**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 29, 2017**

Commission File Number: 001-09249

# GRACO INC.

(Exact name of registrant as specified in its charter)

| Minnesota | 41-0285640 |
|---|---|
| (State of incorporation) | (I.R.S. Employer Identification Number) |
| 88 - 11th Avenue N.E.<br>Minneapolis, Minnesota | 55413 |
| (Address of principal executive offices) | (Zip Code) |

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (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 X No ___

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

Yes X No ___

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

Large Accelerated Filer X Accelerated Filer ___ Non-accelerated Filer ___ Smaller reporting company ___

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

Yes ___ No X

56,130,000 shares of the Registrant's Common Stock, $1.00 par value, were outstanding as of October 19, 2017.

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## 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 29, 2017 | September 23, 2016 | September 29, 2017 | September 23, 2016 |
| Net Sales | $ 379,812 | $ 327,192 | $ 1,099,885 | $ 980,230 |
| Cost of products sold | 176,347 | 150,594 | 507,206 | 456,695 |
| Gross Profit | 203,465 | 176,598 | 592,679 | 523,535 |
| Product development | 14,815 | 14,671 | 44,215 | 44,964 |
| Selling, marketing and distribution | 57,941 | 49,269 | 168,912 | 158,106 |
| General and administrative | 31,072 | 31,194 | 95,325 | 99,710 |
| Operating Earnings | 99,637 | 81,464 | 284,227 | 220,755 |
| Interest expense | 3,901 | 4,432 | 12,110 | 13,468 |
| Other expense (income), net | (656) | 416 | (1,454) | (338) |
| Earnings Before Income Taxes | 96,392 | 76,616 | 273,571 | 207,625 |
| Income taxes | 20,932 | 22,228 | 57,551 | 62,738 |
| Net Earnings | $ 75,460 | $ 54,388 | $ 216,020 | $ 144,887 |
| Per Common Share | | | | |
| Basic net earnings | $ 1.35 | $ 0.98 | $ 3.87 | $ 2.61 |
| Diluted net earnings | $ 1.30 | $ 0.95 | $ 3.73 | $ 2.55 |
| Cash dividends declared | $ 0.36 | $ 0.33 | $ 1.08 | $ 0.99 |

See notes to consolidated financial statements.

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2017 | September 23, 2016 | September 29, 2017 | September 23, 2016 |
| Net Earnings | $ 75,460 | $ 54,388 | $ 216,020 | $ 144,887 |
| Components of other comprehensive income (loss) | | | | |
| Cumulative translation adjustment | 574 | (6,642) | 17,921 | (16,679) |
| Pension and postretirement medical liability adjustment | 2,250 | 1,707 | 6,034 | 4,957 |
| Income taxes - pension and postretirement medical liability adjustment | (797) | (619) | (2,280) | (1,823) |
| Other comprehensive income (loss) | 2,027 | (5,554) | 21,675 | (13,545) |
| Comprehensive Income | $ 77,487 | $ 48,834 | $ 237,695 | $ 131,342 |

See notes to consolidated financial statements.

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

| | September 29, 2017 | December 30, 2016 |
|---|---|---|
| **ASSETS** | | |
| Current Assets | | |
| Cash and cash equivalents | $ 140,000 | $ 52,365 |
| Accounts receivable, less allowances of $14,100 and $12,700 | 258,632 | 218,365 |
| Inventories | 222,878 | 201,609 |
| Other current assets | 20,889 | 31,023 |
| Total current assets | 642,399 | 503,362 |
| Property, Plant and Equipment | | |
| Cost | 518,486 | 489,642 |
| Accumulated depreciation | (319,058) | (300,046) |
| Property, Plant and Equipment, net | 199,428 | 189,596 |
| Goodwill | 272,858 | 259,849 |
| Other Intangible Assets, net | 181,108 | 178,336 |
| Deferred Income Taxes | 81,756 | 86,653 |
| Other Assets | 26,674 | 25,313 |
| Total Assets | $ 1,404,223 | $ 1,243,109 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Current Liabilities | | |
| Notes payable to banks | $ 6,215 | $ 8,913 |
| Current portion of long term debt | 75,000 | — |
| Trade accounts payable | 46,603 | 39,988 |
| Salaries and incentives | 49,574 | 37,109 |
| Dividends payable | 20,196 | 20,088 |
| Other current liabilities | 90,683 | 71,887 |
| Total current liabilities | 288,271 | 177,985 |
| Long-term Debt | 225,000 | 305,685 |
| Retirement Benefits and Deferred Compensation | 145,224 | 159,250 |
| Deferred Income Taxes | 17,433 | 17,672 |
| Other Non-current Liabilities | 8,306 | 8,697 |
| Shareholders' Equity | | |
| Common stock | 56,115 | 55,834 |
| Additional paid-in-capital | 504,072 | 453,394 |
| Retained earnings | 280,355 | 206,820 |
| Accumulated other comprehensive income (loss) | (120,553) | (142,228) |
| Total shareholders' equity | 719,989 | 573,820 |
| Total Liabilities and Shareholders' Equity | $ 1,404,223 | $ 1,243,109 |

See notes to consolidated financial statements.

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

| | Nine Months Ended | |
|---|---|---|
| | September 29, 2017 | September 23, 2016 |
| **Cash Flows From Operating Activities** | | |
| Net Earnings | $ 216,020 | $ 144,887 |
| Adjustments to reconcile net earnings to net cash provided by operating activities | | |
| Depreciation and amortization | 33,620 | 36,846 |
| Deferred income taxes | 58 | (8,470) |
| Share-based compensation | 19,154 | 16,143 |
| Change in | | |
| Accounts receivable | (31,614) | 6,100 |
| Inventories | (16,788) | 1,628 |
| Trade accounts payable | 4,319 | 1,057 |
| Salaries and incentives | 7,214 | (6,914) |
| Retirement benefits and deferred compensation | (8,595) | 7,431 |
| Other accrued liabilities | 25,402 | 9,379 |
| Other | (2,642) | (367) |
| Net cash provided by operating activities | 246,148 | 207,720 |
| **Cash Flows From Investing Activities** | | |
| Property, plant and equipment additions | (28,899) | (34,347) |
| Acquisition of businesses, net of cash acquired | (12,905) | (48,643) |
| Change in restricted assets | 1,349 | 150 |
| Other | (124) | (130) |
| Net cash provided by (used in) investing activities | (40,579) | (82,970) |
| **Cash Flows From Financing Activities** | | |
| Borrowings (payments) on short-term lines of credit, net | (3,361) | (7,349) |
| Borrowings on long-term line of credit | 293,880 | 532,724 |
| Payments on long-term line of credit | (299,565) | (569,639) |
| Common stock issued | 53,422 | 28,729 |
| Common stock repurchased | (90,160) | (48,050) |
| Taxes paid related to net share settlement of equity awards | (10,735) | (3,165) |
| Cash dividends paid | (60,273) | (55,058) |
| Net cash provided by (used in) financing activities | (116,792) | (121,808) |
| Effect of exchange rate changes on cash | (1,142) | (1,915) |
| Net increase (decrease) in cash and cash equivalents | 87,635 | 1,027 |
| **Cash and Cash Equivalents** | | |
| Beginning of year | 52,365 | 52,295 |
| End of period | $ 140,000 | $ 53,322 |

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 29, 2017 and the related statements of earnings and comprehensive income for the three and nine months ended September 29, 2017 and September 23, 2016, and cash flows for the nine months ended September 29, 2017 and September 23, 2016 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 29, 2017, 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 2016 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):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2017 | September 23, 2016 | September 29, 2017 | September 23, 2016 |
| Net earnings available to common shareholders | $ 75,460 | $ 54,388 | $ 216,020 | $ 144,887 |
| Weighted average shares outstanding for basic earnings per share | 56,023 | 55,684 | 55,864 | 55,571 |
| Dilutive effect of stock options computed using the treasury stock method and the average market price | 2,181 | 1,285 | 2,084 | 1,335 |
| Weighted average shares outstanding for diluted earnings per share | 58,204 | 56,969 | 57,948 | 56,906 |
| Basic earnings per share | $ 1.35 | $ 0.98 | $ 3.87 | $ 2.61 |
| Diluted earnings per share | $ 1.30 | $ 0.95 | $ 3.73 | $ 2.55 |

Stock options to purchase 6,000 and 1,034,000 shares were not included in the September 29, 2017 and September 23, 2016 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 30, 2016 | 5,535 | $ 55.26 | 3,672 | $ 45.40 |
| Granted | 575 | 92.13 | | |
| Exercised | (1,138) | 40.97 | | |
| Canceled | (38) | 80.31 | | |
| Outstanding, September 29, 2017 | 4,934 | $ 62.66 | 3,071 | $ 51.40 |

The Company recognized year-to-date share-based compensation of $19.2 million in 2017 and $16.1 million in 2016. As of September 29, 2017, there was $12.5 million of unrecognized compensation cost related to unvested options, expected to be recognized over a weighted average period of 2.3 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 29, 2017 | September 23, 2016 |
| Expected life in years | 7.0 | 7.0 |
| Interest rate | 2.2% | 1.4% |
| Volatility | 26.7% | 30.1% |
| Dividend yield | 1.6% | 1.8% |
| Weighted average fair value per share | $ 24.23 | $ 19.00 |

Under the Company’s Employee Stock Purchase Plan, the Company issued 167,000 shares in 2017 and 170,000 shares in 2016. 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 29, 2017 | September 23, 2016 |
| Expected life in years | 1.0 | 1.0 |
| Interest rate | 0.9% | 0.7% |
| Volatility | 22.3% | 24.6% |
| Dividend yield | 1.5% | 1.7% |
| Weighted average fair value per share | $ 21.97 | $ 19.14 |

## 4. 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 29, 2017 | September 23, 2016 | September 29, 2017 | September 23, 2016 |
| Pension Benefits | | | | |
| Service cost | $ 1,917 | $ 1,968 | $ 5,732 | $ 5,880 |
| Interest cost | 3,874 | 3,902 | 11,477 | 11,765 |
| Expected return on assets | (4,236) | (4,504) | (12,700) | (13,509) |
| Amortization and other | 2,408 | 2,491 | 6,932 | 7,410 |
| Net periodic benefit cost | $ 3,963 | $ 3,857 | $ 11,441 | $ 11,546 |
| Postretirement Medical | | | | |
| Service cost | $ 150 | $ 136 | $ 451 | $ 407 |
| Interest cost | 274 | 271 | 820 | 813 |
| Amortization | (2) | (120) | (7) | (360) |
| Net periodic benefit cost | $ 422 | $ 287 | $ 1,264 | $ 860 |

The Company made a $20 million tax-deductible contribution to its funded U.S. defined benefit plan in the third quarter of 2017. Also in the third quarter, the Company approved an amendment to restructure the plan effective October 30, 2017. Under the restructuring, the plan will purchase insurance contracts to settle a portion of its benefit obligations. The Company expects that net periodic benefit cost for the fourth quarter will include a settlement loss related to the restructuring, estimated to be in the range of $11 million to $13 million. The actual amount of the settlement loss will depend on the value of plan assets, the amount transferred to the insurance company and the discount rate as of the measurement date.

## 5. Shareholders' Equity

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

| | Pension and Postretirement Medical | Cumulative Translation Adjustment | Total |
|---|---|---|---|
| Balance, June 24, 2016 | $ (67,876) | $ (44,612) | $ (112,488) |
| Other comprehensive income (loss) before reclassifications | — | (6,642) | (6,642) |
| Amounts reclassified from accumulated other comprehensive income | 1,088 | — | 1,088 |
| Balance, September 23, 2016 | $ (66,788) | $ (51,254) | $ (118,042) |
| Balance, June 30, 2017 | $ (74,125) | $ (48,455) | $ (122,580) |
| Other comprehensive income (loss) before reclassifications | — | 574 | 574 |
| Amounts reclassified from accumulated other comprehensive income | 1,453 | — | 1,453 |
| Balance, September 29, 2017 | $ (72,672) | $ (47,881) | $ (120,553) |
| Balance, December 25, 2015 | $ (69,922) | $ (34,575) | $ (104,497) |
| Other comprehensive income (loss) before reclassifications | — | (16,679) | (16,679) |
| Amounts reclassified from accumulated other comprehensive income | 3,134 | — | 3,134 |
| Balance, September 23, 2016 | $ (66,788) | $ (51,254) | $ (118,042) |
| Balance, December 30, 2016 | $ (76,426) | $ (65,802) | $ (142,228) |
| Other comprehensive income (loss) before reclassifications | — | 17,921 | 17,921 |
| Amounts reclassified from accumulated other comprehensive income | 3,754 | — | 3,754 |
| Balance, September 29, 2017 | $ (72,672) | $ (47,881) | $ (120,553) |

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):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2017 | September 23, 2016 | September 29, 2017 | September 23, 2016 |
| Cost of products sold | $ 765 | $ 611 | $ 2,093 | $ 1,776 |
| Product development | 331 | 241 | 887 | 706 |
| Selling, marketing and distribution | 703 | 578 | 1,865 | 1,633 |
| General and administrative | 451 | 277 | 1,189 | 842 |
| Total before tax | $ 2,250 | $ 1,707 | $ 6,034 | $ 4,957 |
| Income tax (benefit) | (797) | (619) | (2,280) | (1,823) |
| Total after tax | $ 1,453 | $ 1,088 | $ 3,754 | $ 3,134 |

On February 21, 2017, the Company entered into an accelerated share repurchase arrangement ("ASR") with a financial institution. In exchange for an up-front payment of $90 million, the financial institution delivered 850,000 shares of Company common stock with a fair value of $78 million. The total number of shares ultimately delivered under the ASR was determined at the end of the purchase period based on the volume weighted-average price ("VWAP") of the Company's common stock during that period. The purchase period ended in the third quarter and the Company received an additional 31,499 shares to complete the ASR at an average realized price of $102.10 per share.

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

## 6. Segment Information

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 29, 2017 | September 23, 2016 | September 29, 2017 | September 23, 2016 |
| Net Sales | | | | |
| Industrial | $ 178,461 | $ 150,893 | $ 509,719 | $ 454,978 |
| Process | 73,656 | 67,077 | 217,084 | 196,068 |
| Contractor | 127,695 | 109,222 | 373,082 | 329,184 |
| Total | $ 379,812 | $ 327,192 | $ 1,099,885 | $ 980,230 |
| Operating Earnings | | | | |
| Industrial | $ 61,790 | $ 50,573 | $ 177,121 | $ 147,419 |
| Process | 12,088 | 10,394 | 38,969 | 25,305 |
| Contractor | 33,471 | 25,593 | 93,249 | 71,700 |
| Unallocated corporate (expense) | (7,712) | (5,096) | (25,112) | (23,669) |
| Total | $ 99,637 | $ 81,464 | $ 284,227 | $ 220,755 |

Assets by segment were as follows (in thousands):

| | September 29, 2017 | December 30, 2016 |
|---|---|---|
| Industrial | $ 575,024 | $ 546,366 |
| Process | 335,769 | 318,444 |
| Contractor | 254,342 | 208,016 |
| Unallocated corporate | 239,088 | 170,283 |
| Total | $ 1,404,223 | $ 1,243,109 |

Geographic information follows (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2017 | September 23, 2016 | September 29, 2017 | September 23, 2016 |
| Net Sales (based on customer location) | | | | |
| United States | $ 190,178 | $ 171,988 | $ 559,651 | $ 511,273 |
| Other countries | 189,634 | 155,204 | 540,234 | 468,957 |
| Total | $ 379,812 | $ 327,192 | $ 1,099,885 | $ 980,230 |

| | September 29, 2017 | December 30, 2016 |
|---|---|---|
| Long-lived Assets | | |
| United States | $ 161,034 | $ 151,911 |
| Other countries | 38,394 | 37,685 |
| Total | $ 199,428 | $ 189,596 |

7. Inventories

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

| | September 29, 2017 | December 30, 2016 |
|---|---|---|
| Finished products and components | $ 111,481 | $ 113,643 |
| Products and components in various stages of completion | 59,961 | 50,557 |
| Raw materials and purchased components | 98,720 | 84,631 |
| Subtotal | 270,162 | 248,831 |
| Reduction to LIFO cost | (47,284) | (47,222) |
| Total | $ 222,878 | $ 201,609 |

8. Intangible Assets

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

| | Finite Life | | | Indefinite Life | |
|---|---|---|---|---|---|
| | Customer Relationships | Patents and Proprietary Technology | Trademarks, Trade Names and Other | Trade Names | Total |
| As of September 29, 2017 | | | | | |
| Cost | $ 176,065 | $ 18,322 | $ 1,070 | $ 57,853 | $ 253,310 |
| Accumulated amortization | (51,312) | (7,448) | (472) | — | (59,232) |
| Foreign currency translation | (9,029) | (703) | (57) | (3,181) | (12,970) |
| Book value | $ 115,724 | $ 10,171 | $ 541 | $ 54,672 | $ 181,108 |
| Weighted average life in years | 13 | 10 | 4 | N/A | |
| As of December 30, 2016 | | | | | |
| Cost | $ 170,284 | $ 17,321 | $ 895 | $ 57,853 | $ 246,353 |
| Accumulated amortization | (41,599) | (6,088) | (337) | — | (48,024) |
| Foreign currency translation | (13,630) | (1,055) | (59) | (5,249) | (19,993) |
| Book value | $ 115,055 | $ 10,178 | $ 499 | $ 52,604 | $ 178,336 |
| Weighted average life in years | 13 | 10 | 4 | N/A | |

Amortization of intangibles for the quarter was $3.8 million in 2017 and $4.6 million in 2016 and for the year to date was $11.0 million in 2017 and $14.3 million in 2016. Estimated annual amortization expense based on the current carrying amount of other intangible assets is as follows (in thousands):

| | 2017 | 2018 | 2019 | 2020 | 2021 | Thereafter |
|---|---|---|---|---|---|---|
| Estimated Amortization Expense | $ 14,834 | $ 14,959 | $ 14,630 | $ 14,448 | $ 14,279 | $ 64,311 |

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

| | Industrial | Process | Contractor | Total |
|---|---|---|---|---|
| Balance, December 30, 2016 | $ 150,556 | $ 96,561 | $ 12,732 | $ 259,849 |
| Additions (adjustments) from business acquisitions | 7,152 | (63) | — | 7,089 |
| Foreign currency translation | 4,480 | 1,440 | — | 5,920 |
| Balance, September 29, 2017 | $ 162,188 | $ 97,938 | $ 12,732 | $ 272,858 |

## 9. Other Current Liabilities

Components of other current liabilities were (in thousands):

| | September 29, 2017 | December 30, 2016 |
|---|---|---|
| Accrued self-insurance retentions | $ 7,164 | $ 7,105 |
| Accrued warranty and service liabilities | 9,876 | 8,934 |
| Accrued trade promotions | 8,126 | 6,007 |
| Payable for employee stock purchases | 7,188 | 9,328 |
| Customer advances and deferred revenue | 21,097 | 9,400 |
| Income taxes payable | 9,778 | 8,608 |
| Other | 27,454 | 22,505 |
| Total | $ 90,683 | $ 71,887 |

The Company manages certain self-insured loss exposures through a wholly-owned captive insurance subsidiary. Cash balances of $7.9 million as of September 29, 2017 and $9.2 million as of December 30, 2016 were restricted to funding of the captive's loss reserves and are included within other current assets on the Company's Consolidated Balance Sheets.

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 30, 2016 | $ 8,934 |
| Charged to expense | 5,708 |
| Margin on parts sales reversed | 1,977 |
| Reductions for claims settled | (6,743) |
| Balance, September 29, 2017 | $ 9,876 |

## 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 | September 29, 2017 | December 30, 2016 |
|---|---|---|---|
| Assets | | | |
| Cash surrender value of life insurance | 2 | $ 15,480 | $ 13,785 |
| Forward exchange contracts | 2 | 513 | 571 |
| Total assets at fair value | | $ 15,993 | $ 14,356 |
| Liabilities | | | |
| Contingent consideration | 3 | $ 4,081 | $ 4,081 |
| Deferred compensation | 2 | 3,640 | 3,265 |
| Forward exchange contracts | 2 | — | — |
| Total liabilities at fair value | | $ 7,721 | $ 7,346 |

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 (including $75 million classified as current) and an estimated fair value of $325 million as of September 29, 2017 and $325 million as of December 30, 2016. 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. Recent Accounting Pronouncements

A new accounting standard that changed certain aspects of accounting for share-based payments became effective for the Company in the first quarter of 2017. Excess tax benefits on exercised stock options that were previously credited to equity now reduce the current income tax provision. For the quarter, the change in accounting for excess tax benefits decreased the current income tax provision and increased net earnings by $3.2 million, reduced the effective income tax rate by 3 percentage points, and increased diluted earnings per share by $0.06. For the year to date, the change in accounting for excess tax benefits decreased the current income tax provision and increased net earnings by $20.5 million, reduced the effective income tax rate by 7 percentage points, and increased diluted earnings per share by $0.36. Under the new standard, excess tax benefits are no longer reclassified out of cash flows from operating activities to financing activities in the Consolidated Statements of Cash Flows. We elected to apply the cash flow presentation requirements retrospectively to all periods presented, which resulted in a year-to-date increase in previously reported net cash provided by operating activities and a decrease in net cash provided by financing activities of $5.5 million for the nine months ended September 23, 2016. Also under the new standard, the Company elected to account for share-based grant forfeitures as they occur. The impact of the change in accounting for forfeitures was not significant, and was reflected in share-based compensation cost in the first quarter.

In May 2014, the Financial Accounting Standards Board (FASB) issued a final standard on revenue from contracts with customers. The new standard sets forth a single comprehensive model for recognizing and reporting revenue. The new standard will become effective for the Company beginning with the first quarter of 2018, and the Company plans to adopt the accounting standard using the modified retrospective transition approach. The modified retrospective transition approach will recognize any changes from the beginning of the year of initial application through retained earnings with no restatement of comparative periods.

We have established an implementation team and engaged a third-party consultant to assist with our assessment of the impact of the new revenue guidance on our operations, consolidated financial statements and related disclosures. To date, this assessment has included (1) utilizing questionnaires to assist with the identification of our revenue streams, (2) performing contract analyses for each revenue stream identified, (3) assessing the noted differences in recognition and measurement that may result from adopting this new standard, (4) performing detailed analyses of contracts with large customers, and (5) performing transaction level testing (based on our designed test plans) for consistency with contract provisions that affect revenue recognition. Based on the preliminary results of the evaluation, which is still in process, nothing has come to our attention that would indicate that adoption of the new standard will have a material impact on our consolidated financial statements. However, given our acquisition strategy, there may be additional revenue streams acquired prior to the adoption date. We currently believe the most significant potential change relates to whether certain project-based revenues will be recognized over time or at a point in time, although our technical analysis of potential impacts is still on-going. We also anticipate changes to the consolidated balance sheet related to accounts receivable, contract assets, and contract liabilities.

We are in the process of evaluating and designing the necessary changes to our business processes, policies, systems and controls to support recognition and disclosure under the new standard. Further, we are continuing to assess what incremental disaggregated revenue disclosures will be required in our consolidated financial statements. The implementation team has reported these findings and the progress of the project to the Audit Committee of our Board of Directors.

In March 2017, the FASB issued a final standard that changes the presentation of net periodic benefit cost related to defined benefit plans. The Company will adopt the standard when it becomes effective in fiscal 2018 and it will be applied retrospectively to all periods presented. Under the new standard, net periodic benefit costs are required to be disaggregated between service costs presented as operating expenses and other components of pension costs presented as non-operating expenses. The Company currently charges service costs to segment operations and includes other components of pension cost in unallocated corporate operating expenses. Under the new standard, unallocated corporate operating expenses will decrease, operating earnings will increase and other expense will increase by the amount of other (non-service) components of pension cost. There will be no impact on reported segment earnings, net earnings or earnings per share.

# 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 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 | | |
|---|---|---|---|---|---|---|
| | September 29, 2017 | September 23, 2016 | % Change | September 29, 2017 | September 23, 2016 | % Change |
| Net Sales | $ 379.8 | $ 327.2 | 16% | $ 1,099.9 | $ 980.2 | 12% |
| Operating Earnings | 99.6 | 81.5 | 22% | 284.2 | 220.8 | 29% |
| Net Earnings | 75.5 | 54.4 | 39% | 216.0 | 144.9 | 49% |
| Net Earnings adjusted (1) | 66.8 | 54.4 | 23% | 190.0 | 144.9 | 31% |
| Diluted Net Earnings per Common Share | $ 1.30 | $ 0.95 | 37% | $ 3.73 | $ 2.55 | 46% |
| Diluted Net Earnings per Common Share, adjusted (1) | $ 1.15 | $ 0.95 | 21% | $ 3.28 | $ 2.55 | 29% |

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

All segments and regions had double-digit percentage sales growth for the quarter and year to date. Sales growth and operating expense leverage drove operating earnings increases of 22 percent for the quarter and 29 percent for the year to date.

Adoption of a new stock compensation accounting standard and recognition of certain tax planning benefits in 2017 created large fluctuations in net earnings compared to prior periods. Excluding the excess tax benefits on exercised stock options and other tax planning benefits recognized as reductions of income taxes in 2017 presents a more consistent comparison of financial results. A calculation of the non-GAAP measurements of adjusted income taxes, net earnings and diluted earnings per share follows (in millions except per share amounts):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | Sep 29, 2017 | Sep 23, 2016 | Sep 29, 2017 | Sep 23, 2016 |
| Income taxes, as reported | $ 20.9 | $ 22.2 | $ 57.6 | $ 62.7 |
| Excess tax benefit from option exercises | 3.2 | — | 20.5 | — |
| Tax planning benefit | 5.5 | — | 5.5 | — |
| Income taxes, adjusted | $ 29.6 | $ 22.2 | $ 83.6 | $ 62.7 |
| | | | | |
| Effective income tax rate | | | | |
| As reported | 22% | 29% | 21% | 30% |
| Adjusted | 31% | 29% | 31% | 30% |
| | | | | |
| Net Earnings, as reported | $ 75.5 | $ 54.4 | $ 216.0 | $ 144.9 |
| Excess tax benefit from option exercises | (3.2) | — | (20.5) | — |
| Tax planning benefit | (5.5) | — | (5.5) | — |
| Net Earnings, adjusted | $ 66.8 | $ 54.4 | $ 190.0 | $ 144.9 |
| | | | | |
| Weighted Average Diluted Shares | 58.2 | 57.0 | 57.9 | 56.9 |
| Diluted Earnings per Share | | | | |
| As reported | $ 1.30 | $ 0.95 | $ 3.73 | $ 2.55 |
| Adjusted | $ 1.15 | $ 0.95 | $ 3.28 | $ 2.55 |

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2017 | September 23, 2016 | September 29, 2017 | September 23, 2016 |
| Net Sales | 100.0 % | 100.0% | 100.0 % | 100.0 % |
| Cost of products sold | 46.4 | 46.0 | 46.1 | 46.6 |
| Gross Profit | 53.6 | 54.0 | 53.9 | 53.4 |
| Product development | 3.9 | 4.5 | 4.0 | 4.6 |
| Selling, marketing and distribution | 15.3 | 15.1 | 15.4 | 16.1 |
| General and administrative | 8.2 | 9.5 | 8.7 | 10.2 |
| Operating Earnings | 26.2 | 24.9 | 25.8 | 22.5 |
| Interest expense | 1.0 | 1.4 | 1.1 | 1.3 |
| Other expense (income), net | (0.2) | 0.1 | (0.1) | — |
| Earnings Before Income Taxes | 25.4 | 23.4 | 24.8 | 21.2 |
| Income taxes | 5.5 | 6.8 | 5.2 | 6.4 |
| Net Earnings | 19.9 % | 16.6% | 19.6 % | 14.8 % |

## Net Sales

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2017 | September 23, 2016 | September 29, 2017 | September 23, 2016 |
| Americas[1] | $ 217.7 | $ 194.4 | $ 639.1 | $ 575.3 |
| EMEA[2] | 86.7 | 73.6 | 252.8 | 229.4 |
| Asia Pacific | 75.4 | 59.2 | 208.0 | 175.5 |
| Consolidated | $ 379.8 | $ 327.2 | $ 1,099.9 | $ 980.2 |

(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 Ended | | | | Nine Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | Volume and Price | Acquisitions | Currency | Total | Volume and Price | Acquisitions | Currency | Total |
| Americas | 11% | 1% | 0% | 12% | 11% | 0% | 0% | 11% |
| EMEA | 14% | 0% | 4% | 18% | 12% | 0% | (2)% | 10% |
| Asia Pacific | 28% | 0% | (1)% | 27% | 20% | 0% | (2)% | 18% |
| Consolidated | 15% | 0% | 1% | 16% | 13% | 0% | (1)% | 12% |

## Gross Profit

Gross profit margin rate decreased by one-half percentage point for the quarter and increased one-half percentage point for the year to date. Favorable effects from higher production volume and realized pricing were offset in varying degrees for the quarter and the year to date by the unfavorable impact of product mix.

## Operating Expenses

Total operating expenses for the quarter increased $9 million (9 percent) compared to the third quarter last year. More than half of the increase was from increases in sales and earnings-based incentives and unallocated corporate operating expense (mostly from market-based stock compensation and pension costs). Year-to-date operating expenses increased $6 million (2 percent). Volume and rate-related increases were partially offset by a $3 million decrease in amortization expense and the impact of currency translation.

## Income Taxes

The effective income tax rate for the quarter was 22 percent, down from 29 percent last year. The effective income tax rate for the year to date was 21 percent, down from 30 percent last year. Adoption of a new accounting standard, requiring excess tax benefits related to stock option exercises to be credited to the income tax provision (formerly credited to equity), reduced the tax provision by $3.2 million for the quarter and $20.5 million for the year to date, decreasing the effective tax rate for the quarter and year to date by 3 and 7 percentage points, respectively. The effective tax rates for both the quarter and year to date were further reduced by the impacts of tax planning that will not recur in 2018 and foreign earnings taxed at lower 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 29, 2017 | September 23, 2016 | September 29, 2017 | September 23, 2016 |
| Net Sales | | | | |
| Americas | $ 74.9 | $ 66.8 | $ 219.8 | $ 201.3 |
| EMEA | 52.1 | 44.4 | 146.1 | 134.2 |
| Asia Pacific | 51.5 | 39.7 | 143.8 | 119.5 |
| Total | $ 178.5 | $ 150.9 | $ 509.7 | $ 455.0 |
| Operating earnings as a percentage of net sales | 35% | 34% | 35% | 32% |

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

| | Three Months Ended | | | | Nine Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | Volume and Price | Acquisitions | Currency | Total | Volume and Price | Acquisitions | Currency | Total |
| Americas | 11% | 1% | 0% | 12% | 9% | 0% | 0% | 9% |
| EMEA | 13% | 0% | 5% | 18% | 10% | 0% | (1)% | 9% |
| Asia Pacific | 30% | 1% | (1)% | 30% | 22% | 1% | (3)% | 20% |
| Segment Total | 17% | 0% | 1% | 18% | 12% | 1% | (1)% | 12% |

Sales increased in all Industrial segment product applications. Year-to-date operating margin rate for the Industrial segment increased 3 percentage points compared to last year. Favorable effects of higher sales volume and expense leverage were partially offset by the unfavorable effect 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 29, 2017 | September 23, 2016 | September 29, 2017 | September 23, 2016 |
| Net Sales | | | | |
| Americas | $ 47.9 | $ 43.0 | $ 139.1 | $ 124.3 |
| EMEA | 12.4 | 12.7 | 41.2 | 40.1 |
| Asia Pacific | 13.4 | 11.4 | 36.8 | 31.7 |
| Total | $ 73.7 | $ 67.1 | $ 217.1 | $ 196.1 |
| Operating earnings as a percentage of net sales | 16% | 15% | 18% | 13% |

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

| | Three Months Ended | | | | Nine Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | Volume and Price | Acquisitions | Currency | Total | Volume and Price | Acquisitions | Currency | Total |
| Americas | 11% | 0% | 0% | 11% | 12% | 0% | 0% | 12% |
| EMEA | (3)% | 0% | 1% | (2)% | 7% | 0% | (4)% | 3% |
| Asia Pacific | 17% | 0% | 0% | 17% | 17% | 0% | (1)% | 16% |
| Segment Total | 9% | 0% | 1% | 10% | 12% | 0% | (1)% | 11% |

The Process segment had solid sales growth in legacy product applications, partially offset by the effects of continued weakness in Oil and Natural Gas. Year-to-date operating margin rates for this segment increased 5 percentage points compared to last year due to higher sales volume, favorable expense leverage and a decrease in intangible amortization related to the impairment recorded in the fourth quarter of 2016.

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 29, 2017 | September 23, 2016 | September 29, 2017 | September 23, 2016 |
| Net Sales | | | | |
| Americas | $ 94.9 | $ 84.6 | $ 280.2 | $ 249.7 |
| EMEA | 22.3 | 16.5 | 65.6 | 55.2 |
| Asia Pacific | 10.5 | 8.1 | 27.3 | 24.3 |
| Total | $ 127.7 | $ 109.2 | $ 373.1 | $ 329.2 |
| Operating earnings as a percentage of net sales | 26% | 23% | 25% | 22% |

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

| | Three Months Ended | | | | Nine Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | Volume and Price | Acquisitions | Currency | Total | Volume and Price | Acquisitions | Currency | Total |
| Americas | 12% | 0% | 0% | 12% | 12% | 0% | 0% | 12% |
| EMEA | 29% | 0% | 5% | 34% | 20% | 0% | (1)% | 19% |
| Asia Pacific | 30% | 0% | 1% | 31% | 13% | 0% | 0% | 13% |
| Segment Total | 16% | 0% | 1% | 17% | 13% | 0% | 0% | 13% |

Contractor segment sales increased in all channels. Operating margin rates for both the quarter and the year to date for the Contractor segment increased 3 percentage points compared to last year due to higher sales volume, improved gross margin rate and favorable expense leverage.

## Liquidity and Capital Resources

Net cash provided by operating activities of $246 million increased $38 million compared to the first nine months of last year, mostly driven by the increase in net earnings. Increases in accounts receivable, inventories and accrued liabilities reflect growth in business activity in the first nine months of 2017. The Company used cash of $13 million in 2017 and $49 million in 2016 to acquire businesses that were not material to the consolidated financial statements. Other significant uses of cash in 2017 included share repurchases of $90 million (partially offset by $43 million of net proceeds from shares issued), cash dividends of $60 million, property, plant and equipment additions of $29 million and a contribution of $20 million to a funded pension plan.

At September 29, 2017, cash balances of $8 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 sheet.

At September 29, 2017, the Company had various lines of credit totaling $545 million, of which $540 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 2017.

**Outlook**

Demand levels remained robust and broad based in the third quarter. We expect the positive business environment to continue into 2018, however we do note that our fourth quarter represents our most difficult comparable of the year. In addition to the strong fourth quarter last year, we also had 14 weeks compared to only 13 weeks in this year's fourth quarter. Consequently, we anticipate low single-digit organic, constant currency growth in the fourth quarter. With that outlook we have the possibility to achieve double-digit sales growth for the full year 2017.

**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 2016 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 and trade 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 2016 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 2016 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 2016 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) |
|---|---|---|---|---|
| Jul 1, 2017 - Jul 28, 2017 (1) | 31,499 | $ 102.10 | — | 2,935,868 |
| Jul 29, 2017 - Aug 25, 2017 | — | $ — | — | 2,935,868 |
| Aug 26, 2017 - Sep 29, 2017 | — | $ — | — | 2,935,868 |

(1) On February 21, 2017, the Company entered into an accelerated share repurchase arrangement (“ASR”) with a financial institution. In exchange for an up-front payment of $90 million, the financial institution delivered 850,000 shares of Company common stock with a fair value of $78 million. The total number of shares ultimately delivered under the ASR is determined at the end of the purchase period based on the volume weighted-average price (“VWAP”) of the Company’s common stock during that period. The purchase period ended in the third quarter and the Company received an additional 31,499 shares to complete the ASR at an average realized price of $102.10 per share.

## Item 6. Exhibits

| | |
|---|---|
| 3.1 | Restated Articles of Incorporation as amended December 9, 2016. (Incorporated by reference to Exhibit 3.1 to the Company's Report on Form 8-K filed December 9, 2016.) |
| 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 25, 2017. |
| 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: | October 25, 2017 | By: | /s/ Patrick J. McHale |
| | | | Patrick J. McHale |
| | | | President and Chief Executive Officer |
| | | | *(Principal Executive Officer)* |
| Date: | October 25, 2017 | By: | /s/ Christian E. Rothe |
| | | | Christian E. Rothe |
| | | | Chief Financial Officer and Treasurer |
| | | | *(Principal Financial Officer)* |
| Date: | October 25, 2017 | By: | /s/ Caroline M. Chambers |
| | | | Caroline M. Chambers |
| | | | Vice President, Corporate Controller and Information Systems |
| | | | *(Principal Accounting Officer)* |

Exhibit 31.1

# CERTIFICATION

I, Patrick J. McHale, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 25, 2017

/s/ Patrick J. McHale

Patrick J. McHale

President and Chief Executive Officer

Exhibit 31.2

# 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: October 25, 2017

/s/ Christian E. Rothe
Christian E. Rothe
Chief Financial Officer and Treasurer

Exhibit 32

CERTIFICATION UNDER SECTION 1350

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

Date: October 25, 2017

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

Date: October 25, 2017

/s/ Christian E. Rothe
Christian E. Rothe
Chief Financial Officer and Treasurer

Exhibit 99.1

# News Release

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

**FOR IMMEDIATE RELEASE:**
Wednesday, October 25, 2017

**FOR FURTHER INFORMATION:**
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## Graco Reports Record Third Quarter Sales and Earnings
## Strong Sales Growth in All Segments and Regions

**MINNEAPOLIS (October 25, 2017)** - Graco Inc. **(NYSE: GGG)** today announced results for the third quarter and nine months ended September 29, 2017.

**Summary**
$ in millions except per share amounts

| | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| | Sep 29, 2017 | Sep 23, 2016 | % Change | Sep 29, 2017 | Sep 23, 2016 | % Change |
| Net Sales | $ 379.8 | $ 327.2 | 16% | $ 1,099.9 | $ 980.2 | 12% |
| Operating Earnings | 99.6 | 81.5 | 22% | 284.2 | 220.8 | 29% |
| Net Earnings | 75.5 | 54.4 | 39% | 216.0 | 144.9 | 49% |
| Diluted Net Earnings per Common Share | $ 1.30 | $ 0.95 | 37% | $ 3.73 | $ 2.55 | 46% |
| Diluted Net Earnings per Common Share, adjusted (1) | $ 1.15 | $ 0.95 | 21% | $ 3.28 | $ 2.55 | 29% |

(1) Excludes the reduction of income taxes resulting from a required change in accounting for excess tax benefits on stock option exercises. Also excludes the effect of tax planning benefits realized in the third quarter of 2017. See Financial Results Adjusted for Comparability below for a reconciliation of the adjusted non-GAAP financial measures to GAAP.

- All segments and regions had double-digit percentage sales growth for the quarter and year to date.
- Gross margin rate declined slightly in the third quarter compared to the prior year, with favorable price-cost dynamics more than offset by the impacts of project sales and product mix.
- Sales growth and operating expense leverage drove operating earnings increases of 22 percent for the quarter and 29 percent for the year to date.
- Diluted earnings per share include $0.06 for the quarter and $0.36 for the year to date from a required change in accounting for stock compensation.
- Diluted earnings per share for the quarter and year to date include $0.09 related to tax planning benefits that will not recur in 2018.

"For the third consecutive quarter Graco posted double-digit sales growth on an organic, constant currency basis, achieving new Company sales records for both the quarter and year to date. This also marks the third consecutive quarter where we have achieved growth in every region and reportable segment," said Patrick J. McHale, Graco's President and CEO. "Overall Company profitability trends remained solid in the third quarter, similar to the first half results, reflecting strong operating expense leverage on the double-digit sales increase."

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## Consolidated Results

Sales for the quarter increased 16 percent, with increases of 12 percent in the Americas, 18 percent in EMEA (14 percent at consistent translation rates) and 27 percent in Asia Pacific (28 percent at consistent translation rates). Sales for the year to date increased 12 percent, with increases of 11 percent in the Americas, 10 percent in EMEA (12 percent at consistent translation rates) and 18 percent in Asia Pacific (20 percent at consistent translation rates).

Changes in currency translation rates increased sales by approximately $3 million (1 percentage point) for the quarter and decreased sales by approximately $6 million (1 percentage point) for the year to date.

Gross profit margin rate decreased by one-half percentage point for the quarter and increased one-half percentage point for the year to date. Favorable effects from higher production volume and realized pricing were offset in varying degrees for the quarter and the year to date by the unfavorable impact of product mix.

Total operating expenses for the quarter increased $9 million (9 percent) compared to the third quarter last year. More than half of the increase was from increases in sales and earnings-based incentives and unallocated corporate operating expense (mostly from market-based stock compensation and pension costs). Year-to-date operating expenses increased $6 million (2 percent). Volume and rate-related increases were partially offset by a $3 million decrease in amortization expense and the impact of currency translation.

The effective income tax rate for the quarter was 22 percent, down from 29 percent last year. The effective income tax rate for the year to date was 21 percent, down from 30 percent last year. Adoption of a new accounting standard, requiring excess tax benefits related to stock option exercises to be credited to the income tax provision (formerly credited to equity), reduced the tax provision by $3.2 million for the quarter and $20.5 million for the year to date, decreasing the effective tax rate for the quarter and year to date by 3 and 7 percentage points, respectively. The effective tax rates for both the quarter and year to date were further reduced by the impacts of tax planning that will not recur in 2018 and foreign earnings taxed at lower rates than the U.S.

## Segment Results

Certain measurements of segment operations are summarized below:

| | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| | Industrial | Process | Contractor | Industrial | Process | Contractor |
| Net Sales (in millions) | $ 178.5 | $ 73.7 | $ 127.7 | $ 509.7 | $ 217.1 | $ 373.1 |
| Percentage change from last year | | | | | | |
| Sales | 18% | 10% | 17% | 12% | 11% | 13% |
| Operating earnings | 22% | 16% | 31% | 20% | 54% | 30% |
| Operating earnings as a percentage of sales | | | | | | |
| 2017 | 35% | 16% | 26% | 35% | 18% | 25% |
| 2016 | 34% | 15% | 23% | 32% | 13% | 22% |

More . . .

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

| | Three Months Ended | | | | Nine Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | Volume and Price | Acquisitions | Currency | Total | Volume and Price | Acquisitions | Currency | Total |
| Americas | 11% | 1% | 0% | 12% | 9% | 0% | 0% | 9% |
| EMEA | 13% | 0% | 5% | 18% | 10% | 0% | (1)% | 9% |
| Asia Pacific | 30% | 1% | (1)% | 30% | 22% | 1% | (3)% | 20% |
| Consolidated | 17% | 0% | 1% | 18% | 12% | 1% | (1)% | 12% |

Sales increased in all Industrial segment product applications. Year-to-date operating margin rate for the Industrial segment increased 3 percentage points compared to last year. Favorable effects of higher sales volume and expense leverage were partially offset by the unfavorable effect of currency translation.

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

| | Three Months Ended | | | | Nine Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | Volume and Price | Acquisitions | Currency | Total | Volume and Price | Acquisitions | Currency | Total |
| Americas | 11% | 0% | 0% | 11% | 12% | 0% | 0% | 12% |
| EMEA | (3)% | 0% | 1% | (2)% | 7% | 0% | (4)% | 3% |
| Asia Pacific | 17% | 0% | 0% | 17% | 17% | 0% | (1)% | 16% |
| Consolidated | 9% | 0% | 1% | 10% | 12% | 0% | (1)% | 11% |

The Process segment had solid sales growth in legacy product applications, partially offset by the effects of continued weakness in Oil and Natural Gas. Year-to-date operating margin rates for this segment increased 5 percentage points compared to last year due to higher sales volume, favorable expense leverage and a decrease in intangible amortization related to the impairment recorded in the fourth quarter of 2016.

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

| | Three Months Ended | | | | Nine Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | Volume and Price | Acquisitions | Currency | Total | Volume and Price | Acquisitions | Currency | Total |
| Americas | 12% | 0% | 0% | 12% | 12% | 0% | 0% | 12% |
| EMEA | 29% | 0% | 5% | 34% | 20% | 0% | (1)% | 19% |
| Asia Pacific | 30% | 0% | 1% | 31% | 13% | 0% | 0% | 13% |
| Consolidated | 16% | 0% | 1% | 17% | 13% | 0% | 0% | 13% |

Contractor segment sales increased in all channels. Operating margin rates for both the quarter and the year to date for the Contractor segment increased 3 percentage points compared to last year due to higher sales volume, improved gross margin rate and favorable expense leverage.

**Outlook**

“Demand levels remained robust and broad based in the third quarter,” said McHale. “We expect the positive business environment to continue into 2018, however we do note that our fourth quarter represents our most difficult comparable of the year. In addition to the strong fourth quarter last year, we also had 14 weeks compared to only 13 weeks in this year's fourth quarter. Just given the math, we anticipate low single-digit organic, constant currency growth in the fourth quarter. With that outlook we have the possibility to achieve double-digit sales growth for the full year 2017. I'd like to thank our employees, suppliers, distributor partners and end customers for their contribution to our strong 2017 results. We will continue to invest in our core growth strategies as we finish the year, and will be working hard to get 2018 off to a good start."

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**Financial Results Adjusted for Comparability**

Adoption of a new stock compensation accounting standard and recognition of certain tax planning benefits in 2017 created large fluctuations in financial results compared to prior periods. Excluding the excess tax benefits on exercised stock options and other tax planning benefits recognized as reductions of income taxes in 2017 presents a more consistent comparison of financial results. A calculation of the non-GAAP measurements of adjusted income taxes, net earnings and diluted earnings per share follows (in millions except per share amounts):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | Sep 29, 2017 | Sep 23, 2016 | Sep 29, 2017 | Sep 23, 2016 |
| Income taxes, as reported | $ 20.9 | $ 22.2 | $ 57.6 | $ 62.7 |
| Excess tax benefit from option exercises | 3.2 | — | 20.5 | — |
| Tax planning benefit | 5.5 | — | 5.5 | — |
| Income taxes, adjusted | $ 29.6 | $ 22.2 | $ 83.6 | $ 62.7 |
| | | | | |
| Effective income tax rate | | | | |
| As reported | 22% | 29% | 21% | 30% |
| Adjusted | 31% | 29% | 31% | 30% |
| | | | | |
| Net Earnings, as reported | $ 75.5 | $ 54.4 | $ 216.0 | $ 144.9 |
| Excess tax benefit from option exercises | (3.2) | — | (20.5) | — |
| Tax planning benefit | (5.5) | — | (5.5) | — |
| Net Earnings, adjusted | $ 66.8 | $ 54.4 | $ 190.0 | $ 144.9 |
| | | | | |
| Weighted Average Diluted Shares | 58.2 | 57.0 | 57.9 | 56.9 |
| Diluted Earnings per Share | | | | |
| As reported | $ 1.30 | $ 0.95 | $ 3.73 | $ 2.55 |
| Adjusted | $ 1.15 | $ 0.95 | $ 3.28 | $ 2.55 |

**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 2016 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 and trade laws; new entrants who copy our

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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 2016 (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 26, 2017, at 11 a.m. ET, 10 a.m. CT, to discuss Graco's third quarter results.

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

For those unable to listen to the live event, a replay will be available soon after the conference call at Graco's website, or by telephone beginning at approximately 2 p.m. ET on October 27, 2017, by dialing 888-203-1112, Conference ID #9177064, 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 October 30, 2017.

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.

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | Sep 29, 2017 | Sep 23, 2016 | Sep 29, 2017 | Sep 23, 2016 |
| Net Sales | $ 379,812 | $ 327,192 | $ 1,099,885 | $ 980,230 |
| Cost of products sold | 176,347 | 150,594 | 507,206 | 456,695 |
| Gross Profit | 203,465 | 176,598 | 592,679 | 523,535 |
| Product development | 14,815 | 14,671 | 44,215 | 44,964 |
| Selling, marketing and distribution | 57,941 | 49,269 | 168,912 | 158,106 |
| General and administrative | 31,072 | 31,194 | 95,325 | 99,710 |
| Operating Earnings | 99,637 | 81,464 | 284,227 | 220,755 |
| Interest expense | 3,901 | 4,432 | 12,110 | 13,468 |
| Other expense (income), net | (656) | 416 | (1,454) | (338) |
| Earnings Before Income Taxes | 96,392 | 76,616 | 273,571 | 207,625 |
| Income taxes | 20,932 | 22,228 | 57,551 | 62,738 |
| Net Earnings | $ 75,460 | $ 54,388 | $ 216,020 | $ 144,887 |
| Net Earnings per Common Share | | | | |
| Basic | $ 1.35 | $ 0.98 | $ 3.87 | $ 2.61 |
| Diluted | $ 1.30 | $ 0.95 | $ 3.73 | $ 2.55 |
| Weighted Average Number of Shares | | | | |
| Basic | 56,023 | 55,684 | 55,864 | 55,571 |
| Diluted | 58,204 | 56,969 | 57,948 | 56,906 |

## SEGMENT INFORMATION (Unaudited)
(In thousands)

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | Sep 29, 2017 | Sep 23, 2016 | Sep 29, 2017 | Sep 23, 2016 |
| Net Sales | | | | |
| Industrial | $ 178,461 | $ 150,893 | $ 509,719 | $ 454,978 |
| Process | 73,656 | 67,077 | 217,084 | 196,068 |
| Contractor | 127,695 | 109,222 | 373,082 | 329,184 |
| Total | $ 379,812 | $ 327,192 | $ 1,099,885 | $ 980,230 |
| Operating Earnings | | | | |
| Industrial | $ 61,790 | $ 50,573 | $ 177,121 | $ 147,419 |
| Process | 12,088 | 10,394 | 38,969 | 25,305 |
| Contractor | 33,471 | 25,593 | 93,249 | 71,700 |
| Unallocated corporate (expense) | (7,712) | (5,096) | (25,112) | (23,669) |
| Total | $ 99,637 | $ 81,464 | $ 284,227 | $ 220,755 |

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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