

GRACO INC  
Form 10-Q  
April 24, 2019

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

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15 (d) of the  
Securities Exchange Act of 1934

For the quarterly period ended March 29, 2019

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. 55413  
Minneapolis, Minnesota  
(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  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 NoX

166,518,239 shares of the Registrant's Common Stock, \$1.00 par value, were outstanding as of April 17, 2019.

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TABLE OF CONTENTS

|  | Page      |
|--|-----------|
| PART I - FINANCIAL INFORMATION   |           |
| Item 1. <u>Financial Statements</u>  |           |
| <u>Consolidated Statements of Earnings</u>   | <u>3</u>  |
| <u>Consolidated Statements of Comprehensive Income</u>   | <u>3</u>  |
| <u>Consolidated Balance Sheets</u>   | <u>4</u>  |
| <u>Consolidated Statements of Cash Flows</u>   | <u>5</u>  |
| <u>Consolidated Statements of Shareholders' Equity</u>   | <u>6</u>  |
| <u>Notes to Consolidated Financial Statements</u>  | <u>7</u>  |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>15</u> |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>                            | <u>21</u> |
| Item 4. <u>Controls and Procedures</u>   | <u>21</u> |
| PART II - OTHER INFORMATION  |           |
| Item 1A. <u>Risk Factors</u>   | <u>22</u> |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>                           | <u>22</u> |
| Item 6. <u>Exhibits</u>  | <u>23</u> |

SIGNATURES

EXHIBITS

Table of Contents

## PART I Item 1.

## GRACO INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited) (In thousands except per share amounts)

|                                     | Three Months Ended  |           |
|-------------------------------------|---------------------|-----------|
|                                     | March 29, March 30, |           |
|                                     | 2019                | 2018      |
| Net Sales                           | \$404,870           | \$406,348 |
| Cost of products sold               | 188,828             | 183,927   |
| Gross Profit                        | 216,042             | 222,421   |
| Product development                 | 16,569              | 15,289    |
| Selling, marketing and distribution | 60,817              | 62,522    |
| General and administrative          | 34,129              | 32,914    |
| Operating Earnings                  | 104,527             | 111,696   |
| Interest expense                    | 3,535               | 3,233     |
| Other expense, net                  | 269                 | 1,035     |
| Earnings Before Income Taxes        | 100,723             | 107,428   |
| Income taxes                        | 13,974              | 21,918    |
| Net Earnings                        | \$86,749            | \$85,510  |
| Net Earnings per Common Share       |                     |           |
| Basic                               | \$0.52              | \$0.51    |
| Diluted                             | \$0.51              | \$0.49    |

See notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited) (In thousands)

|  | Three Months        |          |
|--|---------------------|----------|
|  | Ended               |          |
|  | March 29, March 30, |          |
|  | 2019                | 2018     |
| Net Earnings   | \$86,749            | \$85,510 |
| Components of other comprehensive income (loss)                        |                     |          |
| Cumulative translation adjustment                                      | 1,169               | 8,746    |
| Pension and postretirement medical liability adjustment                | 2,127               | 1,826    |
| Income taxes - pension and postretirement medical liability adjustment | (470 )              | (401 )   |
| Other comprehensive income   | 2,826               | 10,171   |
| Comprehensive Income   | \$89,575            | \$95,681 |

See notes to consolidated financial statements.

Table of Contents

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

|   | March 29,<br>2019 | December 28,<br>2018 |
|---|-------------------|----------------------|
| <b>ASSETS</b>   |                   |                      |
| Current Assets  |                   |                      |
| Cash and cash equivalents                                   | \$ 119,711        | \$ 132,118           |
| Accounts receivable, less allowances of \$5,400 and \$5,300 | 289,047           | 274,608              |
| Inventories   | 297,458           | 283,982              |
| Other current assets  | 27,293            | 32,508               |
| Total current assets  | 733,509           | 723,216              |
| Property, Plant and Equipment, net                          | 256,776           | 229,295              |
| Goodwill  | 295,136           | 293,846              |
| Other Intangible Assets, net                                | 166,613           | 166,310              |
| Operating Lease Assets                                      | 33,726            | —                    |
| Deferred Income Taxes                                       | 33,368            | 32,055               |
| Other Assets  | 29,919            | 28,019               |
| Total Assets  | \$ 1,549,047      | \$ 1,472,741         |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                 |                   |                      |
| Current Liabilities   |                   |                      |
| Notes payable to banks                                      | \$ 7,557          | \$ 11,083            |
| Current portion of long term debt                           | 75,000            | —                    |
| Trade accounts payable                                      | 67,275            | 56,902               |
| Salaries and incentives                                     | 39,937            | 62,297               |
| Dividends payable   | 26,486            | 26,480               |
| Other current liabilities                                   | 137,789           | 143,041              |
| Total current liabilities                                   | 354,044           | 299,803              |
| Long-term Debt  | 173,738           | 266,391              |
| Retirement Benefits and Deferred Compensation               | 134,631           | 133,388              |
| Operating Lease Liabilities                                 | 26,225            | —                    |
| Deferred Income Taxes                                       | 15,971            | 16,586               |
| Other Non-current Liabilities                               | —                 | 4,700                |
| Shareholders' Equity  |                   |                      |
| Common stock  | 166,364           | 165,171              |
| Additional paid-in-capital                                  | 539,067           | 510,825              |
| Retained earnings   | 281,038           | 220,734              |
| Accumulated other comprehensive income (loss)               | (142,031 )        | (144,857 )           |
| Total shareholders' equity                                  | 844,438           | 751,873              |
| Total Liabilities and Shareholders' Equity                  | \$ 1,549,047      | \$ 1,472,741         |
| See notes to consolidated financial statements.             |                   |                      |

Table of Contents

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

|  | Three Months Ended |                   |
|--|--------------------|-------------------|
|  | March 29,<br>2019  | March 30,<br>2018 |
| Cash Flows From Operating Activities   |                    |                   |
| Net Earnings   | \$86,749           | \$85,510          |
| Adjustments to reconcile net earnings to net cash provided by operating activities |                    |                   |
| Depreciation and amortization  | 12,013             | 12,651            |
| Deferred income taxes  | (2,215 )           | (2,037 )          |
| Share-based compensation   | 7,221              | 6,622             |
| Change in  |                    |                   |
| Accounts receivable  | (13,874 )          | (20,798 )         |
| Inventories  | (13,547 )          | (7,142 )          |
| Trade accounts payable   | 8,043              | (1,659 )          |
| Salaries and incentives  | (23,692 )          | (22,803 )         |
| Retirement benefits and deferred compensation                                      | 3,547              | 3,558             |
| Other accrued liabilities  | (11,437 )          | 6,247             |
| Other  | (2,262 )           | (1,397 )          |
| Net cash provided by operating activities  | 50,546             | 58,752            |
| Cash Flows From Investing Activities   |                    |                   |
| Property, plant and equipment additions  | (30,433 )          | (8,961 )          |
| Acquisition of businesses, net of cash acquired                                    | (5,353 )           | (10,880 )         |
| Other  | (367 )             | 5                 |
| Net cash provided by (used in) investing activities                                | (36,153 )          | (19,836 )         |
| Cash Flows From Financing Activities   |                    |                   |
| Borrowings (payments) on short-term lines of credit, net                           | (3,596 )           | 5,050             |
| Borrowings on long-term lines of credit  | 16,057             | 115,465           |
| Payments on long-term debt and lines of credit                                     | (34,540 )          | (58,828 )         |
| Common stock issued  | 24,847             | 17,316            |
| Common stock repurchased   | (2,438 )           | (84,719 )         |
| Taxes paid related to net share settlement of equity awards                        | (1,268 )           | —                 |
| Cash dividends paid  | (26,438 )          | (22,445 )         |
| Net cash provided by (used in) financing activities                                | (27,376 )          | (28,161 )         |
| Effect of exchange rate changes on cash  | 576                | (606 )            |
| Net increase (decrease) in cash and cash equivalents                               | (12,407 )          | 10,149            |
| Cash, Cash Equivalents and Restricted Cash   |                    |                   |
| Beginning of year  | 132,118            | 112,904           |
| End of period  | \$119,711          | \$123,053         |
| Reconciliation to Consolidated Balance Sheets                                      |                    |                   |
| Cash and cash equivalents  | \$119,711          | \$113,832         |
| Restricted cash included in other current assets                                   | —                  | 9,221             |
| Cash, cash equivalents and restricted cash   | \$119,711          | \$123,053         |
| See notes to consolidated financial statements.                                    |                    |                   |

Table of Contents

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

|   | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total      |
|---|-----------------|----------------------------------|----------------------|--|------------|
| Balance, December 29, 2017                  | \$ 169,319      | 499,934                          | 181,599              | \$ (127,789 )  | \$ 723,063 |
| Shares issued                               | 765             | 17,323                           | —                    | —  | 18,088     |
| Shares repurchased                          | (2,051 )        | (6,055 )                         | (83,407 )            | —  | (91,513 )  |
| Stock compensation cost                     | —               | 5,263                            | —                    | —  | 5,263      |
| Restricted stock canceled (issued)          | —               | (772 )                           | —                    | —  | (772 )     |
| Net earnings                                | —               | —                                | 85,510               | —  | 85,510     |
| Dividends declared (\$0.1325 per share)     | —               | —                                | (22,631 )            | —  | (22,631 )  |
| Reclassified to retained earnings from AOCI | —               | —                                | 15,453               | (15,453 )  | —          |
| Other comprehensive income (loss)           | —               | —                                | —                    | 10,171   | 10,171     |
| Balance, March 30, 2018                     | \$ 168,033      | 515,693                          | 176,524              | \$ (133,071 )  | \$ 727,179 |
| Balance, December 28, 2018                  | \$ 165,171      | \$ 510,825                       | \$ 220,734           | \$ (144,857)   | \$ 751,873 |
| Shares issued                               | 1,193           | 22,386                           | —                    | 23,579   |            |
| Stock compensation cost                     | —               | 5,856                            | —                    | 5,856  |            |
| Net earnings                                | —               | —                                | 86,749               | 86,749   |            |
| Dividends declared (\$0.1600 per share)     | —               | —                                | (26,445 )            | (26,445 )  |            |
| Other comprehensive income (loss)           | —               | —                                | —                    | 2,826  | 2,826      |
| Balance, March 29, 2019                     | \$ 166,364      | 539,067                          | 281,038              | \$ (142,031)   | \$ 844,438 |

See notes to consolidated financial statements.

Table of Contents

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

## 1. Basis of Presentation

The consolidated balance sheet of Graco Inc. and Subsidiaries (the “Company”) as of March 29, 2019 and the related statements of earnings, comprehensive income and shareholders' equity for the three months ended March 29, 2019 and March 30, 2018, and cash flows for the three months ended March 29, 2019 and March 30, 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 March 29, 2019, and the results of operations and cash flows for all periods presented. Certain prior year disclosures have been revised to conform to current year reporting.

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 |                   |
|---------------------------------|--------------------|-------------------|
|                                 | March 29,<br>2019  | March 30,<br>2018 |
| Net Sales                       |                    |                   |
| Industrial                      | \$ 189,100         | \$ 195,196        |
| Process                         | 86,894             | 80,035            |
| Contractor                      | 128,876            | 131,117           |
| Total                           | \$ 404,870         | \$ 406,348        |
| Operating Earnings              |                    |                   |
| Industrial                      | \$ 65,203          | \$ 69,125         |
| Process                         | 20,014             | 17,702            |
| Contractor                      | 26,539             | 31,411            |
| Unallocated corporate (expense) | (7,229 )           | (6,542 )          |
| Total                           | \$ 104,527         | \$ 111,696        |

Assets by segment were as follows (in thousands):

|                       | March 29,<br>2019 | December 28,<br>2018 |
|-----------------------|-------------------|----------------------|
| Industrial            | \$ 649,643        | \$ 640,683           |
| Process               | 366,501           | 350,306              |
| Contractor            | 295,457           | 283,727              |
| Unallocated corporate | 237,446           | 198,025              |



Total \$1,549,047 \$ 1,472,741

7

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Table of Contents

Geographic information follows (in thousands):

|  | Three Months Ended |                |
|--|--------------------|----------------|
|  | March 29, 2019     | March 30, 2018 |
| Net Sales (based on customer location) |                    |                |
| United States                          | \$202,885          | \$193,782      |
| Other countries                        | 201,985            | 212,566        |
| Total                                  | \$404,870          | \$406,348      |

|  | March 29, 2019 | December 28, 2018 |
|--|----------------|-------------------|
|--|----------------|-------------------|

|                   |           |           |
|-------------------|-----------|-----------|
| Long-lived Assets |           |           |
| United States     | \$202,733 | \$178,331 |
| Other countries   | 54,043    | 50,964    |
| Total             | \$256,776 | \$229,295 |

## 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 |                |
|--|--------------------|----------------|
|  | March 29, 2019     | March 30, 2018 |
| Net earnings available to common shareholders  | \$86,749           | \$85,510       |
| Weighted average shares outstanding for basic earnings per share                                       | 165,616            | 169,073        |
| Dilutive effect of stock options computed using the treasury stock method and the average market price | 5,243              | 6,576          |
| Weighted average shares outstanding for diluted earnings per share                                     | 170,859            | 175,649        |
| Basic earnings per share   | \$0.52             | \$0.51         |
| Diluted earnings per share   | \$0.51             | \$0.49         |

Stock options to purchase 1,681,000 and 1,020,000 shares were not included in the March 29, 2019 and March 30, 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                        | 1,200         | 45.55                           |                     |                                 |
| Exercised                      | (815)         | 12.75                           |                     |                                 |
| Canceled                       | (10)          | 30.25                           |                     |                                 |
| Outstanding, March 29, 2019    | 12,645        | \$27.41                         | 8,029               | \$22.74                         |



Table of Contents

The Company recognized year-to-date share-based compensation of \$7.2 million in 2019 and \$6.6 million in 2018. As of March 29, 2019, there was \$18.4 million of unrecognized compensation cost related to unvested options, expected to be recognized over a weighted average period of 1.7 years.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions and results:

|                                       | Three Months<br>Ended<br>March 29, March 30,<br>2019 2018 |   |         |   |
|---------------------------------------|---|---|---------|---|
| Expected life in years                | 7.5   |   | 7.5     |   |
| Interest rate                         | 2.6   | % | 2.8     | % |
| Volatility                            | 24.6  | % | 25.6    | % |
| Dividend yield                        | 1.4   | % | 1.2     | % |
| Weighted average fair value per share | \$12.19   |   | \$12.79 |   |

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:

|                                       | Three Months<br>Ended<br>March 29, March 30,<br>2019 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<br>Ended<br>March 29, March 30,<br>2019 2018 |          |
|-------------------------------|---|----------|
| <b>Pension Benefits</b>       |   |          |
| Service cost                  | \$2,009   | \$ 2,213 |
| Interest cost                 | 3,738   | 3,434    |
| Expected return on assets     | (4,359 )  | (4,086 ) |
| Amortization and other        | 1,979   | 2,095    |
| Net periodic benefit cost     | \$3,367   | \$ 3,656 |
| <b>Postretirement Medical</b> |   |          |
| Service cost                  | \$ 150  | \$ 175   |
| Interest cost                 | 317   | 264      |
| Amortization                  | 108   | 136      |
| Net periodic benefit cost     | \$575   | \$ 575   |



Table of Contents

## 6.Shareholders' Equity

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

|  | Pension and<br>Postretirement<br>Medical | Cumulative<br>Translation<br>Adjustment | Total        |
|--|--|---|--------------|
| Balance, December 29, 2017                                 | \$ (78,430 )                             | \$ (49,359 )                            | \$ (127,789) |
| Other comprehensive income (loss) before reclassifications | —  | 8,746                                   | 8,746        |
| Reclassified to pension cost and deferred tax              | 1,425                                    | —                                       | 1,425        |
| Reclassified to retained earnings                          | (15,453 )                                | —                                       | (15,453 )    |
| Balance, March 30, 2018                                    | \$ (92,458 )                             | \$ (40,613 )                            | \$ (133,071) |
| Balance, December 28, 2018                                 | \$(86,889)                               | \$(57,968)                              | \$(144,857)  |
| Other comprehensive income (loss) before reclassifications | —  | 1,169                                   | 1,169        |
| Reclassified to pension cost and deferred tax              | 1,657                                    | —                                       | 1,657        |
| Balance, March 29, 2019                                    | \$(85,232)                               | \$(56,799)                              | \$(142,031)  |

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.

Table of Contents

## 7. Inventories

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

|   | March 29,<br>2019 | December 28,<br>2018 |
|---|-------------------|----------------------|
| Finished products and components                        | \$145,934         | \$ 142,535           |
| Products and components in various stages of completion | 86,721            | 83,768               |
| Raw materials and purchased components                  | 123,509           | 115,705              |
| Subtotal  | 356,164           | 342,008              |
| Reduction to LIFO cost                                  | (58,706 )         | (58,026 )            |
| Total   | \$297,458         | \$ 283,982           |

## 8. Intangible Assets

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

|                                | Finite Life               |  |  | Indefinite<br>Life | Total     |
|--------------------------------|---------------------------|--|--|--------------------|-----------|
|                                | Customer<br>Relationships | Patents and<br>Proprietary<br>Technology | Trademarks,<br>Trade<br>Names<br>and Other | Trade<br>Names     |           |
| As of March 29, 2019           |                           |  |  |                    |           |
| Cost                           | \$182,410                 | \$ 18,913                                | \$ 1,021                                   | \$60,220           | \$262,564 |
| Accumulated amortization       | (70,646 )                 | (9,100 )                                 | (492 )                                     | —                  | (80,238 ) |
| Foreign currency translation   | (10,560 )                 | (896 )                                   | (74 )                                      | (4,183 )           | (15,713 ) |
| Book value                     | \$101,204                 | \$ 8,917                                 | \$ 455                                     | \$56,037           | \$166,613 |
| Weighted average life in years | 13                        | 10                                       | 4  | N/A                |           |
| 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 | 13                        | 10                                       | 4  | N/A                |           |

Amortization of intangibles for the quarter was \$3.8 million in 2019 and \$4.0 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 | \$15,424 | \$15,413 | \$14,838 | \$14,980 | \$13,992 | \$39,759   |

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 | —          | 1,354    | —          | 1,354     |
| Foreign currency translation                      | (630 )     | 566      | —          | (64 )     |
| Balance, March 29, 2019                           | \$176,494  | \$99,088 | \$19,554   | \$295,136 |

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





Table of Contents

## 9. Other Current Liabilities

Components of other current liabilities were (in thousands):

|  | March 29, December 28, |            |
|--|------------------------|------------|
|  | 2019                   | 2018       |
| Accrued self-insurance retentions        | \$ 7,795               | \$ 7,870   |
| Accrued warranty and service liabilities | 11,448                 | 11,056     |
| Accrued trade promotions                 | 7,222                  | 11,449     |
| Payable for employee stock purchases     | 2,413                  | 11,916     |
| Customer advances and deferred revenue   | 39,922                 | 39,995     |
| Income taxes payable                     | 11,221                 | 8,515      |
| Right of return refund liability         | 12,691                 | 12,705     |
| Operating lease liability, current       | 9,460                  | —          |
| Other                                    | 35,617                 | 39,535     |
| Total                                    | \$ 137,789             | \$ 143,041 |

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             | 2,429     |
| Margin on parts sales reversed | 961       |
| Reductions for claims settled  | (2,998 )  |
| Balance, March 29, 2019        | \$ 11,448 |

## 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 \$39.9 million as of March 29, 2019 and \$40.0 million as of December 28, 2018. Net sales for the quarter included \$19.7 million in 2019 and \$17.9 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 | March 29, December 28, |           |
|--|-------|------------------------|-----------|
|  |       | 2019                   | 2018      |
| <b>Assets</b>                          |       |                        |           |
| Cash surrender value of life insurance | 2     | \$ 16,078              | \$ 14,320 |
| Forward exchange contracts             | 2     | —                      | 82        |
| Total assets at fair value             |       | \$ 16,078              | \$ 14,402 |
| <b>Liabilities</b>                     |       |                        |           |
| Contingent consideration               | 3     | \$ 4,000               | \$ 7,200  |
| Deferred compensation                  | 2     | 4,595                  | 4,203     |
| Forward exchange contracts             | 2     | 9                      | —         |
| Total liabilities at fair value        |       | \$ 8,604               | \$ 11,403 |



## Table of Contents

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 \$225 million and an estimated fair value of \$240 million as of March 29, 2019 and \$235 million as of December 28, 2018. 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 approximately \$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 whether existing lease 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 March 29, 2019, the weighted average remaining lease term was 6.0 years and the weighted average discount rate used to determine the operating lease liability was 4.2%. For the three months ended March 29, 2019, expense related to operating leases was \$2.8 million, operating lease payments included in operating cash flows totaled \$2.7 million and non-cash additions to operating lease assets totaled \$1.8 million.

Table of Contents

As of March 29, 2019, future maturities of operating lease liabilities were as follows (in thousands):

|                             | Operating<br>Leases |
|-----------------------------|---------------------|
| 2019                        | \$7,651             |
| 2020                        | 8,250               |
| 2021                        | 6,317               |
| 2022                        | 5,012               |
| 2023                        | 3,839               |
| 2024                        | 1,831               |
| Thereafter                  | 7,527               |
| Total lease payments        | \$40,427            |
| Present value adjustment    | (4,742 )            |
| Operating lease liabilities | \$35,685            |

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      | \$38,280 |

## 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 is evaluating the effect of the new standard on its consolidated financial statements and related disclosures and accounting systems.

Table of Contents

## 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 |         |        |
|--|--------------------|---------|--------|
|  | Mar 29, Mar 30, %  |         |        |
|  | 2019               | 2018    | Change |
| Net Sales  | \$404.9            | \$406.3 | — %    |
| Operating Earnings   | 104.5              | 111.7   | (6 )%  |
| Net Earnings   | 86.7               | 85.5    | 1 %    |
| Net Earnings, adjusted <sup>(1)</sup>                          | 80.1               | 84.1    | (5 )%  |
| Diluted Net Earnings per Common Share                          | \$0.51             | \$0.49  | 4 %    |
| Diluted Net Earnings per Common Share, adjusted <sup>(1)</sup> | \$0.47             | \$0.48  | (2 )%  |

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

Sales for the quarter were down slightly from the comparable period last year, with increases of 5 percent in the Americas offset by decreases of 2 percent in EMEA (increase of 5 percent at consistent translation rates) and 12 percent in Asia Pacific (decrease of 8 percent at consistent translation rates). In Asia Pacific, increases in Process and Contractor segment sales partially offset a decrease in Industrial segment sales. Changes in currency translation rates decreased worldwide sales and operating earnings by approximately \$11 million (2 percentage points) and \$6 million (5 percentage points), respectively.

Table of Contents

Excluding the impact of tax benefits related to stock option exercises and the effects of 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<br>Ended |                 |
|--|-----------------------|-----------------|
|  | Mar 29,<br>2019       | Mar 30,<br>2018 |
| Earnings before income taxes             | \$ 100.7              | \$ 107.4        |
| Income taxes, as reported                | \$ 14.0               | \$ 21.9         |
| Excess tax benefit from option exercises | 5.1                   | 1.4             |
| Other non-recurring tax benefit          | 1.5                   | —               |
| Income taxes, adjusted                   | \$ 20.6               | \$ 23.3         |
| Effective income tax rate                |                       |                 |
| As reported                              | 13.9 %                | 20.4 %          |
| Adjusted                                 | 20.5 %                | 21.7 %          |
| Net Earnings, as reported                | \$ 86.7               | \$ 85.5         |
| Excess tax benefit from option exercises | (5.1 )                | (1.4 )          |
| Other non-recurring tax benefit          | (1.5 )                | —               |
| Net Earnings, adjusted                   | \$ 80.1               | \$ 84.1         |
| Weighted Average Diluted Shares          | 170.9                 | 175.6           |
| Diluted Earnings per Share               |                       |                 |
| As reported                              | \$ 0.51               | \$ 0.49         |
| Adjusted                                 | \$ 0.47               | \$ 0.48         |

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

|                                     | Three Months<br>Ended |                 |
|-------------------------------------|-----------------------|-----------------|
|                                     | Mar 29,<br>2019       | Mar 30,<br>2018 |
| Net Sales                           | 100.0%                | 100.0%          |
| Cost of products sold               | 46.6                  | 45.3            |
| Gross Profit                        | 53.4                  | 54.7            |
| Product development                 | 4.1                   | 3.7             |
| Selling, marketing and distribution | 15.0                  | 15.4            |
| General and administrative          | 8.4                   | 8.1             |
| Operating Earnings                  | 25.8                  | 27.5            |
| Interest expense                    | 0.9                   | 0.8             |
| Other expense, net                  | 0.1                   | 0.3             |
| Earnings Before Income Taxes        | 24.9                  | 26.4            |
| Income taxes                        | 3.5                   | 5.4             |
| Net Earnings                        | 21.4 %                | 21.0 %          |





Table of Contents

## Net Sales

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

|                         | Three Months<br>Ended<br>Mar 29, Mar 30,<br>2019 2018 |         |
|-------------------------|---|---------|
| Americas <sup>(1)</sup> | \$232.0   | \$221.4 |
| EMEA <sup>(2)</sup>     | 99.5  | 101.4   |
| Asia Pacific            | 73.4  | 83.5    |
| Consolidated            | \$404.9   | \$406.3 |

(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<br>Volume and Price Acquisitions Currency Total |    |      |       |
|--------------|--|----|------|-------|
| Americas     | 5%   | 0% | 0%   | 5%    |
| EMEA         | 5%   | 0% | (7)% | (2)%  |
| Asia Pacific | (8)%   | 0% | (4)% | (12)% |
| Consolidated | 2%   | 0% | (2)% | 0%    |

## Gross Profit

Gross profit margin rate for the quarter decreased by 1 percentage point from the comparable period last year. Changes in currency translation rates accounted for approximately half of the decrease, and the impact of price changes partially offset the adverse impacts of higher material costs and product and channel mix. The full impact of price changes implemented in the first quarter will be realized as the year progresses.

## Operating Expenses

Total operating expenses for the quarter increased \$1 million (1 percent) compared to last year. Product development expense increased 8 percent as the Company continued to invest to launch products and drive future sales.

## Income Taxes

The effective income tax rate was 14 percent for the quarter, down 6 percentage points from the comparable period last year. The decrease was primarily due to an increase in excess tax benefits related to stock option exercises and non-recurring benefits from other tax planning activities.

Table of Contents

## 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<br>Ended |                 |
|---|-----------------------|-----------------|
|   | Mar 29,<br>2019       | Mar 30,<br>2018 |
| Net Sales                                       |                       |                 |
| Americas  | \$80.9                | \$74.2          |
| EMEA  | 58.1                  | 60.2            |
| Asia Pacific                                    | 50.1                  | 60.8            |
| Total   | \$189.1               | \$195.2         |
| Operating earnings as a percentage of net sales | 34 %                  | 35 %            |

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

|               | Three Months     |              |          |       |
|---------------|------------------|--------------|----------|-------|
|               | Volume and Price | Acquisitions | Currency | Total |
| Americas      | 10%              | 0%           | (1)%     | 9%    |
| EMEA          | 3%               | 0%           | (7)%     | (4)%  |
| Asia Pacific  | (14)%            | 0%           | (4)%     | (18)% |
| Segment Total | 0%               | 0%           | (3)%     | (3)%  |

Industrial segment constant-currency sales growth in the Americas and EMEA was offset by a decrease in Asia Pacific, where 2018 included large system sales that did not repeat in 2019. Currency translation drove a decrease in operating margin as a percentage of sales. Gross margin and operating expenses were flat at consistent currency translation rates.

## 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<br>Ended |                 |
|---|-----------------------|-----------------|
|   | Mar 29,<br>2019       | Mar 30,<br>2018 |
| Net Sales                                       |                       |                 |
| Americas  | \$57.1                | \$51.3          |
| EMEA  | 15.8                  | 15.0            |
| Asia Pacific                                    | 14.0                  | 13.7            |
| Total   | \$86.9                | \$80.0          |
| Operating earnings as a percentage of net sales | 23 %                  | 22 %            |



Table of Contents

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

|               | Three Months     |              |          |       |
|---------------|------------------|--------------|----------|-------|
|               | Volume and Price | Acquisitions | Currency | Total |
| Americas      | 12%              | 0%           | (1)%     | 11%   |
| EMEA          | 9%               | 1%           | (5)%     | 5%    |
| Asia Pacific  | 6%               | 0%           | (4)%     | 2%    |
| Segment Total | 10%              | 0%           | (1)%     | 9%    |

The Process segment had strong sales growth in all product applications. Gross margin rates were consistent with the comparable period last year at constant currency translation rates. Operating margin rates for this segment improved by 1 percentage point, driven by higher sales volume and expense leverage.

## 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           |                 |
|   | Mar 29,<br>2019 | Mar 30,<br>2018 |
| Net Sales                                       |                 |                 |
| Americas  | \$94.0          | \$95.9          |
| EMEA  | 25.6            | 26.2            |
| Asia Pacific                                    | 9.3             | 9.0             |
| Total   | \$128.9         | \$131.1         |
| Operating earnings as a percentage of net sales | 21 %            | 24 %            |

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

|               | Three Months     |              |          |       |
|---------------|------------------|--------------|----------|-------|
|               | Volume and Price | Acquisitions | Currency | Total |
| Americas      | (2)%             | 0%           | 0%       | (2)%  |
| EMEA          | 5%               | 0%           | (7)%     | (2)%  |
| Asia Pacific  | 9%               | 0%           | (5)%     | 4%    |
| Segment Total | 0%               | 0%           | (2)%     | (2)%  |

Contractor segment sales decreased by 2 percent (but were flat at consistent translation rates) against tough comparisons from 2018 (up 15 percent over 2017). Segment sales in 2019 were lower than planned as new products scheduled for launch early in the first quarter were released for sale late in the quarter. At consistent currency translation rates, segment gross margin rate decreased 2 percentage points due to lower factory volume, higher factory spending, higher material costs and unfavorable channel mix. The segment limited operating expenses to an increase of 1 percent.

## Liquidity and Capital Resources

Net cash provided by operating activities totaled \$51 million in the first quarter of 2019 compared to \$59 million in 2018. Changes in accrued liabilities, including income taxes payable, drove the decrease. Increases in accounts receivable and inventories reflect growth in business activity in the three months ended March 29, 2019. Significant uses of cash in 2019 included cash dividends of \$26 million, property, plant and equipment additions of \$30 million and business acquisitions of \$5 million. Proceeds from shares issued in the first quarter of 2019 totaled \$25 million,

partially offset by \$2 million of payments for shares repurchased in 2018 and settled in 2019. Although the Company did not repurchase any shares in the first quarter of 2019, it may make additional opportunistic purchases going forward.

## Table of Contents

In 2018, significant uses of cash included share repurchases of \$85 million (partially offset by \$17 million of net proceeds from shares issued), cash dividends of \$22 million, business acquisitions of \$11 million, and property, plant and equipment additions of \$9 million.

At March 29, 2019, the Company had various lines of credit totaling \$594 million, of which \$564 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, acquisitions and potential early retirement of \$75 million of fixed rate notes due in January 2020.

## Outlook

The Company continues to target mid single-digit organic sales growth on a constant currency basis, and growth in all reportable segments and regions for the full-year 2019,

## 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.



Table of Contents

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.



Table of Contents

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.

No shares were purchased in the first quarter of 2019. As of March 29, 2019, there were 21,002,528 shares that may yet be purchased under the Board authorizations.

Table of Contents

Item 6.Exhibits

3.1 Restated Articles of Incorporation as amended December 8, 2017. (Incorporated by reference to Exhibit 3.1 to the Company's Report on Form 8-K filed December 8, 2017.)

3.2 Restated Bylaws as amended February 14, 2014. (Incorporated by reference to Exhibit 3.2 to the Company's 2013 Annual Report on Form 10-K.)

31.1 Certification of President and Chief Executive Officer pursuant to Rule 13a-14(a).

31.2 Certification of Chief Financial Officer and Treasurer pursuant to Rule 13a-14(a).

32 Certification of President and Chief Executive Officer and Chief Financial Officer and Treasurer pursuant to Section 1350 of Title 18, U.S.C.

99.1 Press Release Reporting First Quarter Earnings dated April 24, 2019.

101 Interactive Data File.

23

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Table of Contents

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: April 24, 2019 By: /s/ Patrick J. McHale  
Patrick J. McHale  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: April 24, 2019 By: /s/ Mark W. Sheahan  
Mark W. Sheahan  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)

Date: April 24, 2019 By: /s/ Caroline M. Chambers  
Caroline M. Chambers  
Executive Vice President, Corporate Controller  
and Information Systems  
(Principal Accounting Officer)