

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

**FORM 10-Q**

☒ Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934  
For the quarterly period ended **September 27, 2019**

☐ 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	GGG	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 ☒

166,780,000 shares of the Registrant's Common Stock, \$1.00 par value, were outstanding as of October 16, 2019.

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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 27, 2019	September 28, 2018	September 27, 2019	September 28, 2018
Net Sales	\$ 400,555	\$ 415,936	\$ 1,233,753	\$ 1,246,854
Cost of products sold	193,176	194,477	583,378	573,071
Gross Profit	207,379	221,459	650,375	673,783
Product development	16,723	15,734	50,616	47,135
Selling, marketing and distribution	55,538	57,270	176,796	182,741
General and administrative	31,719	33,676	102,676	104,054
Operating Earnings	103,399	114,779	320,287	339,853
Interest expense	3,618	3,583	10,584	10,707
Other expense, net	2,972	3,139	4,360	8,425
Earnings Before Income Taxes	96,809	108,057	305,343	320,721
Income taxes	12,677	15,376	46,325	53,390
Net Earnings	\$ 84,132	\$ 92,681	\$ 259,018	\$ 267,331
Net Earnings per Common Share				
Basic	\$ 0.50	\$ 0.55	\$ 1.56	\$ 1.59
Diluted	\$ 0.49	\$ 0.54	\$ 1.51	\$ 1.54

See notes to consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	September 27, 2019	September 28, 2018	September 27, 2019	September 28, 2018
Net Earnings	\$ 84,132	\$ 92,681	\$ 259,018	\$ 267,331
Components of other comprehensive income (loss)				
Cumulative translation adjustment	(6,396)	4,161	(3,995)	(2,205)
Pension and postretirement medical liability adjustment	2,268	1,972	6,305	6,503
Income taxes - pension and postretirement medical liability adjustment	(505)	(448)	(1,398)	(1,445)
Other comprehensive income	(4,633)	5,685	912	2,853
Comprehensive Income	\$ 79,499	\$ 98,366	\$ 259,930	\$ 270,184

See notes to consolidated financial statements.

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

	September 27, 2019	December 28, 2018
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 177,306	\$ 132,118
Accounts receivable, less allowances of \$5,200 and \$5,300	277,417	274,608
Inventories	288,588	283,982
Other current assets	29,316	32,508
Total current assets	772,627	723,216
Property, Plant and Equipment, net	308,656	229,295
Goodwill	301,420	293,846
Other Intangible Assets, net	161,525	166,310
Operating Lease Assets	30,898	—
Deferred Income Taxes	32,069	32,055
Other Assets	30,229	28,019
Total Assets	\$ 1,637,424	\$ 1,472,741
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities		
Notes payable to banks	\$ 4,686	\$ 11,083
Trade accounts payable	54,882	56,902
Salaries and incentives	49,798	62,297
Dividends payable	26,716	26,480
Other current liabilities	151,445	143,041
Total current liabilities	287,527	299,803
Long-term Debt	192,101	266,391
Retirement Benefits and Deferred Compensation	136,871	133,388
Operating Lease Liabilities	24,822	—
Deferred Income Taxes	12,307	16,586
Other Non-current Liabilities	—	4,700
Shareholders' Equity		
Common stock	166,858	165,171
Additional paid-in-capital	563,566	510,825
Retained earnings	397,317	220,734
Accumulated other comprehensive income (loss)	(143,945)	(144,857)
Total shareholders' equity	983,796	751,873
Total Liabilities and Shareholders' Equity	\$ 1,637,424	\$ 1,472,741

See notes to consolidated financial statements.

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

	Nine Months Ended	
	September 27, 2019	September 28, 2018
<b>Cash Flows From Operating Activities</b>		
Net Earnings	\$ 259,018	\$ 267,331
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	36,401	35,570
Deferred income taxes	(6,067)	15,407
Share-based compensation	23,186	22,016
Change in		
Accounts receivable	(2,906)	(25,576)
Inventories	(5,052)	(23,094)
Trade accounts payable	(776)	74
Salaries and incentives	(15,422)	(4,943)
Retirement benefits and deferred compensation	10,206	(30,202)
Other accrued liabilities	198	(1,348)
Other	695	(974)
Net cash provided by operating activities	299,481	254,261
<b>Cash Flows From Investing Activities</b>		
Property, plant and equipment additions	(102,496)	(39,569)
Acquisition of businesses, net of cash acquired	(19,216)	(10,769)
Other	(961)	(1,386)
Net cash provided by (used in) investing activities	(122,673)	(51,724)
<b>Cash Flows From Financing Activities</b>		
Borrowings (payments) on short-term lines of credit, net	(6,240)	(2,558)
Borrowings on long-term lines of credit	106,454	612,979
Payments on long-term debt and lines of credit	(179,270)	(575,113)
Common stock issued	36,244	23,471
Common stock repurchased	(5,121)	(155,601)
Taxes paid related to net share settlement of equity awards	(1,268)	(16,151)
Cash dividends paid	(79,762)	(66,794)
Net cash provided by (used in) financing activities	(128,963)	(179,767)
Effect of exchange rate changes on cash	(2,657)	1,915
Net increase (decrease) in cash and cash equivalents	45,188	24,685
<b>Cash and Cash Equivalents</b>		
Beginning of year	132,118	112,904
End of period	\$ 177,306	\$ 137,589

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
<b>Three Months Ended September 27, 2019</b>					
<b>Balance, June 28, 2019</b>	\$ 166,792	\$ 556,170	\$ 342,308	\$ (139,312)	\$ 925,958
Shares issued	126	2,163	—	—	2,289
Shares repurchased	(60)	(186)	(2,437)	—	(2,683)
Stock compensation cost	—	5,419	—	—	5,419
Net earnings	—	—	84,132	—	84,132
Dividends declared (\$0.1600 per share)	—	—	(26,686)	—	(26,686)
Other comprehensive income (loss)	—	—	—	(4,633)	(4,633)
<b>Balance, September 27, 2019</b>	<u>\$ 166,858</u>	<u>\$ 563,566</u>	<u>\$ 397,317</u>	<u>\$ (143,945)</u>	<u>\$ 983,796</u>
<b>Nine Months Ended September 27, 2019</b>					
<b>Balance, December 28, 2018</b>	\$ 165,171	\$ 510,825	\$ 220,734	\$ (144,857)	\$ 751,873
Shares issued	1,747	33,227	—	—	34,974
Shares repurchased	(60)	(186)	(2,437)	—	(2,683)
Stock compensation cost	—	19,700	—	—	19,700
Net earnings	—	—	259,018	—	259,018
Dividends declared (\$0.4800 per share)	—	—	(79,998)	—	(79,998)
Other comprehensive income (loss)	—	—	—	912	912
<b>Balance, September 27, 2019</b>	<u>\$ 166,858</u>	<u>\$ 563,566</u>	<u>\$ 397,317</u>	<u>\$ (143,945)</u>	<u>\$ 983,796</u>
<b>Three Months Ended September 28, 2018</b>					
<b>Balance, June 29, 2018</b>	\$ 167,130	505,342	185,407	\$ (146,074)	\$ 711,805
Shares issued	279	3,140	—	—	3,419
Stock compensation cost	—	5,161	—	—	5,161
Net earnings	—	—	92,681	—	92,681
Dividends declared (\$0.1325 per share)	—	—	(22,189)	—	(22,189)
Other comprehensive income (loss)	—	—	—	5,685	5,685
<b>Balance, September 28, 2018</b>	<u>\$ 167,409</u>	<u>513,643</u>	<u>255,899</u>	<u>\$ (140,389)</u>	<u>\$ 796,562</u>
<b>Nine Months Ended September 28, 2018</b>					
<b>Balance, December 29, 2017</b>	\$ 169,319	\$ 499,934	\$ 181,599	\$ (127,789)	\$ 723,063
Shares issued	1,592	6,500	—	—	8,092
Shares repurchased	(3,502)	(10,340)	(141,759)	—	(155,601)
Stock compensation cost	—	18,321	—	—	18,321
Restricted stock canceled (issued)	—	(772)	—	—	(772)
Net earnings	—	—	267,331	—	267,331
Dividends declared (\$0.3975 per share)	—	—	(66,725)	—	(66,725)
Reclassified to retained earnings from AOCI	—	—	15,453	(15,453)	—
Other comprehensive income (loss)	—	—	—	2,853	2,853
<b>Balance, September 28, 2018</b>	<u>\$ 167,409</u>	<u>\$ 513,643</u>	<u>\$ 255,899</u>	<u>\$ (140,389)</u>	<u>\$ 796,562</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 27, 2019 and the related statements of earnings, comprehensive income and shareholders' equity for the three and nine months ended September 27, 2019 and September 28, 2018, and cash flows for the nine months ended September 27, 2019 and September 28, 2018 have been prepared by the Company and have not been audited.

In the opinion of management, these consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of the Company as of September 27, 2019, 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 2018 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**

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 27, 2019	September 28, 2018	September 27, 2019	September 28, 2018
<b>Net Sales</b>				
Industrial	\$ 175,016	\$ 195,855	\$ 552,623	\$ 581,510
Process	84,090	84,556	256,048	249,650
Contractor	141,449	135,525	425,082	415,694
<b>Total</b>	<b>\$ 400,555</b>	<b>\$ 415,936</b>	<b>\$ 1,233,753</b>	<b>\$ 1,246,854</b>
<b>Operating Earnings</b>				
Industrial	\$ 57,023	\$ 70,572	\$ 186,654	\$ 206,727
Process	18,194	17,862	56,586	52,629
Contractor	34,005	32,739	100,598	102,532
Unallocated corporate (expense)	(5,823)	(6,394)	(23,551)	(22,035)
<b>Total</b>	<b>\$ 103,399</b>	<b>\$ 114,779</b>	<b>\$ 320,287</b>	<b>\$ 339,853</b>

Assets by segment were as follows (in thousands):

	September 27, 2019	December 28, 2018
Industrial	\$ 611,075	\$ 640,683
Process	375,933	350,306
Contractor	370,707	283,727
Unallocated corporate	279,709	198,025
<b>Total</b>	<b>\$ 1,637,424</b>	<b>\$ 1,472,741</b>

Geographic information follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 27, 2019	September 28, 2018	September 27, 2019	September 28, 2018
Net Sales (based on customer location)				
United States	\$ 214,468	\$ 208,269	\$ 638,918	\$ 614,592
Other countries	186,087	207,667	594,835	632,262
Total	<u>\$ 400,555</u>	<u>\$ 415,936</u>	<u>\$ 1,233,753</u>	<u>\$ 1,246,854</u>
			September 27, 2019	December 28, 2018
Long-lived Assets				
United States			\$ 253,039	\$ 178,331
Other countries			55,617	50,964
Total			<u>\$ 308,656</u>	<u>\$ 229,295</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 27, 2019	September 28, 2018	September 27, 2019	September 28, 2018
Net earnings available to common shareholders	<u>\$ 84,132</u>	<u>\$ 92,681</u>	<u>\$ 259,018</u>	<u>\$ 267,331</u>
Weighted average shares outstanding for basic earnings per share	166,848	167,247	166,383	167,860
Dilutive effect of stock options computed using the treasury stock method and the average market price	4,929	5,790	5,178	6,124
Weighted average shares outstanding for diluted earnings per share	<u>171,777</u>	<u>173,037</u>	<u>171,561</u>	<u>173,984</u>
Basic earnings per share	\$ 0.50	\$ 0.55	\$ 1.56	\$ 1.59
Diluted earnings per share	\$ 0.49	\$ 0.54	\$ 1.51	\$ 1.54

Stock options to purchase 802,000 and 435,000 shares were not included in the September 27, 2019 and September 28, 2018 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 28, 2018	12,270	\$ 24.67	7,312	\$ 20.17
Granted	1,285	45.91		
Exercised	(1,364)	15.73		
Canceled	(35)	32.09		
Outstanding, September 27, 2019	<u>12,156</u>	<u>\$ 27.89</u>	7,620	\$ 23.08



The Company recognized year-to-date share-based compensation of \$23.2 million in 2019 and \$22.0 million in 2018. As of September 27, 2019, there was \$8.2 million of unrecognized compensation cost related to unvested options, expected to be recognized over a weighted average period of 2.4 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 27, 2019	September 28, 2018
Expected life in years	7.5	7.5
Interest rate	2.6%	2.8%
Volatility	24.6%	25.5%
Dividend yield	1.4%	1.2%
Weighted average fair value per share	\$ 12.26	\$ 12.84

Under the Company's Employee Stock Purchase Plan, the Company issued 398,000 shares in 2019 and 480,000 shares in 2018. 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 27, 2019	September 28, 2018
Expected life in years	1.0	1.0
Interest rate	2.6%	2.1%
Volatility	22.7%	21.3%
Dividend yield	1.4%	1.2%
Weighted average fair value per share	\$ 11.36	\$ 10.28

## 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 27, 2019	September 28, 2018	September 27, 2019	September 28, 2018
<b>Pension Benefits</b>				
Service cost	\$ 2,161	\$ 2,165	\$ 5,805	\$ 6,376
Interest cost	3,711	3,227	11,021	10,072
Expected return on assets	(4,289)	(4,369)	(12,864)	(13,087)
Amortization and other	3,095	2,077	6,912	6,252
Net periodic benefit cost	<u>\$ 4,678</u>	<u>\$ 3,100</u>	<u>\$ 10,874</u>	<u>\$ 9,613</u>
<b>Postretirement Medical</b>				
Service cost	\$ 136	\$ 127	\$ 409	\$ 477
Interest cost	291	284	872	813
Amortization	68	213	205	485
Net periodic benefit cost	<u>\$ 495</u>	<u>\$ 624</u>	<u>\$ 1,486</u>	<u>\$ 1,775</u>

## 6. 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
<b>Three Months Ended September 27, 2019</b>			
<b>Balance, June 28, 2019</b>	\$ (83,745)	\$ (55,567)	\$ (139,312)
Other comprehensive income (loss) before reclassifications	—	(6,396)	(6,396)
Reclassified to pension cost and deferred tax	1,763	—	1,763
<b>Balance, September 27, 2019</b>	<u>\$ (81,982)</u>	<u>\$ (61,963)</u>	<u>\$ (143,945)</u>
<b>Nine Months Ended September 27, 2019</b>			
<b>Balance, December 28, 2018</b>	\$ (86,889)	\$ (57,968)	\$ (144,857)
Other comprehensive income (loss) before reclassifications	—	(3,995)	(3,995)
Reclassified to pension cost and deferred tax	4,907	—	4,907
<b>Balance, September 27, 2019</b>	<u>\$ (81,982)</u>	<u>\$ (61,963)</u>	<u>\$ (143,945)</u>
<b>Three Months Ended September 28, 2018</b>			
<b>Balance, June 29, 2018</b>	\$ (90,349)	\$ (55,725)	\$ (146,074)
Other comprehensive income (loss) before reclassifications	—	4,161	4,161
Reclassified to pension cost and deferred tax	1,524	—	1,524
<b>Balance, September 28, 2018</b>	<u>\$ (88,825)</u>	<u>\$ (51,564)</u>	<u>\$ (140,389)</u>
<b>Nine Months Ended September 28, 2018</b>			
<b>Balance, December 29, 2017</b>	\$ (78,430)	\$ (49,359)	\$ (127,789)
Other comprehensive income (loss) before reclassifications	—	(2,205)	(2,205)
Reclassified to pension cost and deferred tax	5,058	—	5,058
Reclassified to retained earnings	(15,453)	—	(15,453)
<b>Balance, September 28, 2018</b>	<u>\$ (88,825)</u>	<u>\$ (51,564)</u>	<u>\$ (140,389)</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.

In February 2018, the Financial Accounting Standards Board ("FASB") issued a new standard related to reclassification of certain tax effects from accumulated other comprehensive income (AOCI). We adopted the new standard in the first quarter of 2018. We elected to reclassify \$15.5 million from accumulated other comprehensive income to retained earnings, representing the amount of "stranded" tax effects resulting from the change in the U.S. federal tax rate and the consequent revaluation of deferred tax assets related to pension and postretirement medical expense.

## 7. Inventories

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

	September 27, 2019	December 28, 2018
Finished products and components	\$ 142,184	\$ 142,535
Products and components in various stages of completion	88,345	83,768
Raw materials and purchased components	119,242	115,705
Subtotal	349,771	342,008
Reduction to LIFO cost	(61,183)	(58,026)
Total	<u>\$ 288,588</u>	<u>\$ 283,982</u>

## 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 27, 2019					
Cost	\$ 184,410	\$ 20,013	\$ 1,020	\$ 61,020	\$ 266,463
Accumulated amortization	(77,345)	(10,053)	(597)	—	(87,995)
Foreign currency translation	(11,581)	(978)	(74)	(4,310)	(16,943)
Book value	\$ 95,484	\$ 8,982	\$ 349	\$ 56,710	\$ 161,525
Weighted average life in years	<u>13</u>	<u>10</u>	<u>4</u>	<u>N/A</u>	<u></u>
As of December 28, 2018					
Cost	\$ 179,449	\$ 18,571	\$ 1,020	\$ 59,537	\$ 258,577
Accumulated amortization	(67,322)	(8,647)	(439)	—	(76,408)
Foreign currency translation	(10,817)	(895)	(73)	(4,074)	(15,859)
Book value	\$ 101,310	\$ 9,029	\$ 508	\$ 55,463	\$ 166,310
Weighted average life in years	<u>13</u>	<u>10</u>	<u>4</u>	<u>N/A</u>	<u></u>

Amortization of intangibles for the quarter was \$3.9 million in 2019 and \$3.8 million in 2018 and for the year to date was \$11.6 million in 2019 and \$11.8 million in 2018. Estimated annual amortization expense based on the current carrying amount of other intangible assets is as follows (in thousands):

	2019	2020	2021	2022	2023	Thereafter
Estimated Amortization Expense	\$ 15,497	\$ 15,543	\$ 15,343	\$ 15,253	\$ 14,359	\$ 40,413

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

	Industrial	Process	Contractor	Total
Balance, December 28, 2018	\$ 177,124	\$ 97,168	\$ 19,554	\$ 293,846
Additions, adjustments from business acquisitions	—	9,197	—	9,197
Foreign currency translation	(1,192)	(431)	—	(1,623)
Balance, September 27, 2019	<u>\$ 175,932</u>	<u>\$ 105,934</u>	<u>\$ 19,554</u>	<u>\$ 301,420</u>

The Company completed business acquisitions in 2019 that were not material to the consolidated financial statements.

#### 9. Other Current Liabilities

Components of other current liabilities were (in thousands):

	September 27, 2019	December 28, 2018
Accrued self-insurance retentions	\$ 8,337	\$ 7,870
Accrued warranty and service liabilities	12,222	11,056
Accrued trade promotions	7,954	11,449
Payable for employee stock purchases	10,123	11,916
Customer advances and deferred revenue	46,693	39,995
Income taxes payable	8,939	8,515
Right of return refund liability	13,293	12,705
Operating lease liability, current	7,906	—
Other	35,978	39,535
Total	<u>\$ 151,445</u>	<u>\$ 143,041</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 28, 2018	\$ 11,056
Charged to expense	7,781
Margin on parts sales reversed	2,096
Reductions for claims settled	(8,711)
Balance, September 27, 2019	<u>\$ 12,222</u>

#### Deferred Revenues

For certain products or services and customer types, we require payment before delivery to the customer. We defer revenue when cash payments are received or due in advance of our performance, including amounts which are refundable. This is also the case for services associated with certain product sales. The balance in the deferred revenue and customer advances was \$46.7 million as of September 27, 2019 and \$40.0 million as of December 28, 2018. Net sales for the year to date included \$34.9 million in 2019 and \$21.8 million in 2018 that related to deferred revenue as of the beginning of each period.

#### 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 27, 2019	December 28, 2018
<b>Assets</b>			
Cash surrender value of life insurance	2	\$ 16,474	\$ 14,320
Forward exchange contracts	2	138	82
Total assets at fair value		<u>\$ 16,612</u>	<u>\$ 14,402</u>
<b>Liabilities</b>			
Contingent consideration	3	\$ 6,800	\$ 7,200
Deferred compensation	2	4,489	4,203
Total liabilities at fair value		<u>\$ 11,289</u>	<u>\$ 11,403</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 \$150 million as of September 27, 2019 and \$225 million as of December 28, 2018, and estimated fair value of \$165 million and \$235 million, respectively. 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

### **Leases**

#### *Adoption of New Accounting Standard*

The Company adopted ASU No. 2016-02— *Leases (Topic 842)* as of December 29, 2018, the beginning of our fiscal year 2019. Using the modified retrospective approach with transition relief, we recorded operating lease assets and liabilities of \$35 million as of December 29, 2018, and made no adjustments to retained earnings. Adoption of the new standard did not materially impact our consolidated net earnings and cash flows.

#### *Practical Expedients and Exemptions*

Electing the package of practical expedients permitted under transition guidance, we did not reassess previous conclusions about whether existing contracts contained a lease, historical lease classification, or initial direct costs. Electing the hindsight practical expedient to determine the lease term for existing leases did not result in any changes to existing lease terms. We elected not to apply recognition requirements to short term leases with terms of twelve months or less across all asset classes. We elected to analyze vehicle assets using the portfolio approach. Lastly, we elected as an accounting policy not to separate the lease and non-lease components in the lease payments across all asset classes.

#### *Accounting Policy*

The Company owns most of the assets used in its operations, but leases certain buildings and land, vehicles, office equipment and other rental assets. The Company determines if an arrangement is a lease at inception. All of the Company's current lease arrangements are classified as operating leases. The Company historically has not entered into financing leases. Operating lease assets and obligations are recognized at the lease commencement date based on the present value of lease payments over the lease term. Lease expense is recognized by amortizing the amount recorded as an asset on a straight-line basis over the lease term.

In determining lease asset value, the Company considers fixed or variable payment terms, prepayments, incentives, and options to extend, terminate or purchase. Renewal, termination or purchase options affect the lease term used for determining lease asset value only if the option is reasonably certain to be exercised. The Company generally uses its incremental borrowing rate based on information available at the lease commencement date in determining the present value of lease payments.

As of September 27, 2019, the weighted average remaining lease term was 5.8 years and the weighted average discount rate used to determine the operating lease liability was 4.0%. For the nine months ended September 27, 2019, expense related to operating leases was \$8.6 million, operating lease payments included in operating cash flows totaled \$8.2 million, and non-cash additions to operating lease assets totaled \$2.2 million.

As of September 27, 2019, future maturities of operating lease liabilities were as follows (in thousands):

	Operating Leases
2019	\$ 2,870
2020	9,063
2021	6,840
2022	5,497
2023	3,955
2024	1,808
Thereafter	7,481
Total lease payments	\$ 37,514
Present value adjustment	(4,786)
Operating lease liabilities	<u>\$ 32,728</u>

Aggregate annual rental commitments under operating leases with noncancelable terms of more than one year at December 28, 2018 were reported under previous lease accounting standards as follows (in thousands):

	Total
2019	\$ 11,613
2020	8,759
2021	6,745
2022	5,102
2023	3,721
Thereafter	2,340
Total	<u>\$ 38,280</u>

### **Credit Losses**

In June 2016, the FASB issued a final standard on accounting for credit losses. The new standard is effective for the Company in fiscal 2020 and requires a change in credit loss calculations using the expected loss method. The Company expects no significant impact on earnings or financial condition from the adoption of the new standard. The Company is continuing to evaluate the effects of the new standard on related disclosures and accounting systems.

## 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 27, 2019	September 28, 2018	% Change	September 27, 2019	September 28, 2018	% Change
Net Sales	\$ 400.6	\$ 415.9	(4)%	\$ 1,233.8	\$ 1,246.9	(1)%
Operating Earnings	103.4	114.8	(10)%	320.3	339.9	(6)%
Net Earnings	84.1	92.7	(9)%	259.0	267.3	(3)%
Net Earnings, adjusted <sup>(1)</sup>	77.4	85.8	(10)%	243.4	252.5	(4)%
Diluted Net Earnings per Common Share	\$ 0.49	\$ 0.54	(9)%	\$ 1.51	\$ 1.54	(2)%
Diluted Net Earnings per Common Share, adjusted <sup>(1)</sup>	\$ 0.45	\$ 0.50	(10)%	\$ 1.42	\$ 1.45	(2)%

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

Changes in currency translation rates decreased worldwide sales by approximately \$6 million (2 percentage points) for the quarter and \$26 million (2 percentage points) for the year to date. At consistent translation rates, sales increases in the Americas and EMEA were more than offset by decreases in Asia Pacific. Gross margin rates decreased from the comparable periods last year, and operating expenses decreased both in dollars and as a percentage of sales.

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

	Three Months Ended		Nine Months Ended	
	September 27, 2019	September 28, 2018	September 27, 2019	September 28, 2018
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	48.2	46.8	47.3	46.0
Gross Profit	51.8	53.2	52.7	54.0
Product development	4.2	3.8	4.1	3.8
Selling, marketing and distribution	13.9	13.7	14.3	14.6
General and administrative	7.9	8.1	8.3	8.3
Operating Earnings	25.8	27.6	26.0	27.3
Interest expense	0.9	0.9	0.9	0.9
Other expense, net	0.7	0.7	0.4	0.7
Earnings Before Income Taxes	24.2	26.0	24.7	25.7
Income taxes	3.2	3.7	3.7	4.3
Net Earnings	21.0%	22.3%	21.0%	21.4%

### Net Sales

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

	Three Months Ended		Nine Months Ended	
	September 27, 2019	September 28, 2018	September 27, 2019	September 28, 2018
Americas <sup>(1)</sup>	\$ 243.0	\$ 235.9	\$ 728.9	\$ 703.0
EMEA <sup>(2)</sup>	94.0	94.2	294.5	292.4
Asia Pacific	63.6	85.8	210.4	251.5
Consolidated	\$ 400.6	\$ 415.9	\$ 1,233.8	\$ 1,246.9

(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	3%	0%	0%	3%	4%	0%	0%	4%
EMEA	2%	2%	(4)%	0%	5%	1%	(5)%	1%
Asia Pacific	(25)%	1%	(2)%	(26)%	(13)%	0%	(3)%	(16)%
Consolidated	(3)%	1%	(2)%	(4)%	1%	0%	(2)%	(1)%

### Gross Profit

Gross profit margin rates for the quarter and year to date decreased from the comparable periods last year driven by lower factory volume, unfavorable channel and product mix and changes in currency translation rates. Price changes implemented in the first quarter offset the adverse impact of higher material costs.

### Operating Expenses

Total operating expenses for the quarter and year to date decreased \$3 million (3 percent) and \$4 million (1 percent), respectively, compared to last year. Reductions in volume and earnings-based expenses more than offset increases in product development expenses, which increased 6 percent for the quarter and 7 percent for the year to date.



## Other Expense

Other expense for the year to date was \$4 million lower than the comparable period last year, driven by lower exchange losses on net assets of foreign operations.

## Income Taxes

The effective income tax rate was 13 percent for the quarter and 15 percent for the year to date, both down approximately 1 percentage point from the comparable periods last year. The decrease was driven by a revaluation of deferred taxes pursuant to a tax rate change in a foreign jurisdiction. The impact of the tax rate change was partially offset by the effects of decreases in excess tax benefits related to stock option exercises.

## Financial Results Adjusted for Comparability

Excluding the impact of tax benefits related to stock option exercises and certain 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 27, 2019	September 28, 2018	September 27, 2019	September 28, 2018
Earnings before income taxes	\$ 96.8	\$ 108.1	\$ 305.3	\$ 320.7
Income taxes, as reported	\$ 12.7	\$ 15.4	\$ 46.3	\$ 53.4
Excess tax benefit from option exercises	0.7	1.9	8.1	9.8
Other non-recurring tax benefit	6.0	5.0	7.5	5.0
Income taxes, adjusted	\$ 19.4	\$ 22.3	\$ 61.9	\$ 68.2
Effective income tax rate				
As reported	13.1%	14.2%	15.2%	16.6%
Adjusted	20.0%	20.6%	20.3%	21.2%
Net Earnings, as reported	\$ 84.1	\$ 92.7	\$ 259.0	\$ 267.3
Excess tax benefit from option exercises	(0.7)	(1.9)	(8.1)	(9.8)
Other non-recurring tax benefit	(6.0)	(5.0)	(7.5)	(5.0)
Net Earnings, adjusted	\$ 77.4	\$ 85.8	\$ 243.4	\$ 252.5
Weighted Average Diluted Shares	171.8	173.0	171.6	174.0
Diluted Earnings per Share				
As reported	\$ 0.49	\$ 0.54	\$ 1.51	\$ 1.54
Adjusted	\$ 0.45	\$ 0.50	\$ 1.42	\$ 1.45

## 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 27, 2019	September 28, 2018	September 27, 2019	September 28, 2018
Net Sales				
Americas	\$ 77.6	\$ 78.6	\$ 239.2	\$ 232.1
EMEA	55.3	58.1	172.5	174.7
Asia Pacific	42.1	59.2	140.9	174.7
Total	\$ 175.0	\$ 195.9	\$ 552.6	\$ 581.5
Operating earnings as a percentage of net sales	33%	36%	34%	36%

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	(1)%	0%	0%	(1)%	3%	0%	0%	3%
EMEA	(1)%	0%	(4)%	(5)%	4%	0%	(5)%	(1)%
Asia Pacific	(28)%	0%	(1)%	(29)%	(16)%	0%	(3)%	(19)%
Segment Total	(9)%	0%	(2)%	(11)%	(2)%	0%	(3)%	(5)%

Continued softness in Asia Pacific end markets led to steep declines in third quarter Industrial segment sales. For the year to date, underlying sales growth in the Americas and EMEA was more than offset by decreases in Asia Pacific. Operating earnings as a percentage of sales decreased as the favorable effects of pricing were more than offset by the adverse impacts of currency translation, higher material costs, lower sales and factory volume, and product and channel mix.

### 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 27, 2019	September 28, 2018	September 27, 2019	September 28, 2018
Net Sales				
Americas	\$ 55.2	\$ 53.5	\$ 167.5	\$ 159.5
EMEA	15.4	13.8	45.5	43.2
Asia Pacific	13.5	17.3	43.1	47.0
Total	\$ 84.1	\$ 84.6	\$ 256.1	\$ 249.7
Operating earnings as a percentage of net sales	22%	21%	22%	21%

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	2%	1%	0%	3%	5%	0%	0%	5%
EMEA	6%	10%	(4)%	12%	6%	3%	(4)%	5%
Asia Pacific	(24)%	3%	(2)%	(23)%	(6)%	1%	(3)%	(8)%
Segment Total	(2)%	2%	(1)%	(1)%	3%	1%	(1)%	3%

Process segment sales comparisons to last year were also affected by weakness in Asia Pacific. For the quarter, decreases in Asia Pacific were largely offset by growth in the Americas and EMEA and the impact of acquired operations. Year-to-date sales at consistent translation rates increased in all product applications, although growth was lower and certain applications had decreases in the third quarter. Operating margin rates for the quarter and year to date improved, driven by lower volume and earnings-based costs.

### 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 27, 2019	September 28, 2018	September 27, 2019	September 28, 2018
Net Sales				
Americas	\$ 110.2	\$ 103.8	\$ 322.2	\$ 311.3
EMEA	23.3	22.4	76.5	74.6
Asia Pacific	8.0	9.3	26.4	29.8
Total	\$ 141.5	\$ 135.5	\$ 425.1	\$ 415.7
Operating earnings as a percentage of net sales	24%	24%	24%	25%

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	6%	0%	0%	6%	4%	0%	(1)%	3%
EMEA	8%	0%	(4)%	4%	8%	0%	(5)%	3%
Asia Pacific	(10)%	0%	(4)%	(14)%	(7)%	0%	(4)%	(11)%
Segment Total	5%	0%	(1)%	4%	4%	0%	(2)%	2%

Contractor segment sales for the quarter, at consistent currency translation rates, increased by 5 percent, driving year-to-date growth to 4 percent. The portion of Contractor sales in Asia Pacific is lower than other reporting segments, so weakness in that region had less impact on Contractor results. Operating margin rate for the quarter was consistent with the rate for the comparable quarter last year. Reductions in volume and earnings-based costs offset the adverse impacts of higher material costs and unfavorable product and channel mix. Operating margin rate for the year to date was 1 percentage point lower than last year due to changes in currency translation rates, higher material costs, lower factory volume and higher factory spending.

### Liquidity and Capital Resources

Net cash provided by operating activities totaled \$299 million in the first nine months of 2019, \$45 million higher than the comparable period of 2018. The 2018 period included a \$40 million cash contribution to one of the Company's U.S. qualified defined benefit retirement plans. Significant uses of cash in 2019 included property, plant and equipment additions of \$102 million, dividend payments of \$80 million, prepayment of \$75 million of private placement debt that was due in 2020, and business acquisitions totaling \$19 million. Proceeds from shares issued in the first nine months of 2019

totaled \$36 million, partially offset by \$5 million of payments for shares repurchased. The Company may make additional opportunistic share purchases going forward.

In 2018, other significant uses of cash included share repurchases of \$156 million, cash dividends of \$67 million, and property, plant and equipment additions of \$40 million.

At September 27, 2019, the Company had various lines of credit totaling \$594 million, of which \$548 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 2019, including its capital expenditure plan (including several building projects to expand production and distribution capacity), planned dividends, share repurchases, and acquisitions.

## **Outlook**

Given the sharp decline in Asia Pacific and slowing in our Industrial and Process businesses in the Americas, we are lowering our full-year 2019 worldwide outlook to flat revenue on a constant currency organic basis. Despite this downward change in outlook, we intend to fully fund our growth initiatives while remaining diligent on discretionary spending in this current cycle.

## **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 2018 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; changes in currency translation rates; economic conditions in the United States and other major world economies; 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; and variations in activity in the construction, automotive, mining and oil and natural gas industries. Please refer to Item 1A of our Annual Report on Form 10-K for fiscal year 2018 for a more comprehensive discussion of these and other risk factors. These reports are available on the Company’s website at [www.graco.com](http://www.graco.com) and the Securities and Exchange Commission’s website at [www.sec.gov](http://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 2018 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

There have been no material changes to the Company's risk factors from those disclosed in the Company's 2018 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 18,000,000 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.

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)
June 29, 2019 - July 26, 2019	—	\$ —	—	21,002,528
July 27, 2019 - Aug 23, 2019	10,000	\$ 44.63	10,000	20,992,528
Aug 24, 2019 - Sep 27, 2019	50,300	\$ 44.47	50,300	20,942,228

## 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.](#))
- 10.1 Graco Inc. Incentive Bonus Plan. ([Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K filed September 19, 2019.](#))
- [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 23, 2019.
- 101 Interactive data files pursuant to Rule 405 of Regulation S-T formatted in iXBRL (Inline eXtensible Business Reporting Language).

## 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 23, 2019</u>	By:	<u>/s/ Patrick J. McHale</u> Patrick J. McHale President and Chief Executive Officer <i>(Principal Executive Officer)</i>
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Date:	<u>October 23, 2019</u>	By:	<u>/s/ Mark W. Sheahan</u> Mark W. Sheahan Chief Financial Officer and Treasurer <i>(Principal Financial Officer)</i>
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Date:	<u>October 23, 2019</u>	By:	<u>/s/ Caroline M. Chambers</u> Caroline M. Chambers Executive Vice President, Corporate Controller and Information Systems <i>(Principal Accounting Officer)</i>
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## CERTIFICATION

I, Patrick J. McHale, certify that:

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

Date: October 23, 2019

/s/ Patrick J. McHale

Patrick J. McHale

President and Chief Executive Officer

## 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 23, 2019

/s/ Mark W. Sheahan

Mark W. Sheahan

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: October 23, 2019

/s/ Patrick J. McHale

Patrick J. McHale

President and Chief Executive Officer

Date: October 23, 2019

/s/ Mark W. Sheahan

Mark W. Sheahan

Chief Financial Officer and Treasurer

# News Release

**FOR IMMEDIATE RELEASE:**

Wednesday, October 23, 2019

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



**FOR FURTHER INFORMATION:**

Financial Contact: Mark Sheahan, 612-623-6656  
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[Charlotte\\_M\\_Boyd@graco.com](mailto:Charlotte_M_Boyd@graco.com)

## Graco Reports Third Quarter Results Weakness in Asia Pacific Pushes Sales and Earnings Down

**MINNEAPOLIS (October 23, 2019)** – Graco Inc. (NYSE: GGG) today announced results for the third quarter ended September 27, 2019.

### Summary

\$ in millions except per share amounts

	Three Months Ended			Nine Months Ended		
	Sep 27, 2019	Sep 28, 2018	% Change	Sep 27, 2019	Sep 28, 2018	% Change
Net Sales	\$ 400.6	\$ 415.9	(4) %	\$ 1,233.8	\$ 1,246.9	(1) %
Operating Earnings	103.4	114.8	(10) %	320.3	339.9	(6) %
Net Earnings	84.1	92.7	(9) %	259.0	267.3	(3) %
Diluted Net Earnings per Common Share	\$ 0.49	\$ 0.54	(9) %	\$ 1.51	\$ 1.54	(2) %
Adjusted (non-GAAP): <sup>(1)</sup>						
Net Earnings, adjusted	\$ 77.4	\$ 85.8	(10) %	\$ 243.4	\$ 252.5	(4) %
Diluted Net Earnings per Common Share, adjusted	\$ 0.45	\$ 0.50	(10) %	\$ 1.42	\$ 1.45	(2) %

(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.

- At consistent currency rates, sales growth in the Americas and EMEA was offset by decreases in Asia Pacific markets.
- Gross margin rates for the quarter and year to date decreased due to lower factory volume, unfavorable product and channel mix, and changes in currency translation rates.
- Total operating expenses decreased 3 percent for the quarter and 1 percent for the year to date.
- The effective income tax rates for the quarter and the year to date decreased mainly due to a tax rate change in a foreign jurisdiction.

“Steep declines in our Asia Pacific end markets continued to have a negative impact on sales for all reported segments, particularly the Industrial and Process segments,” said Patrick J. McHale, Graco’s President and CEO. “The softer end-market demand was broad based and driven by both slower economic growth in Asia Pacific and business uncertainty worldwide. On a positive note, our Contractor segment saw nice growth in the quarter as new products continue to be favorably received by professional painting contractors.”

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## Consolidated Results

Sales for the quarter decreased 4 percent from the comparable period last year (2 percent at consistent translation rates). Sales increased 3 percent in the Americas, were flat in EMEA (up 4 percent at consistent translation rates), and decreased by 26 percent in Asia Pacific (24 percent at consistent translation rates). Sales for the year to date decreased 1 percent from the comparable period last year (up 1 percent at consistent translation rates), with increases of 4 percent in the Americas and 1 percent in EMEA (6 percent at consistent translation rates), offset by a 16 percent decrease in Asia Pacific (13 percent at consistent translation rates). Changes in currency translation rates decreased worldwide sales by approximately \$6 million (2 percentage points) for the quarter and \$26 million (2 percentage points) for the year to date. Sales from acquired operations contributed approximately \$2 million (1 percentage point) of growth to the third quarter, and did not have a significant impact on year-to-date comparisons.

Gross profit margin rates for the quarter and year to date decreased from the comparable periods last year driven by lower factory volume, unfavorable channel and product mix, and changes in currency translation rates. Price changes implemented in the first quarter offset the adverse impact of higher material costs.

Total operating expenses for the quarter and year to date decreased \$3 million (3 percent) and \$4 million (1 percent), respectively, compared to last year. Reductions in volume and earnings-based expenses more than offset increases in product development expenses, which increased 6 percent for the quarter and 7 percent for the year to date.

Other expense for the year to date was \$4 million lower than the comparable period last year, driven by lower exchange losses on net assets of foreign operations.

The effective income tax rate was 13 percent for the quarter and 15 percent for the year to date, both down approximately 1 percentage point from the comparable periods last year. The decrease was driven by a revaluation of deferred taxes pursuant to a tax rate change in a foreign jurisdiction. The impact of the tax rate change was partially offset by the effects of decreases in excess tax benefits related to stock option exercises.

## 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)	\$ 175.0	\$ 84.1	\$ 141.5	\$ 552.6	\$ 256.1	\$ 425.1
Percentage change from last year						
Sales	(11)%	(1)%	4%	(5)%	3%	2 %
Operating earnings	(19)%	2 %	4%	(10)%	8%	(2)%
Operating earnings as a percentage of sales						
2019	33 %	22 %	24%	34 %	22%	24 %
2018	36 %	21 %	24%	36 %	21%	25 %

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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	(1)%	0%	0%	(1)%	3%	0%	0%	3%
EMEA	(1)%	0%	(4)%	(5)%	4%	0%	(5)%	(1)%
Asia Pacific	(28)%	0%	(1)%	(29)%	(16)%	0%	(3)%	(19)%
Consolidated	(9)%	0%	(2)%	(11)%	(2)%	0%	(3)%	(5)%

Continued softness in Asia Pacific end markets led to steep declines in third quarter Industrial segment sales. For the year to date, underlying sales growth in the Americas and EMEA was more than offset by decreases in Asia Pacific. Operating earnings as a percentage of sales decreased as the favorable effects of pricing were more than offset by the adverse impacts of currency translation, higher material costs, lower sales and factory volume, and product and channel mix.

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	2%	1%	0%	3%	5%	0%	0%	5%
EMEA	6%	10%	(4)%	12%	6%	3%	(4)%	5%
Asia Pacific	(24)%	3%	(2)%	(23)%	(6)%	1%	(3)%	(8)%
Consolidated	(2)%	2%	(1)%	(1)%	3%	1%	(1)%	3%

Process segment sales comparisons to last year were also affected by weakness in Asia Pacific. For the quarter, decreases in Asia Pacific were largely offset by growth in the Americas and EMEA and the impact of acquired operations. Year-to-date sales at consistent translation rates increased in all product applications, although growth was lower and certain applications had decreases in the third quarter. Operating margin rates for the quarter and year to date improved, driven by lower volume and earnings-based costs.

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	6%	0%	0%	6%	4%	0%	(1)%	3%
EMEA	8%	0%	(4)%	4%	8%	0%	(5)%	3%
Asia Pacific	(10)%	0%	(4)%	(14)%	(7)%	0%	(4)%	(11)%
Consolidated	5%	0%	(1)%	4%	4%	0%	(2)%	2%

Contractor segment sales at consistent currency translation rates increased by 5 percent, driving year-to-date growth to 4 percent. The portion of Contractor sales in Asia Pacific is lower than other reporting segments, so weakness in that region had less impact on Contractor results. Operating margin rate for the quarter was consistent with the rate for the comparable quarter last year. Reductions in volume and earnings-based costs offset the adverse impacts of higher material costs and unfavorable product and channel mix. Operating margin rate for the year to date was 1 percentage point lower than last year due to changes in currency translation rates, higher material costs, lower factory volume and higher factory spending.

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## Outlook

“Given the sharp decline in Asia Pacific and slowing in our Industrial and Process businesses in the Americas, we are lowering our full-year 2019 worldwide outlook to flat revenue on a constant currency organic basis,” said McHale. “Despite this downward change in outlook, we intend to fully fund our growth initiatives while remaining diligent on discretionary spending in this current cycle.”

## Financial Results Adjusted for Comparability

Excluding the impacts of excess tax benefits related to stock option exercises and certain tax provision adjustments presents a more consistent basis for comparison of financial results. A calculation of the non-GAAP measurements of 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 27, 2019	Sep 28, 2018	Sep 27, 2019	Sep 28, 2018
Earnings before income taxes	\$ 96.8	\$ 108.1	\$ 305.3	\$ 320.7
Income taxes, as reported	\$ 12.7	\$ 15.4	\$ 46.3	\$ 53.4
Excess tax benefit from option exercises	0.7	1.9	8.1	9.8
Other non-recurring tax benefit	6.0	5.0	7.5	5.0
Income taxes, adjusted	\$ 19.4	\$ 22.3	\$ 61.9	\$ 68.2
Effective income tax rate				
As reported	13.1%	14.2%	15.2%	16.6%
Adjusted	20.0%	20.6%	20.3%	21.2%
Net Earnings, as reported	\$ 84.1	\$ 92.7	\$ 259.0	\$ 267.3
Excess tax benefit from option exercises	(0.7)	(1.9)	(8.1)	(9.8)
Other non-recurring tax benefit	(6.0)	(5.0)	(7.5)	(5.0)
Net Earnings, adjusted	\$ 77.4	\$ 85.8	\$ 243.4	\$ 252.5
Weighted Average Diluted Shares	171.8	173.0	171.6	174.0
Diluted Earnings per Share				
As reported	\$ 0.49	\$ 0.54	\$ 1.51	\$ 1.54
Adjusted	\$ 0.45	\$ 0.50	\$ 1.42	\$ 1.45

## 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 2018 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

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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; changes in currency translation rates; economic conditions in the United States and other major world economies; 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; and variations in activity in the construction, automotive, mining and oil and natural gas industries. Please refer to Item 1A of our Annual Report on Form 10-K for fiscal year 2018 (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](http://www.graco.com) and the Securities and Exchange Commission's website at [www.sec.gov](http://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, Oct. 24, 2019, 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](http://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 Thursday, Oct. 24, 2019, by dialing 888-203-1112, Conference ID #9444495, if calling within the U.S. or Canada. The dial-in number for international participants is 719-457-0820, with the same Conference ID number. The replay by telephone will be available through 2 p.m. ET on Monday, Oct. 28, 2019.

### 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](http://www.graco.com).

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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 27, 2019	Sep 28, 2018	Sep 27, 2019	Sep 28, 2018
Net Sales	\$ 400,555	\$ 415,936	\$ 1,233,753	\$ 1,246,854
Cost of products sold	193,176	194,477	583,378	573,071
Gross Profit	207,379	221,459	650,375	673,783
Product development	16,723	15,734	50,616	47,135
Selling, marketing and distribution	55,538	57,270	176,796	182,741
General and administrative	31,719	33,676	102,676	104,054
Operating Earnings	103,399	114,779	320,287	339,853
Interest expense	3,618	3,583	10,584	10,707
Other expense, net	2,972	3,139	4,360	8,425
Earnings Before Income Taxes	96,809	108,057	305,343	320,721
Income taxes	12,677	15,376	46,325	53,390
Net Earnings	\$ 84,132	\$ 92,681	\$ 259,018	\$ 267,331
Net Earnings per Common Share				
Basic	\$ 0.50	\$ 0.55	\$ 1.56	\$ 1.59
Diluted	\$ 0.49	\$ 0.54	\$ 1.51	\$ 1.54
Weighted Average Number of Shares				
Basic	166,848	167,247	166,383	167,860
Diluted	171,777	173,037	171,561	173,984

**SEGMENT INFORMATION (Unaudited)**  
(In thousands)

	Three Months Ended		Nine Months Ended	
	Sep 27, 2019	Sep 28, 2018	Sep 27, 2019	Sep 28, 2018
Net Sales				
Industrial	\$ 175,016	\$ 195,855	\$ 552,623	\$ 581,510
Process	84,090	84,556	256,048	249,650
Contractor	141,449	135,525	425,082	415,694
Total	\$ 400,555	\$ 415,936	\$ 1,233,753	\$ 1,246,854
Operating Earnings				
Industrial	\$ 57,023	\$ 70,572	\$ 186,654	\$ 206,727
Process	18,194	17,862	56,586	52,629
Contractor	34,005	32,739	100,598	102,532
Unallocated corporate (expense)	(5,823)	(6,394)	(23,551)	(22,035)
Total	\$ 103,399	\$ 114,779	\$ 320,287	\$ 339,853

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](http://www.graco.com).

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