quarter compared to last year due to improved product availability. Sales increased 4 percent for the year to date primarily due to continued strength in North American construction markets. Price realization, favorable product and channel mix and expense leverage offset higher product costs for the quarter, which resulted in a consistent operating margin rate compared to last year. For the year to date, the operating margin rate decreased 3 percentage points primarily due to higher product costs and the adverse impacts of currency translation.

Liquidity and Capital Resources

Net cash provided by operating activities of \$272 million decreased \$86 million from the comparable period last year, mostly driven by increased salary and incentive payments, increased inventory purchases to meet demand levels and higher accounts receivable that reflect growth in business activity through the 2022 year to date. Significant uses of cash in 2022 included share repurchases of \$155 million, plant and equipment additions of \$147 million, dividend payments of \$107 million, prepayment of long-term debt of \$75 million, and \$25 million to acquire businesses that were not material to the consolidated financial statements. Proceeds from shares issued in 2022 totaled \$28 million.

Significant uses of cash in 2021 included dividend payments of \$95 million, property, plant and equipment additions of \$83 million and \$19 million to acquire businesses that were not material to the consolidated financial statements. Proceeds from shares issued in 2021 totaled \$40 million.

As of September 30, 2022, the Company had available liquidity of \$941 million, including cash and cash equivalents of \$415 million, of which \$275 million was held outside of the U.S., and available credit under existing committed credit facilities of \$526 million.

Cash balances and unused financing sources are expected to provide the Company with the flexibility to meet its liquidity needs in 2022, including its capital expenditure plan, planned dividends, share repurchases, acquisitions and operating requirements. Capital expenditures for 2022 are expected to be approximately \$230 million, including \$130 million in facility expansion projects. The Company may make opportunistic share repurchases going forward.

Outlook

Demand worldwide remains solid despite uncertain macroeconomic conditions. For the full-year 2022, the Company is raising its target to low double-digit sales growth on an organic, constant currency basis.

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 2021 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: the impact of the COVID-19 pandemic on our business; Russia's invasion of Ukraine, and the sanctions and actions taken against Russia and Belarus in response to the invasion; economic conditions in the United States and other major world economies; our Company's growth strategies, which include making acquisitions, investing in new products, expanding geographically and targeting new industries; changes in currency translation rates; the ability to meet our customers' needs and changes in product demand; supply interruptions or delays; security breaches; new entrants who copy our products or infringe on our intellectual property; risks incident to conducting business internationally; catastrophic events; changes in laws and regulations; compliance with anti-corruption and trade laws; changes in tax rates or the adoption of new tax legislation; 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; our ability to attract, develop and retain qualified personnel; the possibility of decline in purchases from a few large customers of the Contractor segment, variations in activity in the construction, automotive, mining and oil and natural gas industries, and the impact of declines in interest rates, asset values and investment returns on pension costs and required pension contributions. Please refer to Item 1A of our Annual Report on Form 10-K for fiscal year 2021 and Item 1A of this 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.

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 2021 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 and the Chief Financial Officer and Treasurer. Based upon that evaluation, the Company's President and Chief Executive Officer and the Chief Financial Officer and Treasurer 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

Except as noted below, there have been no material changes to the Company's risk factors from those disclosed in the Company's 2021 Annual Report on Form 10-K.

Russian Invasion of Ukraine – Russia's invasion of Ukraine, and the sanctions and actions taken against Russia and Belarus in response to the invasion, could adversely impact our business.

While our sales into Russia and Belarus are not material to our overall business, and we do not have any physical operations in Russia or Belarus or source raw materials or components directly from either country, the Russian invasion of Ukraine and the resulting sanctions and actions taken against Russia and Belarus by the United States, the United Kingdom, the European Union, Switzerland and others have considerably depressed demand for our products in Russia and Belarus and restricted our ability to sell certain products in those countries. As a result, we have decided to suspend sales into Russia and Belarus for the time being. We expect demand for our products in Russia and Belarus to remain depressed, and our ability to sell certain products in Russia and Belarus to continue to be restricted, for the foreseeable future. A significant escalation or expansion of the conflict beyond its current geographic, political and economic scope and scale could have a material adverse effect on our business, results of operations and financial condition, and could exacerbate other risks discussed in our 2021 Annual Report on Form 10-K. Such risks include, but are not limited to: an increase in the frequency and severity of the cybersecurity threats we and various third parties with whom we do business experience; unfavorable changes in exchange rates; further shortages, delivery delays and price inflation in a wide variety of raw materials and components; widespread reductions in end-user demand; and increased logistical challenges.

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 18 million shares of its outstanding common stock, primarily through open-market transactions. There were approximately 3.3 million shares remaining under the authorization on December 7, 2018, when the Board of Directors authorized the purchase of up to an additional 18 million shares. The authorizations are for an indefinite period of time or until terminated by the Board. Shares available for purchase under the April 2015 authorization were exhausted in the first quarter of 2022. Therefore, the Company will no longer purchase shares under the April 2015 authorization, and all purchases during the third quarter of 2022 were made under the December 2018 authorization.

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)
July 2, 2022 - July 29, 2022	—	\$ —	—	16,822,292
July 30, 2022 - August 26, 2022	—	\$ —	—	16,822,292
August 27, 2022 - September 30, 2022	772,716	\$ 61.17	—	16,049,576

Item 6. Exhibits

- 3.1 Restated Articles of Incorporation as amended December 8, 2017. ([Incorporated by reference to Exhibit 3.1 to the Company's Report on Form 8-K filed December 8, 2017.](#))
- 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.](#))
- [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 Third Quarter Earnings dated October 26, 2022.
- 101 Interactive data files pursuant to Rule 405 of Regulation S-T formatted in iXBRL (Inline eXtensible Business Reporting Language).
- 104 Cover Page Interactive Data File (formatted as iXBRL and contained in Exhibit 101).

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>October 26, 2022</u>	By:	<u>/s/ Mark W. Sheahan</u> Mark W. Sheahan President and Chief Executive Officer (Principal Executive Officer)
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Date:	<u>October 26, 2022</u>	By:	<u>/s/ David M. Lowe</u> David M. Lowe Chief Financial Officer and Treasurer (Principal Financial Officer)
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Date:	<u>October 26, 2022</u>	By:	<u>/s/ Kathryn L. Schoenrock</u> Kathryn L. Schoenrock Executive Vice President, Corporate Controller and Information Systems (Principal Accounting Officer)
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CERTIFICATION

I, Mark W. Sheahan, certify that:

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

Date: October 26, 2022

/s/ Mark W. Sheahan

Mark W. Sheahan
President and Chief Executive Officer

CERTIFICATION

I, David M. Lowe, certify that:

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

Date: October 26, 2022

/s/ David M. Lowe

David M. Lowe
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:	<u>October 26, 2022</u>	<u>/s/ Mark W. Sheahan</u> Mark W. Sheahan President and Chief Executive Officer
Date:	<u>October 26, 2022</u>	<u>/s/ David M. Lowe</u> David M. Lowe Chief Financial Officer and Treasurer



News Release

FOR IMMEDIATE RELEASE:

Wednesday, October 26, 2022

FOR FURTHER INFORMATION:

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David_M_Ahlers@graco.com

Graco Reports Record Third Quarter Results Double-Digit Sales Growth in Process and Contractor Segments

MINNEAPOLIS (October 26, 2022) – Graco Inc. (NYSE: GGG) today announced results for the third quarter ended September 30, 2022.

Summary

\$ in millions except per share amounts

	Three Months Ended			Nine Months Ended		
	Sep 30, 2022	Sep 24, 2021	% Change	Sep 30, 2022	Sep 24, 2021	% Change
Net Sales	\$ 545.6	\$ 486.7	12 %	\$ 1,588.5	\$ 1,448.0	10 %
Operating Earnings	143.1	124.6	15 %	420.2	386.7	9 %
Net Earnings	116.2	103.8	12 %	334.5	319.6	5 %
Diluted Net Earnings per Common Share	\$ 0.67	\$ 0.59	14 %	\$ 1.93	\$ 1.83	5 %
Adjusted (non-GAAP): ⁽¹⁾						
Net Earnings, adjusted	\$ 114.8	\$ 100.3	14 %	\$ 331.3	\$ 309.9	7 %
Diluted Net Earnings per Common Share, adjusted	\$ 0.66	\$ 0.57	16 %	\$ 1.91	\$ 1.78	7 %

(1) Excludes impacts of excess tax benefits from stock option exercises and certain non-recurring tax provision adjustments. See Financial Results Adjusted for Comparability below for a reconciliation of adjusted non-GAAP financial measures to GAAP.

- Changes in currency translation rates reduced sales and net earnings by approximately \$20 million and \$9 million, respectively, for the quarter.
- Sales for the quarter increased 12 percent, including 16 percentage points of organic sales growth and 1 percentage point of sales growth from acquired operations, partially offset by 5 percentage points of currency translation headwinds.
- The gross profit margin rate decreased approximately 3 percentage points for the quarter as strong realized pricing was unable to offset higher product costs and unfavorable currency translation.
- Total operating expenses decreased 5 percent for the quarter due to currency translation and lower sales and earnings-based expenses.
- Expense leverage largely offset the effects of lower gross profit margin rates on operating earnings.

"Graco delivered record third quarter sales and earnings despite rising costs and foreign currency headwinds," said Mark Sheahan, Graco's President and CEO. "Business tempo remained solid with strong growth in both revenue and operating earnings in all reportable segments and regions on an organic, constant currency basis."

Incoming orders outpaced product shipments in the quarter giving us substantial backlog as we enter the fourth quarter."

Consolidated Results

Changes in currency translation rates reduced sales and net earnings by approximately \$20 million and \$9 million, respectively, for the quarter and \$43 million and \$20 million, respectively, for the year to date.

Net sales for the quarter increased 12 percent from the comparable period last year (17 percent at consistent translation rates). Sales increased 19 percent in the Americas, 10 percent in Asia Pacific (18 percent at consistent translation rates) and decreased 3 percent in EMEA (up 10 percent at consistent translation rates). Year-to-date sales increased 10 percent from the comparable period last year (13 percent at consistent translation rates). Sales increased 14 percent in the Americas, 14 percent in Asia Pacific (19 percent at consistent translation rates) and decreased 4 percent in EMEA (up 6 percent at consistent translation rates). Sales from acquired operations contributed approximately \$3 million (1 percentage point) to the third quarter and \$8 million (1 percentage point) year to date.

Gross profit margin rates for the quarter and year to date decreased 3 percentage points from the comparable periods last year. Realized pricing was unable to offset higher product costs and the adverse impacts of changes in currency translation rates.

Total operating expenses for the quarter decreased \$6 million (5 percent) compared to the third quarter last year. Reductions of \$5 million from the impact of currency translation and \$3 million from lower sales and earnings-based expenses were partially offset by volume and rate related increases. Year-to-date operating expenses decreased \$8 million compared to the same period last year. Reductions of \$10 million from the impact of currency translation and \$10 million from lower sales and earnings-based expenses were partially offset by \$3 million of allowances for credit losses on customer receivables in Russia and volume and rate related increases.

The effective income tax rate was 18 percent for the quarter and 19 percent for the year to date, up approximately 3 percentage points respectively, from the comparable periods last year. The increases were primarily due to decreases in excess tax benefits from stock option exercises and the unfavorable effects of foreign earnings taxed at higher rates than the U.S.

Segment Results

Management assesses performance of segments by reference to operating earnings excluding unallocated corporate expenses. For a reconciliation of segment operating earnings to consolidated operating earnings, refer to the segment information table included in the financial statement section of this release. Certain measurements of segment operations are summarized below:

	Three Months			Nine Months		
	Industrial	Process	Contractor	Industrial	Process	Contractor
Net Sales (in millions)	\$ 156.1	\$ 125.4	\$ 264.1	\$ 459.2	\$ 364.9	\$ 764.4
Percentage change from last year						
Sales	1 %	30 %	12 %	7 %	28 %	4 %
Operating earnings	6 %	42 %	11 %	17 %	37 %	(5)%
Operating earnings as a percentage of sales						
2022	35 %	24 %	25 %	35 %	24 %	25 %
2021	33 %	22 %	25 %	32 %	23 %	28 %

Components of net sales change by geographic region for the Industrial segment were as follows:

	Three Months				Nine Months			
	Volume and Price	Acquisitions	Currency	Total	Volume and Price	Acquisitions	Currency	Total
Americas	11%	0%	0%	11%	16%	0%	(1)%	15%
EMEA	3%	0%	(14)%	(11)%	9%	0%	(11)%	(2)%
Asia Pacific	11%	0%	(8)%	3%	12%	0%	(5)%	7%
Consolidated	8%	0%	(7)%	1%	12%	0%	(5)%	7%

For both the quarter and year to date, strong Industrial segment sales growth in the Americas and Asia Pacific was partially offset by weakness in EMEA due to unfavorable macroeconomic conditions. The operating margin rate increased for both the quarter and year to date as strong realized pricing and expense leverage more than offset higher product costs and the adverse impacts of currency translation.

Components of net sales change by geographic region for the Process segment were as follows:

	Three Months				Nine Months			
	Volume and Price	Acquisitions	Currency	Total	Volume and Price	Acquisitions	Currency	Total
Americas	27%	4%	0%	31%	24%	3%	0%	27%
EMEA	30%	1%	(11)%	20%	22%	1%	(7)%	16%
Asia Pacific	40%	1%	(7)%	34%	44%	1%	(5)%	40%
Consolidated	30%	4%	(4)%	30%	28%	2%	(2)%	28%

The Process segment had double-digit sales growth in all product applications and regions for the quarter and year to date. The operating margin rate for this segment increased 2 percentage points for the quarter and 1 percentage point for the year to date as increased volume and expense leverage offset higher product costs, unfavorable product and channel mix and the adverse impacts of currency translation.

Components of net sales change by geographic region for the Contractor segment were as follows:

	Three Months				Nine Months			
	Volume and Price	Acquisitions	Currency	Total	Volume and Price	Acquisitions	Currency	Total
Americas	18%	0%	(1)%	17%	9%	0%	0%	9%
EMEA	12%	0%	(13)%	(1)%	(4)%	1%	(9)%	(12)%
Asia Pacific	7%	0%	(8)%	(1)%	6%	0%	(5)%	1%
Consolidated	16%	0%	(4)%	12%	6%	1%	(3)%	4%

Contractor segment sales increased 12 percent for the quarter compared to last year due to improved product availability. Sales increased 4 percent for the year to date primarily due to continued strength in North American construction markets. Price realization, favorable product and channel mix and expense leverage offset higher product costs for the quarter, which resulted in a consistent operating margin rate compared to last year. For the year to date, the operating margin rate decreased 3 percentage points primarily due to higher product costs and the adverse impacts of currency translation.

Outlook

"While macroeconomic conditions are uncertain, we are positioned to have a record year in 2022," said Sheahan. "We remain committed to our strategies of launching new products, entering new markets, expanding our global channel and pursuing strategic acquisitions. We are raising our full-year outlook to low double-digit organic revenue growth on a constant currency basis."

Financial Results Adjusted for Comparability

Excluding the impacts of excess tax benefits related to stock option exercises and certain non-recurring tax provision adjustments presents a more consistent basis for comparison of financial results. A calculation of the non-GAAP measurements of adjusted income taxes, effective income tax rates, net earnings and diluted earnings per share follows (in millions except per share amounts):

	Three Months Ended		Nine Months Ended	
	Sep 30, 2022	Sep 24, 2021	Sep 30, 2022	Sep 24, 2021
Earnings before income taxes	\$ 142.4	\$ 121.8	\$ 411.8	\$ 379.2
Income taxes, as reported	\$ 26.2	\$ 17.9	\$ 77.3	\$ 59.6
Excess tax benefit from option exercises	1.4	2.6	3.2	8.8
Other non-recurring tax benefit	—	0.9	—	0.9
Income taxes, adjusted	\$ 27.6	\$ 21.4	\$ 80.5	\$ 69.3
Effective income tax rate				
As reported	18.4 %	14.7 %	18.8 %	15.7 %
Adjusted	19.4 %	17.6 %	19.6 %	18.3 %
Net Earnings, as reported	\$ 116.2	\$ 103.8	\$ 334.5	\$ 319.6
Excess tax benefit from option exercises	(1.4)	(2.6)	(3.2)	(8.8)
Other non-recurring tax benefit	—	(0.9)	—	(0.9)
Net Earnings, adjusted	\$ 114.8	\$ 100.3	\$ 331.3	\$ 309.9
Weighted Average Diluted Shares	172.8	174.8	173.4	174.4
Diluted Earnings per Share				
As reported	\$ 0.67	\$ 0.59	\$ 1.93	\$ 1.83
Adjusted	\$ 0.66	\$ 0.57	\$ 1.91	\$ 1.78

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 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: the impact of the COVID-19 pandemic on our business; Russia’s invasion of Ukraine, and the sanctions and actions taken against Russia and Belarus in response to the invasion; economic conditions in the United States and other major world economies; our Company’s growth strategies, which include making acquisitions, investing in new products, expanding geographically and targeting new industries; changes in currency translation rates; the ability to meet our customers’ needs and changes in product demand; supply interruptions or delays; security breaches; new entrants who copy our products or infringe on our intellectual property; risks incident to conducting business internationally; catastrophic events; changes in laws and regulations; compliance with anti-corruption and trade laws; changes in tax rates or the adoption of new tax legislation; 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; our ability to attract, develop and retain qualified personnel; the possibility of decline in purchases from a few large customers of the Contractor segment; variations in activity in the construction, automotive, mining and oil and natural gas industries; and the impact of declines in interest rates, asset values and investment returns on pension costs and required pension contributions. Please refer to Item 1A of our Annual Report on Form 10-K for fiscal year 2021 (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.

Conference Call

Graco management will hold a conference call, including slides via webcast, with analysts and institutional investors on Thursday, October 27, 2022, at 11 a.m. ET, 10 a.m. CT, to discuss Graco’s third quarter results.

A real-time listen-only webcast of the conference call will be broadcast by Nasdaq. Individuals can access the call and view the slides on 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.

About Graco

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.

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

	Three Months Ended		Nine Months Ended	
	Sep 30, 2022	Sep 24, 2021	Sep 30, 2022	Sep 24, 2021
Net Sales	\$ 545,644	\$ 486,696	\$ 1,588,476	\$ 1,447,989
Cost of products sold	284,556	238,462	803,853	688,597
Gross Profit	261,088	248,234	784,623	759,392
Product development	19,704	19,762	58,749	60,739
Selling, marketing and distribution	61,386	66,078	186,457	197,432
General and administrative	36,849	37,795	119,225	114,493
Operating Earnings	143,149	124,599	420,192	386,728
Interest expense	1,542	2,500	8,555	7,456
Other expense (income), net	(866)	344	(106)	31
Earnings Before Income Taxes	142,473	121,755	411,743	379,241
Income taxes	26,241	17,926	77,290	59,607
Net Earnings	\$ 116,232	\$ 103,829	\$ 334,453	\$ 319,634
Net Earnings per Common Share				
Basic	\$ 0.69	\$ 0.61	\$ 1.97	\$ 1.89
Diluted	\$ 0.67	\$ 0.59	\$ 1.93	\$ 1.83
Weighted Average Number of Shares				
Basic	169,166	169,834	169,368	169,459
Diluted	172,789	174,774	173,388	174,398

SEGMENT INFORMATION (Unaudited)
(In thousands)

	Three Months Ended		Nine Months Ended	
	Sep 30, 2022	Sep 24, 2021	Sep 30, 2022	Sep 24, 2021
Net Sales				
Industrial	\$ 156,182	\$ 154,560	\$ 459,176	\$ 428,872
Process	125,376	96,185	364,883	284,790
Contractor	264,086	235,951	764,417	734,327
Total	\$ 545,644	\$ 486,696	\$ 1,588,476	\$ 1,447,989
Operating Earnings				
Industrial	\$ 53,964	\$ 50,812	\$ 161,795	\$ 138,879
Process	30,638	21,514	89,183	64,923
Contractor	65,123	58,659	192,314	203,366
Unallocated corporate (expense)	(6,576)	(6,386)	(23,100)	(20,440)
Total	\$ 143,149	\$ 124,599	\$ 420,192	\$ 386,728