

GRACO INC  
Form 10-K  
February 20, 2018

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 29, 2017, or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_ .  
Commission File No. 001-09249

Graco Inc.

(Exact name of Registrant as specified in its charter)

Minnesota

41-0285640

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

88 –11th Avenue Northeast

Minneapolis, MN 55413

(Address of principal executive offices) (Zip Code)

(612) 623-6000

(Registrant's telephone number, including area code)

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

Common Stock, par value \$1.00 per share

Shares registered on the New York Stock Exchange.

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Act). Yes  No

Edgar Filing: GRACO INC - Form 10-K

The aggregate market value of 165,114,221 shares of common stock held by non-affiliates of the registrant was \$6,014,560,705 as of June 30, 2017.

169,442,333 shares of common stock were outstanding as of January 31, 2018.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Company's definitive Proxy Statement for its Annual Meeting of Shareholders to be held on April 27, 2018, are incorporated by reference into Part III, as specifically set forth in said Part III.

---

## TABLE OF CONTENTS

	Page
Part I	
Item 1 <u>Business</u>	<u>3</u>
Item 1A <u>Risk Factors</u>	<u>7</u>
Item 1B <u>Unresolved Staff Comments</u>	<u>10</u>
Item 2 <u>Properties</u>	<u>10</u>
Item 3 <u>Legal Proceedings</u>	<u>11</u>
Item 4 <u>Mine Safety Disclosures</u>	<u>11</u>
<u>Executive Officers of Our Company</u>	<u>12</u>
Part II	
Item 5 <u>Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</u>	<u>14</u>
Item 6 <u>Selected Financial Data</u>	<u>15</u>
Item 7 <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>16</u>
Item 7A <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>28</u>
Item 8 <u>Financial Statements and Supplementary Data</u>	<u>29</u>
<u>Management’s Report on Internal Control Over Financial Reporting</u>	<u>29</u>
<u>Reports of Independent Registered Public Accounting Firm</u>	<u>30</u>
<u>Consolidated Statements of Earnings</u>	<u>32</u>
<u>Consolidated Statements of Comprehensive Income</u>	<u>32</u>
<u>Consolidated Balance Sheets</u>	<u>33</u>
<u>Consolidated Statements of Cash Flows</u>	<u>34</u>
<u>Consolidated Statements of Shareholders’ Equity</u>	<u>35</u>
<u>Notes to Consolidated Financial Statements</u>	<u>36</u>
Item 9 <u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	<u>57</u>
Item 9A <u>Controls and Procedures</u>	<u>57</u>
Item 9B <u>Other Information</u>	<u>57</u>
Part III	
Item 10 <u>Directors, Executive Officers and Corporate Governance</u>	<u>58</u>
Item 11 <u>Executive Compensation</u>	<u>58</u>
Item 12 <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>58</u>
Item 13 <u>Certain Relationships and Related Transactions, and Director Independence</u>	<u>58</u>
Item 14 <u>Principal Accountant Fees and Services</u>	<u>58</u>
Part IV	
Item 15 <u>Exhibits, Financial Statement Schedules</u>	<u>59</u>
<u>Exhibit Index</u>	<u>61</u>
<u>Signatures</u>	<u>63</u>

## ACCESS TO REPORTS

Investors may obtain access free of charge to the Graco Inc. Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, other reports and amendments to the reports by visiting the Graco website at [www.graco.com](http://www.graco.com). These reports will be available as soon as reasonably practicable following electronic filing with, or furnishing to, the Securities and Exchange Commission.



Table of Contents

PART I

Item 1. Business

Graco Inc., together with its subsidiaries (“Graco,” “us,” “we,” or “our Company”), is a multi-national manufacturing company. We supply technology and expertise for the management of fluids and coatings in industrial and commercial applications. We design, manufacture and market systems and equipment used to move, measure, control, dispense and spray fluid and powder materials. Our equipment is used in manufacturing, processing, construction and maintenance industries. Graco is a Minnesota corporation and was incorporated in 1926.

We specialize in providing equipment solutions for difficult-to-handle materials with high viscosities, abrasive or corrosive properties, and multiple component materials that require precise ratio control. We aim to serve niche markets, providing high customer value through product differentiation. Our products enable customers to reduce their use of labor, material and energy, improve quality and achieve environmental compliance.

We make significant investments in developing innovative, high-quality products. We strive to grow into new geographic markets by strategically adding commercial and technical resources and third-party distribution in growing and emerging markets. We have grown our third-party distribution to have specialized experience in particular end-user applications. We leverage our product technologies for new applications and industries.

We also make targeted acquisitions to broaden our product offering, enhance our capabilities in the end-user markets we serve and expand our manufacturing and distribution base. These acquisitions provide new product offerings, such as an expanded high pressure valve line, vapor abrasive blasting, ultra high purity diaphragm pumps, mortar pumps and landfill gas analyzers, as well as additional channel partners and manufacturing capabilities. Note L (Acquisitions) to the Consolidated Financial Statements of this Form 10-K has additional information on recent acquisitions.

We have particularly strong manufacturing, engineering and customer service capabilities that enhance our ability to provide premium customer experience, produce high-quality and reliable products and drive ongoing cost savings.

Our investment in new products, targeted acquisitions and strong manufacturing, engineering and customer service capabilities comprise our long-term growth strategies, which we coordinate and drive across our geographic regions. Values central to our identity - growth, product innovation, premium customer service, quality and continuous improvement - are leveraged to integrate and expand the capabilities of acquired businesses.

We classify our business into three reportable segments, each with a worldwide focus: Industrial, Process and Contractor.

Each segment sells its products in North, Central and South America (the “Americas”), Europe, Middle East and Africa (“EMEA”), and Asia Pacific. Sales in the Americas represent approximately 58 percent of our Company’s total sales. Sales in EMEA represent approximately 23 percent. Sales in Asia Pacific represent approximately 19 percent. We provide marketing and product design in each of these geographic regions. Our Company also provides application assistance to distributors and employs sales personnel in each of these geographic regions.

Financial information concerning our segments and geographic markets is set forth in Part II, Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations and Note B (Segment Information) to the Consolidated Financial Statements of this Form 10-K.

For information about our Company and our products, services and solutions, visit our website at [www.graco.com](http://www.graco.com). The information on the website is not part of this report nor any other report filed or furnished to the Securities and

Exchange Commission (“SEC”).

#### Manufacturing and Distribution

We manufacture a majority of our products in the United States (“U.S.”). We manufacture some of our products in Switzerland (Industrial segment), the United Kingdom (Process segment), the People’s Republic of China (“P.R.C.”) (all segments), Belgium (all segments) and Romania (Industrial segment). Our manufacturing is aligned with our business segments and is co-located with product development to accelerate technology improvements and improve our cost structure. We perform critical machining, assembly and testing in-house for most of our products to control quality, improve response time and maximize cost-effectiveness. We make our products in focused factories and product cells. We source raw materials and components from suppliers around the world.

For all segments, we primarily sell our equipment through third-party distributors worldwide, positioned throughout our geographic regions, and through selected retailers. Our products are sold from our warehouse to our third-party distributors or retailers who sell

## Table of Contents

our products to end users. Certain of our acquired businesses historically sold their products directly to end-user customers and continue to have direct relationships with customers.

Outside of the U.S., our subsidiaries located in Australia, Belgium, Japan, Italy, Korea, the P.R.C., the United Kingdom and Brazil distribute our Company's products. Operations in Maasmechelen, Belgium; St. Gallen, Switzerland; Shanghai, P.R.C.; and Montevideo, Uruguay reinforce our commitment to their regions.

During 2017, manufacturing capacity met business demand. Production requirements in the immediate future are expected to be met through existing facilities, the installation of new automatic and semi-automatic machine tools, efficiency and productivity improvements, the use of leased space and available subcontract services. We are in the planning and design phases for expansion projects in several of our manufacturing and distribution locations to add capacity in the next several years. For more details on our facilities, see Item 2, Properties.

### Product Development

Our primary product development efforts are carried out in facilities located in Minneapolis, Anoka and Rogers, Minnesota; North Canton, Ohio; St. Gallen, Switzerland; Suzhou, P.R.C.; Dexter, Michigan; Erie, Pennsylvania; Kamas, Utah; and Coventry and Brighouse, United Kingdom. The product development and engineering groups focus on new product design, product improvements, new applications for existing products and technologies for their specific customer base. Our product development efforts focus on bringing new and supplemental return on investment value to end users of our products.

Our Company consistently makes significant investments in new products. Total product development expenditures for all segments were \$60 million in 2017, \$61 million in 2016 and \$59 million in 2015. The amounts invested in product development averaged approximately 4½ percent of sales over the last three years. Our product development activities are focused both on upgrades to our current product lines to provide features and benefits that will provide a return on investment to our end-user customers and development of products that will reach into new industries and applications to incrementally grow our sales. Sales of products that refresh and upgrade our product lines are measured and compared with planned results. Sales of products that provide entry into new industries and applications are also measured, with additional focus on commercial resources and activities to build specialized third-party distribution and market acceptance by end users.

Our Company measures the results of acquired businesses as compared to historical results and projections made at the time of acquisition. Our Company will invest in engineering, manufacturing and commercial resources for these businesses based on expected return on investment.

### Business Segments

#### Industrial Segment

The Industrial segment is our largest segment and represents approximately 47 percent of our total sales in 2017. It includes the Industrial Products and Applied Fluid Technologies divisions. The Industrial segment markets equipment and pre-engineered packages for moving and applying paints, coatings, sealants, adhesives and other fluids. Markets served include automotive and vehicle assembly and components production, wood and metal products, rail, marine, aerospace, farm, construction, bus, recreational vehicles and various other industries.

Most Industrial segment equipment is sold worldwide through specialized third-party distributors, integrators, design centers, original equipment manufacturers and material suppliers. Some products are sold directly to end users. We work with material suppliers to develop or adapt our equipment for use with specialized or hard-to-handle materials.

Distributors promote and sell the equipment, hold inventory, provide product application expertise and offer on-site service, technical support and integration capabilities. Integrators implement large individual installations in manufacturing plants where products and services from a number of different manufacturers are aggregated into a single system. Design centers engineer systems for their customers using our products. Original equipment manufacturers incorporate our Company's Industrial segment products into systems and assemblies that they then supply to their customers.

#### Applied Fluid Technologies

The Applied Fluid Technologies division designs and sells equipment for use by industrial customers and specialty contractors. This equipment includes two-component proportioning systems that are used to spray polyurethane foam (spray foam) and polyurea coatings. Spray foam is commonly used for insulating building walls, roofs, water heaters, refrigerators, hot tubs and other items. Polyurea coatings are applied on storage tanks, pipes, roofs, truck beds, concrete and other items. We offer a complete line of pumps and proportioning equipment that sprays specialty coatings on a variety of surfaces for protection and fireproofing. This division also



## Table of Contents

manufactures vapor-abrasive blasting equipment, as well as equipment that pumps, meters, mixes and dispenses sealant, adhesive and composite materials. Our advanced composite equipment includes gel coat equipment, chop and wet-out systems, resin transfer molding systems and applicators. This equipment bonds, molds, seals, vacuum encapsulates and laminates parts and devices in a wide variety of industrial applications.

### Industrial Products

The Industrial Products division makes finishing equipment that applies paint and other coatings to products such as motor vehicles, appliances, furniture and other industrial and consumer products. A majority of this division's business is outside of North America.

This division's products include liquid finishing equipment that applies liquids on metals, wood and plastics, with emphasis on solutions that provide easy integration to paint monitoring and control systems. Products include paint circulating and paint supply pumps, paint circulating advanced control systems, plural component coating proportioners, various accessories to filter, transport, agitate and regulate fluid, and spare parts such as spray tips, seals and filter screens. We also offer a variety of applicators that use different methods of atomizing and spraying the paint or other coatings depending on the viscosity of the fluid, the type of finish desired and the need to maximize transfer efficiency, minimize overspray and minimize the release of volatile organic compounds into the air. Manufacturers in the automotive, automotive feeder, commercial and recreational vehicle, military and utility vehicle, aerospace, farm, construction, wood and general metals industries use our liquid finishing products.

This division also makes powder finishing products that coat powder finishing on metals. These products are sold under the Gema® trademark. Gema powder systems coat window frames, metallic furniture, automotive components and sheet metal. Primary end users of our powder finishing products include manufacturers in the construction, home appliance, automotive component and custom coater industries. We strive to provide innovative solutions in powder coating for end users in emerging and developed markets.

### Process Segment

The Process segment represented approximately 20 percent of our total sales in 2017. It includes our Process, Oil and Natural Gas, and Lubrication divisions. The Process segment markets pumps, valves, meters and accessories to move and dispense chemicals, oil and natural gas, water, wastewater, petroleum, food, lubricants and other fluids. Markets served include food and beverage, dairy, oil and natural gas, pharmaceutical, cosmetics, semi-conductor, electronics, wastewater, mining, fast oil change facilities, service garages, fleet service centers, automobile dealerships and industrial lubrication applications.

Most Process segment equipment is sold worldwide through third-party distributors and original equipment manufacturers. Some products are sold directly to end users, particularly in the oil and natural gas and semi-conductor industries.

### Process

Our Process division makes pumps of various technologies that move chemicals, water, wastewater, petroleum, food and other fluids. Manufacturers and processors in the food and beverage, dairy, pharmaceutical, cosmetic, oil and natural gas, semi-conductor, electronics, wastewater, mining and ceramics industries use these pumps. This division makes environmental monitoring and remediation equipment that is used to conduct ground water sampling and ground water remediation, and for landfill liquid and gas management.

### Oil and Natural Gas

Our Oil and Natural Gas division makes high pressure and ultra-high pressure valves used in the oil and natural gas industry, other industrial processes and research facilities. Our high and ultra-high pressure valves are sold directly to end-user customers as well as through distribution worldwide. The division also has a line of chemical injection pumping solutions for precise injection of chemicals into producing oil wells and pipelines and is sold through third-party distributors.

#### Lubrication

The Lubrication division designs and sells equipment for use in vehicle servicing. We supply pumps, hose reels, meters, valves and accessories for use by fast oil change facilities, service garages, fleet service centers, automobile dealerships, auto parts stores, truck builders and heavy equipment service centers.

We also offer systems, components and accessories for the automatic lubrication of bearings, gears and generators in industrial and commercial equipment, compressors, turbines and on- and off-road vehicles. Automatic lubrication systems reduce maintenance need and down time and extend the life of the equipment. Industries served include gas transmission, petrochemical, pulp and paper,

## Table of Contents

mining, construction, agricultural equipment, food and beverage, material handling, metal manufacturing, wind energy and oil and natural gas.

### Contractor Segment

The Contractor segment represented approximately 33 percent of our total sales in 2017. Through this segment, we offer sprayers that apply paint to walls and other structures, with a range of product models that can be used by do-it-yourself homeowners to professional painting contractors. Contractor equipment also includes sprayers that apply texture to walls and ceilings, highly viscous coatings to roofs, and markings on roads, parking lots, athletic fields and floors.

This segment's end users are primarily professional painters in the construction and maintenance industries, tradesmen and do-it-yourselfers. Contractor products are marketed and sold in all major geographic areas. We continue to add distributors throughout the world that specialize in the sale of Contractor products. Globally, we are pursuing a broad strategy of converting contractors accustomed to manually applying paint and other coatings by brush-and-roller to spray technology.

Our Contractor products are distributed primarily through distributor outlets whose main products are paint and other coatings. Certain sprayers and accessories are distributed globally through the home center channel. Contractor products are also sold through general equipment distributors outside of North America.

### Raw Materials

The primary materials and components in our products are steel of various alloys, sizes and hardness; specialty stainless steel and aluminum bar stock, tubing and castings; tungsten carbide; electric and gas motors; injection molded plastics; sheet metal; forgings; powdered metal; hoses; electronic components and high performance plastics, such as polytetrafluoroethylene (PTFE). The materials and components that we use are generally adequately available through multiple sources of supply. To manage cost, we source significant amounts of materials and components from outside the U.S., primarily in the Asia Pacific region.

In 2017, our raw material and purchased component availability was strong, with some cost pressures, particularly in aluminum, stainless steel, carbon steel bar stock, electronic controls, plastics and copper, which we expect will continue into 2018.

We endeavor to address fluctuations in the price and availability of various materials and components through adjustable surcharges and credits, close management of current suppliers, price negotiations and an intensive search for new suppliers. We have performed risk assessments of our key suppliers, and we factor the risks identified into our commodity plans.

### Intellectual Property

We own a number of patents across our segments and have patent applications pending in the U.S. and other countries. We also license our patents to others and are a licensee of patents owned by others. In our opinion, our business is not materially dependent upon any one or more of these patents or licenses. Our Company also owns a number of trademarks in the U.S. and foreign countries, including registered trademarks for "GRACO," "Gema," several forms of a capital "G," and various product trademarks that are material to our business, inasmuch as they identify Graco and our products to our customers.

### Sales to Major Customers

Worldwide sales in the Contractor and Industrial segments to The Sherwin-Williams Company represented over 10 percent of the Company's consolidated sales in 2017, 2016 and 2015.

## Table of Contents

### Competition

We encounter a wide variety of competitors that vary by product, industry and geographic area. Each of our segments generally has several competitors. Our competitors are both U.S. and foreign companies and range in size. We believe that our ability to compete depends upon product quality, product reliability, innovation, design, customer support and service, specialized engineering and competitive pricing. Although no competitor duplicates all of our products, some competitors are larger than our Company, both in terms of sales of directly competing products and in terms of total sales and financial resources. We also face competitors with different cost structures and expectations of profitability and these companies may offer competitive products at lower prices. We refresh our product line and continue development of our distribution channel to stay competitive. We also face competitors who illegally sell counterfeits of our products or otherwise infringe on our intellectual property rights. We may have to increase our intellectual property and unfair competition enforcement activities.

### Environmental Protection

Our compliance with federal, state and local laws and regulations did not have a material effect upon our capital expenditures, earnings or competitive position during the fiscal year ended December 29, 2017.

### Employees

As of December 29, 2017, we employed approximately 3,500 persons. Of this total, approximately 1,400 were employees based outside of the U.S., and 1,000 were hourly factory workers in the U.S. None of our Company's U.S. employees are covered by a collective bargaining agreement. Various national industry-wide labor agreements apply to certain employees in various countries outside of the U.S. Compliance with such agreements has no material effect on our Company or our operations.

### Acquisition and Divestiture of Liquid Finishing Businesses

In 2012, the Company purchased the finishing businesses of Illinois Tool Works Inc. The acquisition included finishing equipment operations, technologies and brands of the Powder Finishing and Liquid Finishing businesses. Under terms of a hold separate order from the Federal Trade Commission, the Company did not have the power to direct the activities of the Liquid Finishing businesses that most significantly impacted the economic performance of those businesses. Consequently, we reflected our investment in the Liquid Finishing businesses as a cost-method investment on our balance sheet, and their results of operations were not consolidated with those of the Company. The Company sold the Liquid Finishing business assets in 2015. Net earnings in 2015 included after-tax gain on the sale and dividends totaling \$141 million.

### Item 1A. Risk Factors

**Growth Strategies and Acquisitions** - Our growth strategies may not provide the return on investment desired if we are not successful in implementation of these strategies.

Making acquisitions, investing in new products, expanding geographically and targeting new industries are among our growth strategies. We may not obtain the return on investment desired if we are not successful in implementing these growth strategies. The success of our acquisition strategy depends on our ability to successfully identify suitable acquisition candidates, negotiate appropriate acquisition terms, obtain financing at a reasonable cost, prevail against competing acquirers, complete the acquisitions and integrate or add the acquired businesses into our existing businesses or corporate structure. Once successfully integrated into our existing businesses or added to our corporate structure, the acquired businesses may not perform as planned, be accretive to earnings, generate positive cash flows

or otherwise be beneficial to us. We may not realize projected efficiencies and cost-savings from the businesses we acquire. We cannot predict how customers, competitors, suppliers and employees will react to the acquisitions that we make. Acquisitions may result in the assumption of undisclosed or contingent liabilities, the incurrence of increased indebtedness and expenses, and the diversion of management's time and attention away from other business matters. We make significant investments in developing products that have innovative features and differentiated technology in their industries and in niche markets. We are adding to the geographies in which we do business with third-party distributors. We cannot predict whether and when we will be able to realize the expected financial results and accretive effect of the acquisitions that we make, the new products that we develop and the channel expansions that we make.

Economic Environment - Demand for our products depends on the level of commercial and industrial activity worldwide.

An economic downturn or financial market turmoil may depress demand for our equipment in all major geographies and markets. If our distributors and original equipment manufacturers are unable to purchase our products because of unavailable credit or unfavorable credit terms, depressed end-user demand, or are simply unwilling to purchase our products, our net sales and earnings will

## Table of Contents

be adversely affected. An economic downturn may affect our ability to satisfy the financial covenants in the terms of our financing arrangements.

**Tax Rates and New Tax Legislation** - Changes in tax rates or the adoption of new tax legislation may affect our operating results, cash flows and financial condition.

The Company is subject to taxes in the U.S. and a number of foreign jurisdictions where it conducts business. The Company's effective tax rate could be affected by changes in the mix of earnings in jurisdictions with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, and changes in tax laws or their interpretation. On December 22, 2017, the Tax Cuts and Jobs Act (the "Act") was signed into law in the U.S. The Act, among other things, reduces the corporate income tax rate, imposes additional limitations on the deductibility of business interest expense, allows for the expensing of certain capital expenditures, modifies the rules regarding limitations on certain deductions for executive compensation, shifts the taxation of multinational corporations from a tax on worldwide income towards a territorial system, and imposes a one-time tax on certain accumulated foreign earnings. We continue to examine the impact the Act may have on our business. While the Act will reduce the Company's effective tax rate, the overall impact of the Act is uncertain due to the complexity of certain provisions of the Act and ambiguities in the interpretation and application of those provisions.

**Currency** - Changes in currency translation rates could adversely impact our revenue and earnings.

Changes in exchange rates will impact our reported sales and earnings. A majority of our manufacturing and cost structure is based in the U.S. In addition, decreased value of local currency may make it difficult for some of our distributors and end users to purchase products.

**Changes in Laws and Regulations** - Changes may impact how we can do business and the cost of doing business around the world.

The speed and frequency of implementation and the complexity of new or revised laws and regulations globally appear to be increasing. In addition, as our business grows and/or geographically expands, we may become subject to laws and regulations previously inapplicable to our business. These laws and regulations increase our cost of doing business, may affect the manner in which our products will be produced or delivered, may affect the locations and facilities from which we conduct business, and may impact our long-term ability to provide returns to our shareholders.

**Anti-Corruption and Trade Laws** - We may incur costs and suffer damages if our employees, agents, distributors or suppliers violate anti-bribery, anti-corruption or trade laws and regulations.

Laws and regulations related to bribery, corruption and trade, and enforcement thereof, are increasing in frequency, complexity and severity on a global basis. The continued geographic expansion of our business increases our exposure to, and cost of complying with, these laws and regulations. If our internal controls and compliance program do not adequately prevent or deter our employees, agents, distributors, suppliers and other third parties with whom we do business from violating anti-corruption laws, we may incur defense costs, fines, penalties, reputational damage and business disruptions.

**Intellectual Property** - Demand for our products may be affected by new entrants who copy our products and/or infringe on our intellectual property. Competitors may allege that our products infringe the intellectual property of others.

From time to time, we have been faced with instances where competitors have infringed or unfairly used our intellectual property and/or taken advantage of our design and development efforts. The ability to protect and enforce intellectual property rights varies across jurisdictions. Competitors who copy our products are becoming more prevalent in Asia. If we are unable to effectively meet these challenges, they could adversely affect our revenues and profits and hamper our ability to grow. Competitors and others may also initiate litigation to challenge the validity of our intellectual property or allege that we infringe their intellectual property. We may be required to pay substantial damages if it is determined our products infringe their intellectual property. We may also be required to develop an alternative, non-infringing product that could be costly and time-consuming, or acquire a license (if available) on terms that are not favorable to us. Regardless of whether infringement claims against us are successful, defending against such claims could significantly increase our costs, divert management's time and attention away from other business matters, and otherwise adversely affect our results of operations and financial condition.

Foreign Operations - Conducting business internationally exposes our Company to risks that could harm our business.

In 2017, approximately 50 percent of our sales were generated by customers located outside the United States. We are increasing our presence in advancing economies. Operating and selling outside of the United States exposes us to certain risks that could adversely impact our sales volume, rate of growth or profitability. These risks include: complying with foreign legal and regulatory



## Table of Contents

requirements; international trade factors (export controls, trade sanctions, duties, tariff barriers and other restrictions); protection of our proprietary technology in certain countries; potentially burdensome taxes; potential difficulties staffing and managing local operations; and changes in exchange rates.

**Competition** - Our success depends upon our ability to develop, market and sell new products that meet our customers' needs, and anticipate industry changes.

Our profitability will be affected if we do not develop new products and technologies that meet our customers' needs. Our ability to develop, market and sell products that meet our customers' needs depends upon a number of factors, including anticipating the features and products that our customers will need in the future, identifying and entering into new markets, and training our distributors. Changes in industries that we serve, including consolidation of competitors and customers, could affect our success. Price competition and competitor strategies could negatively impact our growth and have an adverse impact on our results of operations.

**Suppliers** - Risks associated with foreign sourcing, supply interruption, delays in raw material or component delivery, supply shortages and counterfeit components may adversely affect our production or profitability.

We source certain of our materials and components from suppliers outside the U.S., and from suppliers within the U.S. who engage in foreign sourcing. Long lead times or supply interruptions associated with a global supply base may reduce our flexibility and make it more difficult to respond promptly to fluctuations in demand or respond quickly to product quality problems. Changes in exchange rates between the U.S. dollar and other currencies and fluctuations in the price of commodities may impact the manufacturing costs of our products and affect our profitability. Protective tariffs, unpredictable changes in duty rates, and trade regulation changes may make certain foreign-sourced parts no longer competitively priced. Long supply chains may be disrupted by environmental events or other political factors. Raw materials may become limited in availability from certain regions. Port labor disputes may delay shipments. We source a large volume and a variety of electronic components, which exposes us to an increased risk of counterfeit components entering our supply chain. If counterfeit components unknowingly become part of our products, we may need to stop delivery and rebuild our products. We may be subject to warranty claims and may need to recall products.

**Information Systems** - Interruption of or intrusion into information systems may impact our business.

We rely on information systems and the Internet to conduct and support various activities related to our business. Cyber-security threats are increasing in frequency, sophistication and severity. Security breaches or intrusion into our information systems, and the breakdown, interruption in or inadequate upgrading or maintenance of our information processing software, hardware or networks or the Internet may adversely affect our business and reputation. Security breaches or intrusion into the systems or data of the third parties with whom we conduct business may also harm our business and reputation.

**Impairment** - If acquired businesses do not meet performance expectations, assets acquired could be subject to impairment.

Our total assets reflect goodwill from acquisitions, representing the excess cost over the fair value of the identifiable net assets acquired. We test annually whether goodwill has been impaired, or more frequently if events or changes in circumstances indicate the goodwill may be impaired. If future operating performance at one or more of our operating units were to fall significantly below forecast levels or if market conditions for one or more of our acquired businesses were to decline, we could be required to incur a non-cash charge to operating income for impairment. Any impairment in the value of our goodwill would have an adverse non-cash impact on our results of operations and reduce our net worth. In 2016, we recorded an impairment charge of \$192 million for our Oil and Natural Gas reporting unit within

the Process segment.

Political Instability - Uncertainty surrounding political leadership may limit our growth opportunities.

Domestic political instability, including government shut downs, may limit our ability to grow our business. International political instability may prevent us from expanding our business into certain geographies and may also limit our ability to grow our business. Civil disturbances may harm our business.

Legal Proceedings - Costs associated with claims, litigation, administrative proceedings and regulatory reviews, and potentially adverse outcomes, may affect our profitability.

As our Company grows, we are at an increased risk of being a target in matters related to the assertion of claims and demands, litigation, administrative proceedings and regulatory reviews. We may also need to pursue claims or litigation to protect our interests. The cost of pursuing, defending and insuring against such matters appears to be increasing, particularly in the U.S. Such costs may adversely affect our Company's profitability. Our businesses expose us to potential toxic tort, product liability and commercial claims. Successful claims against the Company and settlements may adversely affect our results.

Table of Contents

Major Customers - Our Contractor segment depends on a few large customers for a significant portion of its sales. Significant declines in the level of purchases by these customers could reduce our sales and impact segment profitability.

Our Contractor segment derives a significant amount of revenue from a few large customers. Substantial decreases in purchases by these customers, difficulty in collecting amounts due or the loss of their business would adversely affect the profitability of this segment. The business of these customers is dependent upon the economic vitality of the construction and home improvement markets. If these markets decline, the business of our customers could be adversely affected and their purchases of our equipment could decrease.

Variable Industries - Our success may be affected by variations in the construction, automotive, mining and oil and natural gas industries.

Our business may be affected by fluctuations in residential, commercial and institutional building and remodeling activity. Changes in construction materials and techniques may also impact our business. Our business may also be affected by fluctuations of activity in the automotive, mining and oil and natural gas industries.

Personnel - Our success may be affected if we are not able to attract, develop and retain qualified personnel.

Our success depends in large part on our ability to identify, recruit, develop and retain qualified personnel. If we are unable to successfully identify, recruit, develop and retain qualified personnel, it may be difficult for us to meet our strategic objectives and grow our business, which could adversely affect our results of operations and financial condition.

Catastrophic Events - Our operations are at risk of damage, destruction or disruption by natural disasters and other unexpected events.

The loss of, or substantial damage to, one of our facilities or the facilities of our suppliers could make it difficult to supply our customers with product and provide our employees with work. Flooding, tornadoes, typhoons, unusually heavy precipitation or other severe weather events, earthquakes, fire, explosions or acts of war or terrorism could adversely impact our operations.

## Item 1B. Unresolved Staff Comments

None.

## Item 2. Properties

Our facilities are in satisfactory condition, suitable for their respective uses, and are generally adequate to meet current needs. A description of our principal facilities as of February 20, 2018, is set forth in the chart below.

Facility	Owned or Leased	Square Footage	Facility Activities	Operating Segment
North America				
Indianapolis, Indiana, U.S.	Owned	64,000	Warehouse, office, product development and application laboratory	Industrial
Dexter, Michigan, U.S.	Owned	65,000	Manufacturing, warehouse, office and product development	Process
	Owned	141,000		

Edgar Filing: GRACO INC - Form 10-K

Minneapolis, Minnesota, U.S.			Worldwide headquarters; office and product development	Corporate, Industrial and Process
Minneapolis, Minnesota, U.S.	Owned	42,000	Corporate office	All segments
Minneapolis, Minnesota, U.S.	Owned	390,000	Manufacturing and office	Industrial and Process
Minneapolis, Minnesota, U.S.	Owned	87,000	Assembly	Industrial and Process
Anoka, Minnesota, U.S.	Owned	208,000	Manufacturing, warehouse, office and product development	Process
Rogers, Minnesota, U.S.	Owned	325,000	Manufacturing, office and product development	Contractor
Rogers, Minnesota, U.S.	Leased	225,000	Distribution center and office	All segments

Table of Contents

Rogers, Minnesota, U.S.	Leased 100,000	Distribution center	All segments
North Canton, Ohio, U.S.	Owned 131,000	Manufacturing, warehouse, office and application laboratory	Industrial
Erie, Pennsylvania, U.S.	Leased 43,000	Manufacturing, warehouse, office and product development	Process
Sioux Falls, South Dakota, U.S.	Owned 148,000	Manufacturing and office	Industrial and Contractor
Kamas, Utah, U.S.	Owned 21,000	Manufacturing, office and application laboratory	Process
Pompano Beach, Florida, U.S.	Leased 51,000	Warehouse and office	Contractor
Europe			
Maasmechelen, Belgium	Owned 127,000	EMEA headquarters, warehouse, assembly	All segments
Rödermark, Germany	Leased 41,000	Warehouse and office	Industrial
Sibiu, Romania	Leased 31,000	Manufacturing	Industrial
St. Gallen, Switzerland	Owned 82,000	Manufacturing, warehouse, office, product development and application laboratory	Industrial
St. Gallen, Switzerland	Leased 22,000	Manufacturing	Industrial
Brighouse, West Yorkshire, United Kingdom	Owned 68,000	Manufacturing, warehouse, office and product development	Process
Coventry, United Kingdom	Owned 25,000	Office	Process
Leaming Spa, Warwickshire, United Kingdom	Leased 45,000	Manufacturing, warehouse and office	Process
Asia Pacific			
Derrimut, Australia	Leased 22,000	Warehouse	All segments
Gurgaon, India	Leased 18,000	Office	All segments
Yokohama, Japan	Leased 19,000	Office	All segments
Shanghai, P.R.C.	Leased 29,000	Asia Pacific headquarters	All segments
Shanghai Waiqaoqiao Pilot FTZ, P.R.C.	Leased 31,000	Warehouse	All segments
Shanghai, P.R.C.	Leased 27,000	Warehouse and office	Industrial
Suzhou, P.R.C.	Owned 80,000	Manufacturing, warehouse, office and product development	All segments
Gyeonggi-do, South Korea	Leased 22,000	Office and application laboratory	All segments

## Item 3. Legal Proceedings

Our Company is engaged in routine litigation, administrative proceedings and regulatory reviews incident to our business. It is not possible to predict with certainty the outcome of these unresolved matters, but management believes that they will not have a material effect upon our operations or consolidated financial position.

## Item 4. Mine Safety Disclosures

Not applicable.

Table of Contents

Executive Officers of Our Company

The following are all the executive officers of Graco Inc. as of February 20, 2018:

Patrick J. McHale, 56, became President and Chief Executive Officer in June 2007. He served as Vice President and General Manager, Lubrication Equipment Division from June 2003 to June 2007. He was Vice President, Manufacturing and Distribution Operations from April 2001 to June 2003. He served as Vice President, Contractor Equipment Division from February 2000 to April 2001. From September 1999 to February 2000, he was Vice President, Lubrication Equipment Division. Prior to September 1999, he held various manufacturing management positions in Minneapolis, Minnesota; Plymouth, Michigan; and Sioux Falls, South Dakota. Mr. McHale joined the Company in 1989.

David M. Ahlers, 59, became Vice President, Human Resources and Corporate Communications in April 2010. From September 2008 through March 2010, he served as the Company's Vice President, Human Resources. Prior to joining Graco, Mr. Ahlers held various human resources positions, including, most recently, Chief Human Resources Officer and Senior Managing Director of GMAC Residential Capital, from August 2003 to August 2008. He joined the Company in 2008.

Caroline M. Chambers, 53, became Vice President, Corporate Controller and Information Systems in December 2013. She has also served as the Company's principal accounting officer since September 2007. From April 2009 to December 2013, she was Vice President and Corporate Controller. She served as Vice President and Controller from December 2006 to April 2009. She was Corporate Controller from October 2005 to December 2006 and Director of Information Systems from July 2003 through September 2005. Prior to becoming Director of Information Systems, she held various management positions in the internal audit and accounting departments. Prior to joining Graco, Ms. Chambers was an auditor with Deloitte & Touche in Minneapolis, Minnesota and Paris, France. Ms. Chambers joined the Company in 1992.

Mark D. Eberlein, 57, became Vice President and General Manager, Process Division in January 2013. From November 2008 to December 2012, he was Director, Business Development, Industrial Products Division. He was Director, Manufacturing Operations, Industrial Products Division from January to October 2008. From 2001 to 2008, he was Manufacturing Operations Manager of a variety of Graco business divisions. Prior to joining Graco, Mr. Eberlein worked as an engineer at Honeywell and at Sheldahl. He joined the Company in 1996.

Karen Park Gallivan, 61, became Vice President, General Counsel and Secretary in September 2005. She was Vice President, Human Resources from January 2003 to September 2005. Prior to joining Graco, she was Vice President of Human Resources and Communications at Syngenta Seeds, Inc. from January 1999 to January 2003. From 1988 through January 1999, she was the general counsel of Novartis Nutrition Corporation. Prior to joining Novartis, Ms. Gallivan was an attorney with the law firm of Rider, Bennett, Egan & Arundel, L.L.P. She joined the Company in 2003.

Dale D. Johnson, 63, became President, Worldwide Contractor Equipment Division in February 2017. From April 2001 through January 2017, he served as Vice President and General Manager, Contractor Equipment Division. From January 2000 through March 2001, he served as President and Chief Operating Officer. From December 1996 to January 2000, he was Vice President, Contractor Equipment Division. Prior to becoming the Director of Marketing, Contractor Equipment Division in June 1996, he held various marketing and sales positions in the Contractor Equipment Division and the Industrial Equipment Division. He joined the Company in 1976.

Jeffrey P. Johnson, 58, became Vice President and General Manager, EMEA in January 2013. From February 2008 to December 2012 he was Vice President and General Manager, Asia Pacific. He served as Director of Sales and

Marketing, Applied Fluid Technologies Division, from June 2006 until February 2008. Prior to joining Graco, he held various sales and marketing positions, including, most recently, President of Johnson Krumwiede Roads, a full-service advertising agency, and European sales manager at General Motors Corp. He joined the Company in 2006.

David M. Lowe, 62, became Executive Vice President, Industrial Products Division in April 2012. From February 2005 to April 2012, he was Vice President and General Manager, Industrial Products Division. He was Vice President and General Manager, European Operations from September 1999 to February 2005. Prior to becoming Vice President, Lubrication Equipment Division in December 1996, he was Treasurer. Mr. Lowe joined the Company in 1995.

Bernard J. Moreau, 57, became Vice President and General Manager, South and Central America in January 2013. From November 2003 to December 2012, he was Sales and Marketing Director, EMEA, Industrial/Automotive Equipment Division. From January 1997 to October 2003, he was Sales Manager, Middle East, Africa and East Europe. Prior to 1997, he worked in various Graco sales engineering and sales management positions, mainly to support Middle East, Africa and southern Europe territories. He joined the Company in 1985.

Table of Contents

Peter J. O'Shea, 53, became Vice President and General Manager, Lubrication Equipment Division in January 2016. From January 2013 to December 2015, he was Vice President and General Manager, Asia Pacific. From January 2012 until December 2012, he was Director of Sales and Marketing, Industrial Products Division, and from 2008 to 2012, he was Director of Sales and Marketing, Industrial Products Division and Applied Fluid Technologies Division. He was Country Manager, Australia - New Zealand from 2005 to 2008, and from 2002 to 2005 he served as Business Development Manager, Australia - New Zealand. Prior to becoming Business Development Manager, Australia - New Zealand, he worked in various Graco sales management positions. Mr. O'Shea joined the Company in 1995.

Charles L. Rescorla, 66, became Vice President, Corporate Manufacturing, Distribution Operations and Corporate Development in December 2013. From June 2011 to December 2013, he was Vice President, Corporate Manufacturing, Information Systems and Distribution Operations. He was Vice President, Manufacturing, Information Systems and Distribution Operations from April 2009 to June 2011. He served as Vice President, Manufacturing and Distribution Operations from September 2005 to April 2009. From June 2003 to September 2005, he was Vice President, Manufacturing/Distribution Operations and Information Systems. From April 2001 until June 2003, he was Vice President and General Manager, Industrial/Automotive Equipment Division. Prior to April 2001, he held various positions in manufacturing and engineering management. Mr. Rescorla joined the Company in 1988.

Christian E. Rothe, 44, became Chief Financial Officer and Treasurer in September 2015. From June 2011 through August 2015, he was Vice President and Treasurer. Prior to joining Graco, he held various positions in business development, accounting and finance, including, most recently, at Gardner Denver, Inc., a manufacturer of highly engineered products, as Vice President, Treasurer from January 2011 to June 2011, Vice President - Finance, Industrial Products Group from October 2008 to January 2011, and Director, Strategic Planning and Development from October 2006 to October 2008. Mr. Rothe joined the Company in 2011.

Mark W. Sheahan, 53, became Vice President and General Manager, Applied Fluid Technologies Division in February 2008. He served as Chief Administrative Officer from September 2005 until February 2008, and was Vice President and Treasurer from December 1998 to September 2005. Prior to becoming Treasurer in December 1996, he was Manager, Treasury Services. He joined the Company in 1995.

Brian J. Zumbolo, 48, became Vice President and General Manager, Asia Pacific in January 2016. From August 2007 to December 2015, he was Vice President and General Manager, Lubrication Equipment Division. He was Director of Sales and Marketing, Lubrication Equipment and Applied Fluid Technologies, Asia Pacific, from November 2006 through July 2007. From February 2005 to November 2006, he was the Director of Sales and Marketing, High Performance Coatings and Foam, Applied Fluid Technologies Division. Mr. Zumbolo was the Director of Sales and Marketing, Finishing Equipment from May 2004 to February 2005. Prior to May 2004, he held various marketing positions in the Industrial Equipment division. Mr. Zumbolo joined the Company in 1999.



Table of Contents

## PART II

## Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

## Graco Common Stock

Graco common stock is traded on the New York Stock Exchange under the ticker symbol "GGG." As of January 31, 2018, the share price was \$46.80 and there were 169,442,333 shares outstanding and 2,080 common shareholders of record, which includes nominees or broker dealers holding stock on behalf of an estimated 80,000 beneficial owners.

High and low sales prices for the Company's common stock and dividends declared for each quarterly period in the past two years were as follows:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2017 <sup>(1)</sup>				
Stock price per share				
High	\$ 31.70	\$ 38.22	\$ 41.62	\$ 46.01
Low	27.47	30.80	34.89	40.94
Dividends declared per share	0.12	0.12	0.12	0.13
2016 <sup>(1)</sup>				
Stock price per share				
High	\$ 28.33	\$ 28.87	\$ 27.13	\$ 28.33
Low	21.02	25.65	23.49	23.11
Dividends declared per share	0.11	0.11	0.11	0.12

(1) All per share data reflects the three-for-one stock split distributed on December 27, 2017.

The graph below compares the cumulative total shareholder return on the common stock of the Company for the last five fiscal years with the cumulative total return of the S&P 500 Index and the Dow Jones U.S. Industrial Machinery Index over the same period (assuming the value of the investment in Graco common stock and each index was \$100 on December 31, 2012, and all dividends were reinvested).

	2012	2013	2014	2015	2016	2017
Dow Jones U.S. Industrial Machinery	100	146	145	127	172	229
S&P 500	100	132	151	153	171	208
Graco Inc.	100	155	165	151	174	289

Table of Contents

## Issuer Purchases of Equity Securities

On April 24, 2015, the Board of Directors authorized the purchase of up to 18,000,000 shares of common stock, primarily through open market transactions. The authorization is for an indefinite period of time or until terminated by the Board.

In addition to shares purchased under the Board authorization, 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 stock options or vesting of restricted stock.

No shares were purchased in the fourth quarter of 2017. As of December 29, 2017, there were 8,807,604 shares that may yet be purchased under the Board authorization.

## Item 6. Selected Financial Data

The following table includes historical financial data (in millions, except per share amounts):

	2017	2016	2015	2014	2013
Net sales	\$1,474.7	\$1,329.3	\$1,286.5	\$1,221.1	\$1,104.0
Net earnings	252.4	40.7	345.7	225.6	210.8
Per common share <sup>(1)</sup>					
Basic net earnings	\$1.50	\$0.24	\$2.00	\$1.25	\$1.15
Diluted net earnings	1.45	0.24	1.95	1.22	1.12
Cash dividends declared	0.49	0.45	0.41	0.38	0.34
Total assets	\$1,379.2	\$1,243.1	\$1,391.4	\$1,544.8	\$1,327.2
Long-term debt (including current portion)	226.0	305.7	392.7	615.0	408.4

(1) All per share data reflects the three-for-one stock split distributed on December 27, 2017.

Net earnings in 2016 included \$161 million of after-tax loss from impairment charges in the Company's Oil and Natural Gas reporting unit within the Process Segment.

Net earnings in 2015 included \$141 million from the sale of the Liquid Finishing businesses acquired in 2012 held as a cost-method investment. Proceeds from the sale were principally used to retire long-term debt.

Additional information on the comparability of results is included in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis reviews significant factors affecting the Company's consolidated results of operations, financial condition and liquidity. This discussion should be read in conjunction with our financial statements and the accompanying notes to the financial statements. The discussion is organized in the following sections:

Overview

Acquisitions

Impairment (2016)

Divestiture (2015)

Results of Operations

Segment Results

Financial Condition and Cash Flow

Critical Accounting Estimates

Recent Accounting Pronouncements

Overview

Graco designs, manufactures and markets systems and equipment used to move, measure, control, dispense and spray fluid and powder materials. The Company specializes in equipment for applications that involve difficult-to-handle materials with high viscosities, materials with abrasive or corrosive properties and multiple-component materials that require precise ratio control. Graco sells primarily through independent third-party distributors worldwide to industrial and contractor end users. Graco's business is classified by management into three reportable segments: Industrial, Process and Contractor. Each segment is responsible for product development, manufacturing, marketing and sales of their products.

Graco's 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. Long-term financial growth targets accompany these strategies, including our expectation of 10 percent revenue growth and 12 percent consolidated net earnings growth. We continue to develop new products in each operating division that are expected to drive incremental sales growth, as well as continued refresh and upgrades of existing product lines. Graco has made a number of strategic acquisitions that expand and complement organically developed products and provide new market and channel opportunities.

Manufacturing is a key competency of the Company. Our management team in Minneapolis provides strategic manufacturing expertise, and is also responsible for factories not fully aligned with a single division. We manufacture some of our products in Switzerland (Industrial segment), the United Kingdom (Process segment), the People's Republic of China ("P.R.C.") (all segments), Belgium (all segments) and Romania (Industrial segment). Our primary distribution facilities are located in the U.S., Belgium, Switzerland, United Kingdom, P.R.C., Japan, Italy, Korea, Australia and Brazil.

Acquisitions

On January 13, 2016, the Company paid \$48 million cash to acquire two related companies that manufacture and sell portable and fixed gas analyzers for landfill, biogas and medical applications and landfill gas wellhead equipment. The acquisitions enhance and complement the Company's position in environmental monitoring and remediation markets. Results of their operations have been included within the Company's Process segment from the date of acquisition.

On January 20, 2015, the Company completed the acquisition of High Pressure Equipment Holdings, LLC (“HiP”) for \$161 million cash. HiP designs and manufactures valves, fittings and other flow control equipment engineered to perform in ultra-high pressure environments. HiP’s products and business relationships enhance Graco’s position in the oil and natural gas industry and complement Graco’s core competencies of designing and manufacturing advanced flow control technologies. Results of HiP operations have been included in the Company’s Process segment from the date of acquisition.

On January 2, 2015, the Company acquired White Knight Fluid Handling (“White Knight”) for \$16 million cash and a commitment for additional consideration if future revenues exceed certain thresholds, initially valued at \$8 million. The maximum payout is not limited. White Knight designs and manufactures high purity, metal-free pumps used in the production process of manufacturing semiconductors, solar panels, LED flat panel displays and various other electronics. Results of White Knight operations have been included in the Company’s Process segment from the date of acquisition.

The Company completed other business acquisitions in 2017, 2016 and 2015 that were not material to the consolidated financial statements.

Table of Contents

## Impairment (2016)

In 2016, operating results of our Oil and Natural Gas reporting unit (“ONG”) within the Process segment fell short of expectations due to weakness in oil and natural gas markets. At the end of the third quarter of 2016, we concluded that the depth and length of industry weakness, and its continuing impact on ONG results, were greater than previously expected, so we initiated an impairment analysis. We completed the analysis in the fourth quarter of 2016 and recorded adjustments to reduce goodwill by \$147 million and other intangible assets by \$45 million. The impairment charges reduced 2016 operating earnings by \$192 million, created a \$31 million deferred tax benefit, and decreased net earnings by \$161 million.

## Divestiture (2015)

In 2012, the Company purchased the finishing businesses of Illinois Tool Works Inc. The acquisition included finishing equipment operations, technologies and brands of the Powder Finishing and Liquid Finishing businesses. Under terms of a hold separate order from the Federal Trade Commission, the Company did not have the power to direct the activities of the Liquid Finishing businesses that most significantly impacted the economic performance of those businesses. Consequently, we reflected our investment in the Liquid Finishing businesses as a cost-method investment on our balance sheet, and their results of operations were not consolidated with those of the Company.

In 2015, the Company sold the Liquid Finishing business assets for a price of \$610 million cash. Held separate investment income included the pre-tax gain on sale of \$150 million, net of transaction and other related expenses, including a \$7 million contribution to the Company’s charitable foundation. Held separate investment income also included dividends of \$42 million. Net earnings included after-tax gain and dividends totaling \$141 million.

## Results of Operations

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

	2017	2016	2015
Net Sales	\$1,474.7	\$1,329.3	\$1,286.5
Operating Earnings	360.4	113.9	302.1
Net Earnings	252.4	40.7	345.7
Diluted Net Earnings per Common Share	\$1.45	\$0.24	\$1.95
Adjusted (non-GAAP) <sup>(1)</sup> :			
Operating Earnings, adjusted	\$372.5	\$305.9	\$302.1
Net Earnings, adjusted	249.4	202.1	204.3
Diluted Net Earnings per Common Share, adjusted	\$1.43	\$1.18	\$1.15

Excludes impacts of non-recurring income tax adjustments, changes in accounting for stock compensation, and (1) pension restructuring in 2017. Also excludes the effects of impairment charges in 2016 and net investment income from the Liquid Finishing businesses sold in 2015. See adjusted financial results below for a reconciliation of the adjusted non-GAAP financial measures to GAAP.

Table of Contents

Multiple events in the last three years caused significant fluctuations in financial results, including changes in accounting for tax benefits related to stock compensation, U.S. federal income tax reform and pension plan restructuring in 2017, impairment charges in 2016 and investment income from Liquid Finishing businesses sold in 2015. Excluding the impacts of those events presents a more consistent basis for comparison of financial results. A calculation of the non-GAAP measurements of adjusted operating earnings, earnings before income taxes, effective tax rates, net earnings and diluted net earnings per share follows (in millions except percentages and per share amounts):

	2017	2016	2015
Operating Earnings, as reported	\$360.4	\$113.9	\$302.1
Pension settlement loss	12.1	—	—
Impairment	—	192.0	—
Operating Earnings, adjusted	\$372.5	\$305.9	\$302.1
Earnings before income taxes	\$347.1	\$96.7	\$474.7
Adjustments	12.1	192.0	(191.6 )
Earnings before income taxes, adjusted	\$359.2	\$288.7	\$283.1
Income taxes, as reported	\$94.7	\$56.0	\$129.0
Excess tax benefit from option exercises	36.3	—	—
Income tax reform	(35.6 )	—	—
Other non-recurring tax changes	10.0	—	—
Tax effects of adjustments	4.4	30.6	(50.2 )
Income taxes, adjusted	\$109.8	\$86.6	\$78.8
Effective income tax rate			
As reported	27	% 58	% 27
Adjusted	31	% 30	% 28
Net Earnings, as reported	\$252.4	\$40.7	\$345.7
Pension settlement loss, net	7.7	—	—
Excess tax benefit from option exercises	(36.3 )	—	—
Income tax reform	35.6	—	—
Other non-recurring tax changes	(10.0 )	—	—
Impairment, net	—	161.4	—
Held separate investment (income), net	—	—	(141.4 )
Net Earnings, adjusted	\$249.4	\$202.1	\$204.3
Weighted Average Diluted Shares	174.3	170.9	177.0
Diluted Net Earnings per Share			
As reported	\$1.45	\$0.24	\$1.95
Adjusted	\$1.43	\$1.18	\$1.15

Table of Contents

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

	2017	2016	2015
Net Sales	100.0 %	100.0 %	100.0 %
Cost of products sold	46.2	46.7	46.8
Gross profit	53.8	53.3	53.2
Product development	4.1	4.6	4.5
Selling, marketing and distribution	15.9	16.2	15.7
General and administrative	9.4	9.5	9.5
Impairment	—	14.4	—
Operating earnings	24.4	8.6	23.5
Interest expense	1.1	1.3	1.4
Held separate investment (income), net	—	—	(14.9 )
Other expense (income), net	(0.2 )	—	0.1
Earnings before income taxes	23.5	7.3	36.9
Income taxes	6.4	4.2	10.0
Net Earnings	17.1 %	3.1 %	26.9 %
Net Earnings, adjusted (see non-GAAP measurements above)	16.9 %	15.2 %	15.9 %

## Net Sales

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

	2017	2016	2015
Americas <sup>(1)</sup>	\$850.5	\$777.0	\$759.9
EMEA <sup>(2)</sup>	343.3	311.1	291.4
Asia Pacific	280.9	241.2	235.2
Consolidated	\$1,474.7	\$1,329.3	\$1,286.5

(1) North, South and Central America, including the U.S. Sales in the U.S. were \$743 million in 2017, \$686 million in 2016 and \$654 million in 2015.

(2) Europe, Middle East and Africa

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

	2017				2016			
	Volume and Price	Acquisitions	Currency	Total	Volume and Price	Acquisitions	Currency	Total
Americas	9%	0%	0%	9%	1%	1%	0%	2%
EMEA	9%	0%	1%	10%	6%	3%	(2)%	7%
Asia Pacific	17%	0%	(1)%	16%	3%	1%	(1)%	3%
Consolidated	11%	0%	0%	11%	3%	1%	(1)%	3%

There were 52 weeks in fiscal 2017, compared to 53 weeks in fiscal 2016. Strong, broad-based demand levels around the world drove a double-digit percentage increase in sales in 2017. Sales growth was notably strong in China and across most other areas of Asia Pacific.

There were 53 weeks in fiscal 2016, compared to 52 weeks in fiscal 2015. In 2016, net sales at consistent currency translation rates increased 4 percent, including 3 percentage points of organic growth and 1 percentage point from acquired operations. The effects of currency translation offset the impact of sales from acquired operations. Strong sales increases in the Americas from the Contractor segment were mostly offset by decreases in the Industrial and Process segments. EMEA had sales growth in both developed and emerging markets, with strong growth from

Contractor and Industrial segments. Strong sales growth in China more than offset decreases in other areas of Asia Pacific.



## Table of Contents

### Gross Profit

In 2017, gross profit margin rate was one-half percentage point higher than the 2016 rate. Favorable effects from currency translation, higher production volume and realized pricing were partially offset by the unfavorable impact of product and channel mix.

In 2016, gross profit margin rate of 53% was consistent with the rate in the prior year. The favorable effects of realized pricing and product and channel mix offset the unfavorable impacts of lower factory volume.

### Operating Expenses

The Company restructured its funded U.S. defined benefit pension plan in 2017. Included in the restructuring was the transfer of certain plan liabilities and assets to an insurance company that resulted in a \$12 million pension settlement loss included in general and administrative expense. Total operating expenses for 2016 included an impairment charge of \$192 million. Before the pension settlement loss in 2017 and the impairment charge in 2016, total operating expenses for 2017 were \$18 million (5 percent) higher than 2016, driven by volume and rate-related increases. Investment in new product development was \$60 million, slightly lower than 2016.

Total operating expenses for 2016 were \$212 million higher than 2015, including the impairment charge of \$192 million. Incremental expenses from acquired operations accounted for nearly half of the remainder of the increase. Incremental spending related to product and corporate initiatives increased expenses by approximately \$3 million, and changes in currency translation rates reduced operating expenses by approximately \$4 million. Investment in new product development was \$61 million or 4½ percent of sales in 2016, consistent with 2015 expense as a percentage of sales.

### Operating Earnings

Operating earnings in 2017 were three times higher than 2016 operating earnings. Excluding the \$12 million pension settlement loss in 2017 and the \$192 million impairment charge in 2016, improved gross margin rate and expense leverage in 2017 led to a 22 percent gain in operating earnings and a 2 percentage point increase as a percentage of sales.

Operating earnings in 2016 before the impairment charge increased 1 percent, as the 5 percent increase in expenses exceeded the 3 percent increase in sales. Changes in currency translation rates reduced operating earnings by approximately \$4 million in 2016.

### Income Taxes

The effective income tax rate for 2017 was 27 percent. Adoption of a new accounting standard, requiring excess tax benefits related to stock option exercises to be credited to the income tax provision (formerly credited to equity), reduced the tax provision by \$36 million, decreasing the effective tax rate by 10 percentage points. U.S. federal income tax reform legislation passed at the end of 2017 required a revaluation of net deferred tax assets and instituted a toll charge on unrepatriated foreign earnings that increased the tax provision by a total of \$36 million, increasing the effective tax rate by 10 percentage points. Effects of tax planning and other non-recurring tax changes decreased the 2017 effective rate by 3 percentage points.

The effective tax rate for 2016 was 58 percent, including approximately 28 percentage points related to the impairment charge, compared to 27 percent in 2015. The 2015 rate included favorable impacts of non-recurring tax benefits and post-tax dividend income, partially offset by the tax rate effects of the gain on the sale of Liquid

Finishing business assets. The net increase in effective rate from those items was partially offset by additional 2016 benefit from foreign earnings being taxed at lower rates than the U.S.

#### Segment Results

The Company has six operating segments which are aggregated into three reportable segments: Industrial, Process and Contractor. Refer to Part I Item 1. Business, for a description of the Company's three reportable segments. Management assesses performance of segments by reference to operating earnings excluding unallocated corporate expenses and asset impairments.

Table of Contents

The following table presents net sales and operating earnings by reporting segment (in millions):

	2017	2016	2015
Sales			
Industrial	\$692.0	\$629.6	\$616.1
Process	294.6	266.6	273.6
Contractor	488.1	433.1	396.8
Total	\$1,474.7	\$1,329.3	\$1,286.5
Operating Earnings			
Industrial	\$237.7	\$207.2	\$201.8
Process	52.2	35.8	43.8
Contractor	113.9	91.8	86.4
Unallocated corporate (expense) <sup>(1)</sup>	(43.4 )	(28.9 )	(29.9 )
Impairment <sup>(2)</sup>	—	(192.0 )	—
Total	\$360.4	\$113.9	\$302.1

Unallocated corporate (expense) includes such items as stock compensation, divestiture and certain acquisition transaction costs, bad debt expense, charitable contributions, non-service cost portions of pension expense and (1)certain central warehouse expenses. The pension settlement loss and an increase in stock compensation expense account for most of the increase in unallocated corporate expenses in 2017. Unallocated corporate expenses in 2016 were consistent with the prior year.

(2) The impairment charge recorded in 2016 related to assets of our Oil and Natural Gas reporting unit included within the Process Segment. Refer to Critical Accounting Estimates for more discussion on the impairment charge.

## Industrial Segment

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

	2017	2016	2015
Sales			
Americas	\$299.5	\$281.3	\$288.9
EMEA	199.2	184.5	173.3
Asia Pacific	193.3	163.8	153.9
Total	\$692.0	\$629.6	\$616.1
Operating Earnings as a Percentage of Sales	34 %	33 %	33 %

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

	2017				2016			
	Volume and Price	Acquisitions	Currency	Total	Volume and Price	Acquisitions	Currency	Total
Americas	6%	0%	0%	6%	(2)%	0%	(1)%	(3)%
EMEA	6%	1%	1%	8%	8%	0%	(2)%	6%
Asia Pacific	18%	1%	(1)%	18%	7%	1%	(2)%	6%
Segment Total	9%	1%	0%	10%	3%	0%	(1)%	2%

In 2017, strong growth in Asia Pacific drove the Industrial segment to a double-digit percentage increase in sales. The Industrial segment in the Americas benefited from favorable construction markets and continued activity in automotive and general industry, while protective coatings, heavy equipment and South America remained challenging. In EMEA, the Industrial segment benefited from strong improvement in industrial production in Western

Europe as well as growth in Eastern Europe, while sales in Africa and other emerging markets experienced a slight decline. As economies in Asia Pacific benefited from recovery in global demand, we saw growth in automotive and a broad base of general industries.

Table of Contents

Higher sales volume, including strong finishing systems growth, and expense leverage drove a 1 percentage point increase in operating margin rate. Increased spending on product and regional growth initiatives in the fourth quarter partially offset strong operating margins earned in the first three quarters.

In 2016, sales in the Industrial segment were down in the Americas, with a weaker capital spending environment and softness in agriculture, energy, mining and heavy machinery markets. The decrease in the Americas was more than offset by increases in EMEA, led by strong growth in the powder business, and in Asia Pacific. Operating margin rates for this segment in 2016 were consistent with the prior year.

In this segment, sales in each geographic region are significant and management looks at economic and financial indicators in each region, including gross domestic product, industrial production, capital investment rates, automobile production, building construction and the level of the U.S. dollar versus the euro, the Swiss franc, the Canadian dollar, the Australian dollar and various Asian currencies.

## Process Segment

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

	2017	2016	2015
Sales			
Americas	\$187.6	\$170.4	\$171.8
EMEA	56.0	52.4	55.0
Asia Pacific	51.0	43.8	46.8
Total	\$294.6	\$266.6	\$273.6
Operating Earnings as a Percentage of Sales	18 %	13 %	16 %

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

	2017				2016			
	Volume and Price	Acquisitions	Currency	Total	Volume and Price	Acquisitions	Currency	Total
Americas	10%	0%	0%	10%	(5)%	4%	0%	(1)%
EMEA	9%	0%	(2)%	7%	(12)%	12%	(5)%	(5)%
Asia Pacific	17%	0%	(1)%	16%	(8)%	4%	(2)%	(6)%
Segment Total	11%	0%	0%	11%	(7)%	6%	(2)%	(3)%

In 2017, legacy product applications of the Process segment had double-digit percentage growth for the year. In the Americas and in EMEA, the Process segment saw growth in 2017 in technology, sanitary and vehicle service applications and stable markets for industrial lubrication and environmental applications. Sales directly into oil and natural gas applications were flat for the year, though offshore activity remains weak. In Asia Pacific, process applications continued to be favorable and, though sales into mining applications remained low in 2017, rising commodity prices could give rise to higher activity levels going forward. Operating margin rates for this segment increased 5 percentage points, driven by higher sales volume, favorable expense leverage and a decrease in intangible amortization related to the impairment recorded in the fourth quarter of 2016.

In 2016, sales in the Process segment decreased in all regions, with weakness in oil and natural gas and mining markets. Early in 2016, the segment acquired two businesses that enhance and complement the Company's position in environmental monitoring and remediation markets. Incremental sales from the acquired operations totaled \$14 million in 2016. Operating margin rate decreased in 2016 due to lower sales volume and unfavorable expense leverage.

Although the Americas represent the substantial majority of sales for the Process segment, and indicators in that region are the most significant, management monitors indicators such as levels of gross domestic product, capital investment, industrial production, oil and natural gas markets and mining activity worldwide.

Table of Contents

## Contractor Segment

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

	2017	2016	2015
Sales			
Americas	\$363.4	\$325.3	\$299.2
EMEA	88.1	74.3	63.1
Asia Pacific	36.6	33.5	34.5
Total	\$488.1	\$433.1	\$396.8
Operating Earnings as a Percentage of Sales	23 %	21 %	22 %

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

	2017				2016			
	Volume and Price	Acquisitions	Currency	Total	Volume and Price	Acquisitions	Currency	Total
Americas	12%	0%	0%	12%	9%	0%	0%	9%
EMEA	17%	0%	2%	19%	19%	0%	(1)%	18%
Asia Pacific	9%	0%	0%	9%	(1)%	0%	(2)%	(3)%
Segment Total	12%	0%	1%	13%	10%	0%	(1)%	9%

In 2017, the Contractor segment had strong sales growth in all channels and regions. New product sales, expanded distribution and improved economic environment drove strong growth in EMEA from both developed and emerging markets. The Contractor segment benefited from the ongoing strength in both residential and commercial construction in North America, Western Europe, and Central East Europe. Ongoing emphasis on development of commercial resources and distribution in Asia Pacific resulted in growth in many areas of the region. Economic conditions and equipment adoption rates remain challenging in emerging markets in EMEA, Asia Pacific and South America. Contractor segment operating margin rate for the year increased 2 percentage points compared to last year due to higher sales volume, improved gross margin rate and favorable expense leverage.

In 2016, new products and continued strength in U.S. residential and commercial construction markets drove sales growth in the Americas. Both the home center channel and the paint store channel had solid sales growth in the Americas. In EMEA, sales growth came from both developed and emerging markets, with most of the increase from Western and Central Europe. Operating margin rates decreased slightly compared to 2015 rates due to unfavorable expense leverage and product and channel mix.

In this segment, sales in all regions are significant and management reviews economic and financial indicators in each region, including levels of residential, commercial and institutional construction, remodeling rates and interest rates. Management also reviews gross domestic product for the regions and the level of the U.S. dollar versus the euro and other currencies.

## Financial Condition and Cash Flow

Working Capital. The following table highlights several key measures of asset performance (dollars in millions):

	2017	2016
Working capital	\$397.5	\$325.4
Current ratio	2.7	2.8
Days of sales in receivables outstanding	63	61
Inventory turnover (LIFO)	3.1	3.0

Increases in accounts receivable were consistent with higher sales levels, and inventories increased to meet higher demand and service levels.

Capital Structure. At December 29, 2017, the Company's capital structure included current notes payable of \$7 million, long-term debt of \$226 million and shareholders' equity of \$723 million. At December 30, 2016, the Company's capital structure included current notes payable of \$9 million, long-term debt of \$306 million and shareholders' equity of \$574 million.



Table of Contents

Shareholders' equity increased by \$149 million in 2017. The increase from current year earnings of \$252 million was partially offset by dividends of \$83 million and share repurchases of \$90 million. Increases related to shares issued, stock compensation and changes in accumulated other comprehensive income totaled \$70 million.

**Liquidity and Capital Resources.** The Company had cash held in deposit accounts totaling \$104 million at December 29, 2017, and \$52 million as of December 30, 2016. As of December 29, 2017, cash balances of \$9 million were restricted to funding of certain self-insured loss reserves, and included within other current assets on the Company's Consolidated Balance Sheets. In 2015, the Company asserted that it will indefinitely reinvest earnings of foreign subsidiaries to support expansion of its international business. As of December 29, 2017, the amount of cash held outside the U.S. was not significant to the Company's liquidity and was available to fund investments abroad.

On December 15, 2016, the Company executed an amendment to its revolving credit agreement, extending the expiration date to December 15, 2021 and decreasing certain interest rates and fees. The amended agreement with a syndicate of lenders provides up to \$500 million of committed credit, available for general corporate purposes, working capital needs, share repurchases and acquisitions. The Company may borrow up to \$50 million under the swingline portion of the facility for daily working capital needs.

Under terms of the amended revolving credit agreement, borrowings may be denominated in U.S. dollars or certain other currencies. Loans denominated in U.S. dollars bear interest, at the Company's option, at either a base rate or a LIBOR-based rate. Loans denominated in currencies other than U.S. dollars bear interest at a LIBOR-based rate. The base rate is an annual rate equal to a margin ranging from zero percent to 0.75 percent, depending on the Company's cash flow leverage ratio (debt to earnings before interest, taxes, depreciation, amortization and extraordinary non-operating or non-cash charges and expenses) plus the highest of (i) the bank's prime rate, (ii) the federal funds rate plus 0.5 percent, or (iii) one-month LIBOR plus 1.5 percent. In general, LIBOR-based loans bear interest at LIBOR plus 1 percent to 1.75 percent, depending on the Company's cash flow leverage ratio. In addition to paying interest on the outstanding loans, the Company is required to pay a fee on the unused amount of the loan commitments at an annual rate ranging from 0.125 percent to 0.25 percent, depending on the Company's cash flow leverage ratio.

On December 29, 2017, the Company had \$545 million in lines of credit, including the \$500 million in committed credit facilities described above and \$45 million with foreign banks. The unused portion of committed credit lines was \$512 million as of December 29, 2017.

Various debt agreements require the Company to maintain certain financial ratios as to cash flow leverage and interest coverage. The Company is in compliance with all financial covenants of its debt agreements as of December 29, 2017.

Internally generated funds and unused financing sources are expected to provide the Company with the flexibility to meet its liquidity needs in 2018, including its capital expenditure plan of approximately \$40 million (excluding several building expansion projects that are currently in planning and design phases), planned dividends estimated at \$90 million, share repurchases and acquisitions. If acquisition opportunities increase, the Company believes that reasonable financing alternatives are available for the Company to execute on those opportunities.

In December 2017, the Company's Board of Directors increased the Company's regular quarterly dividend to \$0.1325 from \$0.1200 per share, an increase of 10 percent.

**Cash Flow.** A summary of cash flow follows (in millions):

	2017	2016	2015
Operating activities	\$337.9	-\$276.0	\$191.4
Investing activities	(68.5 )	(90.9 )	369.9
Financing activities	(217.1 )	(185.2 )	(536.2 )

Edgar Filing: GRACO INC - Form 10-K

Effect of exchange rates on cash	(1.0 )	0.2	3.5
Net cash provided	51.3	0.1	28.6
Cash and cash equivalents at end of year	\$103.7	\$52.4	\$52.3

Cash Flows From Operating Activities. Net cash provided by operating activities was \$338 million in 2017, up \$62 million compared to 2016, driven by an increase in net earnings. Net cash provided by operating activities was \$276 million in 2016, up \$85 million compared to 2015. Cash flows from operating activities in 2015 included the effects of increases in inventory and accounts receivable and payments of transaction costs and income taxes related to the sale of Liquid Finishing business assets.

Table of Contents

**Cash Flows Used in Investing Activities.** Cash flows used in investing activities totaled \$68 million in 2017, including \$40 million for capital additions and \$28 million for business acquisitions. Cash outflows from investing activities totaled \$91 million in 2016. The Company used proceeds from its revolving line of credit to acquire two related businesses for a total cash price of \$49 million and made capital additions of \$42 million. Cash inflows from investing activities in 2015 included \$610 million from the sale of the Liquid Finishing business assets, partially offset by cash outflows of \$189 million for acquisitions and \$42 million for capital additions.

**Cash Flows Used in Financing Activities.** Cash flows used in financing activities totaled \$217 million in 2017 and included dividends of \$80 million, net payments of \$83 million on long-term debt and outstanding lines of credit (including a \$75 million prepayment of private placement debt that was due in 2018) and share repurchases of \$90 million (partially offset by net proceeds from share issuances of \$36 million). Cash flows used in financing activities totaled \$185 million in 2016. Cash outflows in 2016 included dividend payments of \$73 million, share repurchases of \$50 million (partially offset by proceeds from share issuances of \$33 million) and net payments on outstanding lines of credit of \$93 million. Cash flows used in financing activities in 2015 included net payments on outstanding lines of credit of \$211 million, share repurchases of \$275 million and dividends paid of \$69 million.

On April 24, 2015, the Board of Directors authorized the purchase of up to 18 million shares, primarily through open market transactions. The authorization is for an indefinite period of time or until terminated by the Board. Under the authorization, 8.8 million shares remain available for purchase as of December 29, 2017.

The Company repurchased and retired 2.6 million shares in 2017, compared to 2.3 million shares in 2016 and 11.6 million shares in 2015. The Company expects to continue to make opportunistic share repurchases in 2018 via open market transactions or short-dated accelerated share repurchase (“ASR”) programs.

**Off-Balance Sheet Arrangements and Contractual Obligations.** The Company has no significant off-balance sheet debt or other unrecorded obligations other than the items noted in the following table. In addition, the Company could be obligated to perform under standby letters of credit totaling \$2 million at December 29, 2017. The Company has also guaranteed the debt of its subsidiaries for up to \$10 million. All debt of subsidiaries is reflected in the consolidated balance sheets.

As of December 29, 2017, the Company is obligated to make cash payments in connection with obligations as follows (in millions):

	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt	\$226.0	\$ —	\$75.0	\$1.0	\$ 150.0
Interest on long-term debt	63.2	11.4	20.2	15.6	16.0
Other non-current liabilities <sup>(1)</sup>	6.0	1.0	4.0	0.4	0.6
Operating leases	28.2	8.3	10.2	4.9	4.8
Service contracts	6.4	2.9	3.2	0.3	—
Purchase obligations <sup>(2)</sup>	130.0	130.0	—	—	—
Unfunded pension and postretirement medical benefits <sup>(3)</sup>	35.4	2.7	6.1	7.1	19.5
Total	\$495.2	\$ 156.3	\$ 118.7	\$29.3	\$ 190.9

(1) Other non-current liabilities include estimated obligations for representations and warranties associated with the Liquid Finishing business divestiture, additional purchase consideration based on future revenues of an acquired business in excess of specified thresholds, and amounts related to certain capitalized leasehold improvements.

(2) The Company is committed to pay suppliers under the terms of open purchase orders issued in the normal course of business. The Company also has commitments with certain suppliers to purchase minimum quantities, and under the terms of certain agreements, the Company is committed for certain portions of the supplier’s inventory. The

Company does not purchase, or commit to purchase, quantities in excess of normal usage or amounts that cannot be used within one year.

- (3) The amounts and timing of future Company contributions to the funded qualified defined benefit pension plan are unknown because they are dependent on pension fund asset performance and pension obligation valuation assumptions.

## Table of Contents

### Critical Accounting Estimates

The Company prepares its consolidated financial statements in conformity with generally accepted accounting principles in the United States of America (“U.S. GAAP”). The Company’s most significant accounting policies are disclosed in Note A (Summary of Significant Accounting Policies) to the consolidated financial statements. The preparation of the consolidated financial statements, in conformity with U.S. GAAP, requires management to make estimates and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual amounts will differ from those estimates. The Company considers the following policies to involve the most judgment in the preparation of the Company’s consolidated financial statements.

**Excess and Discontinued Inventory.** The Company’s inventories are valued at the lower of cost or net realizable value. Reserves for excess and discontinued products are estimated. The amount of the reserve is determined based on projected sales information, plans for discontinued products and other factors. Though management considers these balances adequate, changes in sales volumes due to unanticipated economic or competitive conditions are among the factors that would result in materially different amounts for this item.

**Goodwill and Other Intangible Assets.** The Company performs impairment testing for goodwill annually in the fourth quarter or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company estimates the fair value of the reporting units using a present value of future cash flows calculation cross-checked by an allocation of market capitalization approach. The impairment test is performed using a two-step process. In the first step, the fair value of each reporting unit is compared with the carrying amount of the reporting unit. If the estimated fair value exceeds its carrying value, step two of the impairment analysis is not required. If the estimated fair value is less than its carrying amount, impairment is indicated and the second step must be completed in order to determine the amount, if any, of the impairment. In the second step, an impairment loss is recognized for the difference between the implied value of goodwill and the carrying value.

The Company’s primary identifiable intangible assets include customer relationships, trademarks, trade names, proprietary technology and patents. Finite lived intangibles are amortized and are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Indefinite lived intangibles are reviewed for impairment annually in the fourth quarter, or more frequently if events or changes in circumstances indicate the asset might be impaired.

A considerable amount of management judgment and assumptions are required in performing the impairment tests. Management makes several assumptions, including earnings and cash flow projections, discount rate, product offerings and market strategies, customer attrition, and royalty rates, each of which have a significant impact on the estimated fair values. Though management considers its judgments and assumptions to be reasonable, changes in these assumptions could impact the estimated fair value.

In 2016, operating results of our Oil and Natural Gas reporting unit (“ONG”) within the Process segment fell short of expectations due to weakness in oil and natural gas markets. We concluded that the depth and length of industry weakness, and its continuing impact on ONG results, were greater than previously expected, so we completed an impairment analysis and recorded adjustments to reduce goodwill by \$147 million and other intangible assets by \$45 million. The impairment charges reduced 2016 operating earnings by \$192 million, created a \$31 million deferred tax benefit, and decreased net earnings by \$161 million.

In 2017, we completed our annual impairment testing of goodwill and other intangible assets in the fourth quarter. No impairment charges were recorded as a result of that review.

**Income Taxes.** In the preparation of the Company's consolidated financial statements, management calculates income taxes. This includes estimating current tax liability as well as assessing temporary differences resulting from different treatment of items for tax and financial statement purposes. These differences result in deferred tax assets and liabilities, which are recorded on the balance sheet using statutory rates in effect for the year in which the differences are expected to reverse. These assets and liabilities are analyzed regularly and management assesses the likelihood that deferred tax assets will be recoverable from future taxable income. A valuation allowance is established to the extent that management believes that recovery is not likely. Liabilities for uncertain tax positions are also established for potential and ongoing audits of federal, state and international issues. The Company routinely monitors the potential impact of such situations and believes that liabilities are properly stated. Valuations related to amounts owed and tax rates could be impacted by changes to tax codes and the Company's interpretation thereof, changes in statutory rates, the Company's future taxable income levels and the results of tax audits.

**Retirement Obligations.** The measurements of the Company's pension and postretirement medical obligations are dependent on a number of assumptions including estimates of the present value of projected future payments, taking into consideration future events such as salary increase and demographic experience. These assumptions may have an impact on the expense and timing of future contributions.

Table of Contents

The assumptions used in developing the required estimates for pension obligations include discount rate, inflation, salary increases, retirement rates, expected return on plan assets and mortality rates. The assumptions used in developing the required estimates for postretirement medical obligations include discount rates, rate of future increase in medical costs and participation rates.

For U.S. plans, the Company establishes its discount rate assumption by reference to a yield curve published by an actuary and projected plan cash flows. For plans outside the U.S., the Company establishes a rate by country by reference to highly rated corporate bonds. These reference points have been determined to adequately match expected plan cash flows. The Company bases its inflation assumption on an evaluation of external market indicators. The salary assumptions are based on actual historical experience, the near-term outlook and assumed inflation. Retirement rates are based on experience. The investment return assumption is based on the expected long-term performance of plan assets. In setting this number, the Company considers the input of actuaries and investment advisors, its long-term historical returns, the allocation of plan assets and projected returns on plan assets. The Company decreased its investment return assumption for its U.S. plans to a weighted average rate of 7.0 percent for 2018. Mortality rates are based on current common group mortality tables for males and females.

In 2017, net pension cost of \$15 million was allocated to cost of products sold and operating expenses based on salaries and wages, and the \$12 million settlement loss component of pension cost was charged to general and administrative expense. At December 29, 2017, a one-half percentage point decrease in the indicated assumptions would have the following effects (in millions):

Assumption	Funded Status	Expense
Discount rate	\$ (30.6 )	\$ 3.0
Expected return on assets	—	1.3

Recent Accounting Pronouncements

Refer to Note A (Summary of Significant Accounting Policies) to the Consolidated Financial Statements of this Form 10-K for disclosures related to recent accounting pronouncements.

## Table of Contents

### Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The Company sells and purchases products and services in currencies other than the U.S. dollar and pays variable interest rates on borrowings under certain credit facilities. Consequently, the Company is subject to profitability risk arising from exchange and interest rate movements. The Company may use a variety of financial and derivative instruments to manage foreign currency and interest rate risks. The Company does not enter into any of these instruments for trading purposes to generate revenue. Rather, the Company's objective in managing these risks is to reduce fluctuations in earnings and cash flows associated with changes in foreign currency exchange and interest rates.

The Company may use forward exchange contracts, options and other hedging activities to hedge the U.S. dollar value resulting from anticipated currency transactions and net monetary asset and liability positions. At December 29, 2017, the currencies to which the Company had the most significant balance sheet exchange rate exposure were the euro, Swiss franc, Canadian dollar, British pound, Japanese yen, Australian dollar, Chinese yuan renminbi and South Korean won. It is not possible to determine the true impact of currency rate changes; however, the direct translation effect on net sales and net earnings can be estimated. In 2017, changes in currency translation rates increased sales and net earnings by approximately \$2 million and \$1 million, respectively. In 2016, changes in currency translation rates reduced sales and net earnings by approximately \$12 million and \$2 million, respectively. In 2015, changes in currency translation rates reduced sales and net earnings by approximately \$58 million and \$20 million, respectively.

### 2018 Outlook

Our outlook for the full-year 2018 is for mid single-digit sales growth on an organic, constant currency basis, with growth expected in every region and reportable segment. Demand levels in the fourth quarter of 2017 remained solid and provide a foundation for our full-year outlook. While Industrial segment sales growth in the fourth quarter was low, bookings were better than billings and indicative of a capital equipment environment that remains stable-to-improving.

At January 2018 exchange rates, assuming the same volumes, mix of products and mix of business by currency as in 2017, the movement in foreign currencies would be a tailwind of approximately 3 percent on sales and 7 percent on earnings in 2018.

The Company's backlog is typically small compared to annual sales and is not a good indicator of future business levels. In addition to economic growth, the successful launch of new products and expanded distribution coverage, the sales outlook is dependent on many factors, including realization of price increases and stable foreign currency exchange rates.

### 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 this Form 10-K and our Form 10-Qs and Form 8-Ks, and other disclosures, including our 2017 Overview report, press releases, earnings releases, analyst briefings, conference calls and other written documents or oral statements released by our Company, may contain forward-looking statements. Forward-looking statements generally use words such as "expect," "foresee," "anticipate," "believe," "project," "should," "estimate," "will," and similar expressions, and reflect our Company's expectations concerning the future. All forecasts and projections are forward-looking statements. Forward-looking statements are based upon currently available information, but various risks and uncertainties may cause our Company's actual results to differ materially from those expressed in these statements. The Company undertakes no



obligation to update these statements in light of new information or future events.

Future results could differ materially from those expressed, due to the impact of changes in various factors. These risk factors include, but are not limited to, the factors discussed in Item 1A of this Annual Report on Form 10-K. 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 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 8. Financial Statements and Supplementary Data

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. The internal control system was designed to provide reasonable assurance to management and the board of directors regarding the reliability of financial reporting and preparation of financial statements in accordance with generally accepted accounting principles.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 29, 2017. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework (2013).

Based on our assessment and those criteria, management believes the Company's internal control over financial reporting is effective as of December 29, 2017.

The Company's independent auditors have issued an attestation report on the Company's internal control over financial reporting. That report appears in this Form 10-K.

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the shareholders and the Board of Directors of Graco Inc.

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Graco Inc. and Subsidiaries (the "Company") as of December 29, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 29, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements as of and for the year ended December 29, 2017 of the Company and our report dated February 20, 2018 expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB. We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ DELOITTE & TOUCHE LLP

Minneapolis, Minnesota

February 20, 2018

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the shareholders and the Board of Directors of Graco Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Graco Inc. and Subsidiaries (the "Company") as of December 29, 2017 and December 30, 2016, the related consolidated statements of earnings, comprehensive income, cash flows, and shareholders' equity for each of the three years in the period ended December 29, 2017, and the related notes and the financial statement schedule listed in the Index at Item 15 (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 29, 2017, and December 30, 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 29, 2017, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 29, 2017, based on criteria established in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 20, 2018, expressed an unqualified opinion on the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB. We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ DELOITTE & TOUCHE LLP

Minneapolis, Minnesota

February 20, 2018

We have served as the Company's auditor since at least 1969, in connection with its initial public offering.

Table of ContentsGRACO INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share amounts)

	Years Ended		
	December 29, 2017	December 30, 2016	December 25, 2015
Net Sales	\$1,474,744	\$ 1,329,293	\$ 1,286,485
Cost of products sold	681,695	621,054	601,785
Gross Profit	793,049	708,239	684,700
Product development	60,106	60,606	58,559
Selling, marketing and distribution	233,462	215,253	201,855
General and administrative	139,034	126,481	122,161
Impairment	—	192,020	—
Operating Earnings	360,447	113,879	302,125
Interest expense	16,202	17,590	17,643
Held separate investment (income), net	—	—	(191,635 )
Other expense (income), net	(2,849 )	(366 )	1,404 )
Earnings Before Income Taxes	347,094	96,655	474,713
Income taxes	94,682	55,981	129,000
Net Earnings	\$252,412	\$ 40,674	\$ 345,713
Basic Net Earnings per Common Share	\$1.50	\$0.24	\$2.00
Diluted Net Earnings per Common Share	\$1.45	\$0.24	\$1.95
Cash Dividends Declared per Common Share	\$0.49	\$0.45	\$0.41

See notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Years Ended		
	December 29, 2017	December 30, 2016	December 25, 2015
Net Earnings	\$252,412	\$ 40,674	\$ 345,713
Components of other comprehensive income (loss)			
Cumulative translation adjustment	16,443	(31,227 )	(10,423 )
Pension and postretirement medical liability adjustment	(3,321 )	(10,715 )	10,372 )
Income taxes - pension and postretirement medical liability	1,317	4,211	(3,710 )
Other comprehensive income (loss)	14,439	(37,731 )	(3,761 )
Comprehensive Income	\$266,851	\$ 2,943	\$ 341,952

See notes to consolidated financial statements.

Table of ContentsGRACO INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)

	December 29, 2017	December 30, 2016
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 103,662	\$ 52,365
Accounts receivable, less allowances of \$14,000 and \$12,700	256,421	218,365
Inventories	239,349	201,609
Other current assets	32,494	31,023
Total current assets	631,926	503,362
Property, Plant and Equipment, net	204,298	189,596
Goodwill	278,789	259,849
Other Intangible Assets, net	183,056	178,336
Deferred Income Taxes	50,916	86,653
Other Assets	30,220	25,313
Total Assets	\$ 1,379,205	\$ 1,243,109
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities		
Notes payable to banks	\$ 6,578	\$ 8,913
Trade accounts payable	48,748	39,988
Salaries and incentives	55,884	37,109
Dividends payable	22,260	20,088
Other current liabilities	100,956	71,887
Total current liabilities	234,426	177,985
Long-term Debt	226,035	305,685
Retirement Benefits and Deferred Compensation	172,411	159,250
Deferred Income Taxes	17,253	17,672
Other Non-current Liabilities	6,017	8,697
Commitments and Contingencies (Note K)		
Shareholders' Equity		
Common stock, \$1 par value; 291,000,000 shares authorized; 169,318,926 and 167,503,236 shares outstanding in 2017 and 2016	169,319	55,834
Additional paid-in-capital	499,934	453,394
Retained earnings	181,599	206,820
Accumulated other comprehensive income (loss)	(127,789 )	(142,228 )
Total shareholders' equity	723,063	573,820
Total Liabilities and Shareholders' Equity	\$ 1,379,205	\$ 1,243,109
See notes to consolidated financial statements.		

Table of Contents

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

	Years Ended		
	December 30, 2017	December 30, 2016	December 25, 2015
Cash Flows From Operating Activities			
Net Earnings	\$252,412	\$ 40,674	\$ 345,713
Adjustments to reconcile net earnings to net cash provided by operating activities			
Impairment	—	192,020	—
Depreciation and amortization	45,583	48,290	44,607
Deferred income taxes	34,446	(35,561)	(11,585)
Share-based compensation	23,652	21,134	19,224
(Gain) loss on sale of business	—	—	(149,894)
Change in			
Accounts receivable	(28,010)	4,506	(18,276)
Inventories	(32,011)	(693)	(34,109)
Trade accounts payable	4,588	553	4,305
Salaries and incentives	11,431	(6,809)	(1,385)
Retirement benefits and deferred compensation	6,920	10,995	11,870
Other accrued liabilities	23,909	3,298	1,645
Other	(5,056)	(2,401)	(20,701)
Net cash provided by operating activities	337,864	276,006	191,414
Cash Flows From Investing Activities			
Property, plant and equipment additions	(40,194)	(42,113)	(41,749)
Acquisition of businesses, net of cash acquired	(27,905)	(48,946)	(189,017)
Proceeds from sale of assets	—	—	610,162
Change in restricted assets	(12)	288	(9,518)
Other	(348)	(164)	61
Net cash provided by (used in) investing activities	(68,459)	(90,935)	369,939
Cash Flows From Financing Activities			
Borrowings (payments) on short-term lines of credit, net	(3,026)	(5,995)	11,216
Borrowings on long-term line of credit	315,920	648,134	720,605
Payments on long-term debt and line of credit	(395,570)	(735,144)	(942,910)
Payments of debt issuance costs	—	(860)	—
Common stock issued	60,685	35,796	20,165
Common stock repurchased	(90,160)	(50,497)	(274,503)
Taxes paid related to net share settlement of equity awards	(24,448)	(3,165)	(1,330)
Cash dividends paid	(80,477)	(73,434)	(69,429)
Net cash provided by (used in) financing activities	(217,076)	(185,165)	(536,186)
Effect of exchange rate changes on cash	(1,032)	164	3,472
Net increase (decrease) in cash and cash equivalents	51,297	70	28,639
Cash and Cash Equivalents			
Beginning of year	52,365	52,295	23,656
End of year	\$103,662	\$ 52,365	\$ 52,295
See notes to consolidated financial statements.			





Table of Contents

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

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance December 26, 2014	\$59,199	\$384,704	\$252,865	\$ (100,736 )	\$596,032
Shares issued	446	18,040	—	—	18,486
Shares repurchased	(3,879 )	(25,201 )	(242,984 )	—	(272,064 )
Stock compensation cost	—	19,107	—	—	19,107
Tax benefit related to stock options exercised	—	1,775	—	—	1,775
Restricted stock canceled (issued)	—	349	—	—	349
Net earnings	—	—	345,713	—	345,713
Dividends declared	—	—	(70,086 )	—	(70,086 )
Other comprehensive income (loss)	—	—	—	(3,761 )	(3,761 )
Balance December 25, 2015	55,766	398,774	285,508	(104,497 )	635,551
Shares issued	830	31,947	—	—	32,777
Shares repurchased	(762 )	(5,449 )	(44,286 )	—	(50,497 )
Stock compensation cost	—	21,355	—	—	21,355
Tax benefit related to stock options exercised	—	6,913	—	—	6,913
Restricted stock canceled (issued)	—	(146 )	—	—	(146 )
Net earnings	—	—	40,674	—	40,674
Dividends declared	—	—	(75,076 )	—	(75,076 )
Other comprehensive income (loss)	—	—	—	(37,731 )	(37,731 )
Balance December 30, 2016	55,834	453,394	206,820	(142,228 )	573,820
Stock split	112,879	—	(112,879 )	—	—
Shares issued	1,489	35,164	—	—	36,653
Shares repurchased	(883 )	(7,172 )	(82,105 )	—	(90,160 )
Stock compensation cost	—	18,963	—	—	18,963
Restricted stock canceled (issued)	—	(415 )	—	—	(415 )
Net earnings	—	—	252,412	—	252,412
Dividends declared	—	—	(82,649 )	—	(82,649 )
Other comprehensive income (loss)	—	—	—	14,439	14,439
Balance December 29, 2017	\$169,319	\$499,934	\$181,599	\$ (127,789 )	\$723,063

See notes to consolidated financial statements.

Table of Contents

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Graco Inc. and Subsidiaries

Years Ended December 29, 2017, December 30, 2016 and December 25, 2015

## A. Summary of Significant Accounting Policies

**Fiscal Year.** The fiscal year of Graco Inc. and Subsidiaries (the “Company”) is 52 or 53 weeks, ending on the last Friday in December. The years ended December 29, 2017 and December 25, 2015 were 52-week years. The year ended December 30, 2016 was a 53-week year.

**Basis of Statement Presentation.** The consolidated financial statements include the accounts of the parent company and its subsidiaries after elimination of intercompany balances and transactions. As of December 29, 2017, all subsidiaries are 100 percent controlled by the Company. All share and per share data have been adjusted to reflect the three-for-one stock split distributed on December 27, 2017. Certain other prior year disclosures have been revised to conform with current year reporting.

As more fully described in Note M (Divestiture), in 2015, the Company sold the Liquid Finishing business assets acquired in 2012 that were held as a cost-method investment. Investment income in the Company’s consolidated statements of earnings includes the pre-tax gain on the sale, net of transaction and other related expenses, along with dividend income received prior to the sale from after-tax earnings of Liquid Finishing.

**Foreign Currency Translation.** The functional currency of certain subsidiaries is the local currency. Accordingly, adjustments resulting from the translation of those subsidiaries’ financial statements into U.S. dollars are charged or credited to accumulated other comprehensive income (loss). The U.S. dollar is the functional currency for all other foreign subsidiaries. Accordingly, gains and losses from the translation of foreign currency balances and transactions of those subsidiaries are included in other expense (income), net.

**Accounting Estimates.** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Such estimates and assumptions also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Fair Value Measurements.** The three levels of inputs in the fair value measurement hierarchy are as follows:

Level 1 – based on quoted prices in active markets for identical assets

Level 2 – based on significant observable inputs

Level 3 – based on significant unobservable inputs

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

	Level	2017	2016
<b>Assets</b>			
Cash surrender value of life insurance	2	\$ 16,128	\$ 13,785
Forward exchange contracts	2	—	571
Total assets at fair value		\$ 16,128	\$ 14,356
<b>Liabilities</b>			
Contingent consideration	3	\$ 4,081	\$ 4,081
Deferred compensation	2	3,836	3,265
Forward exchange contracts	2	517	—

Total liabilities at fair value                      \$8,434    \$7,346

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

The Company's policy and accounting for forward exchange contracts are described below, in Derivative Instruments and Hedging Activities.

Table of Contents

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 its future revenues (see Note L, Acquisitions).

Disclosures related to other fair value measurements are included below in Impairment of Long-Lived Assets, in Note F (Debt) and in Note J (Retirement Benefits).

Cash Equivalents. All highly liquid investments with a maturity of three months or less at the date of purchase are considered to be cash equivalents.

Accounts Receivable. Accounts receivable includes trade receivables of \$244 million in 2017 and \$209 million in 2016. Other receivables totaled \$12 million in 2017 and \$9 million in 2016.

Inventory Valuation. Inventories are stated at the lower of cost or net realizable value. The last-in, first-out (LIFO) cost method is used for valuing most U.S. inventories. Inventories of foreign subsidiaries are valued using the first-in, first-out (FIFO) cost method.

Other Current Assets. Amounts included in other current assets were (in thousands):

	2017	2016
Prepaid income taxes	\$8,934	\$10,723
Restricted cash	9,242	9,230
Prepaid expenses and other	14,318	11,070
Total	\$32,494	\$31,023

Cash balances included within other current assets were restricted to funding of certain self-insured loss reserves.

Impairment of Long-Lived Assets. The Company evaluates long-lived assets (including property and equipment, goodwill and other intangible assets) for impairment annually in the fourth quarter, or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

We completed our annual impairment review of all long-lived assets in the fourth quarter of 2017. No impairment charges were recorded as a result of that review. In 2016, we recorded an impairment charge of \$192 million for our Oil and Natural Gas reporting unit within the Process segment. There were no impairment charges in 2015.

Property, Plant and Equipment. For financial reporting purposes, plant and equipment are depreciated over their estimated useful lives, primarily by using the straight-line method as follows:

Buildings and improvements	10 to 30 years
Leasehold improvements	lesser of 5 to 10 years or life of lease
Manufacturing equipment	lesser of 5 to 10 years or life of equipment
Office, warehouse and automotive equipment	3 to 10 years

Goodwill and Other Intangible Assets. Goodwill has been assigned to reporting units. Changes in the carrying amounts of goodwill for each reportable segment were (in thousands):

	Industrial	Process	Contractor	Total
Balance, December 25, 2015	\$153,283	\$228,473	\$12,732	\$394,488
Additions from business acquisitions	—	28,130	—	28,130
Impairment	—	(146,669)	—	(146,669)
Foreign currency translation	(2,727)	(13,373)	—	(16,100)
Balance, December 30, 2016	150,556	96,561	12,732	259,849

Edgar Filing: GRACO INC - Form 10-K

Additions (adjustments) from business acquisitions	7,152	(62	) 6,413	13,503
Foreign currency translation	3,965	1,472	—	5,437
Balance, December 29, 2017	\$161,673	\$97,971	\$ 19,145	\$278,789

Table of Contents

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

	Finite Life			Indefinite Life		Total
	Customer Relationships	Patents and Proprietary Technology	Trademarks, Trade Names and Other	Trade Names		
As of December 29, 2017						
Cost	\$ 179,826	\$ 18,479	\$ 1,071	\$ 59,553		\$ 258,929
Accumulated amortization	(54,076 )	(7,795 )	(542 )	—		(62,413 )
Foreign currency translation	(9,186 )	(727 )	(61 )	(3,486 )		(13,460 )
Book value	\$ 116,564	\$ 9,957	\$ 468	\$ 56,067		\$ 183,056
Weighted average life in years	13	10	4	N/A		
As of December 30, 2016						
Cost	\$ 170,284	\$ 17,321	\$ 895	\$ 57,853	\$ 246,353	
Accumulated amortization	(41,599 )	(6,088 )	(337 )	—		(48,024 )
Foreign currency translation	(13,630 )	(1,055 )	(59 )	(5,249 )		(19,993 )
Book value	\$ 115,055	\$ 10,178	\$ 499	\$ 52,604	\$ 178,336	
Weighted average life in years	13	10	4	N/A		

Amortization of intangibles was \$14.8 million in 2017, \$17.8 million in 2016 and \$17.2 million in 2015. Estimated future annual amortization expense based on the current carrying amount of other intangible assets is as follows (in thousands):

	2018	2019	2020	2021	2022	Thereafter
Estimated Amortization Expense	\$ 15,418	\$ 15,089	\$ 14,910	\$ 14,740	\$ 14,740	\$ 52,092

Other Assets. Components of other assets were (in thousands):

	2017	2016
Cash surrender value of life insurance	\$ 16,128	\$ 13,785
Capitalized software	1,784	1,812
Equity method investment	6,755	6,366
Prepaid pension	2,538	—
Deposits and other	3,015	3,350
Total	\$ 30,220	\$ 25,313

The Company has entered into contracts insuring the lives of certain employees who are eligible to participate in certain non-qualified pension and deferred compensation plans. These insurance contracts are used to fund the non-qualified pension and deferred compensation arrangements. The insurance contracts are held in a trust and are available to general creditors in the event of the Company's insolvency. Changes in cash surrender value are recorded in operating expense and were not significant in 2016 and 2015. In 2017, increases in cash surrender value totaled \$2.3 million and were offset by expenses related to the non-qualified pension and deferred compensation plans funded by the insurance contracts.

Capitalized software is amortized over its estimated useful life (generally 2 to 5 years) beginning at date of implementation.

Table of Contents

Other Current Liabilities. Components of other current liabilities were (in thousands):

	2017	2016
Accrued self-insurance retentions	\$7,956	\$7,105
Accrued warranty and service liabilities	10,535	8,934
Accrued trade promotions	10,588	6,007
Payable for employee stock purchases	10,053	9,328
Customer advances and deferred revenue	22,632	9,400
Income taxes payable	7,564	8,608
Other	31,628	22,505
Total	\$100,956	\$71,887

Self-Insurance. The Company is self-insured for certain losses and costs relating to product liability, workers' compensation, employee medical benefit claims and representations and warranties associated with the Liquid Finishing business divestiture. The Company has stop-loss coverage in order to limit its exposure to significant claims. Accrued self-insurance retentions are based on claims filed, estimates of claims incurred but not reported, and other actuarial assumptions. Self-insured reserves totaled \$8.5 million as of December 29, 2017, and \$9.8 million as of December 30, 2016, including \$0.5 million and \$2.7 million, respectively, classified as other long-term liabilities in the Consolidated Balance Sheets.

Product Warranties. 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):

	2017	2016
Balance, beginning of year	\$8,934	\$7,870
Charged to expense	7,930	7,516
Margin on parts sales reversed	2,826	1,796
Reductions for claims settled	(9,155 )	(8,248 )
Balance, end of year	\$10,535	\$8,934

Revenue Recognition. Sales are recognized when revenue is realized or realizable and has been earned. The Company's policy is to recognize revenue when risk and title passes to the customer. This is generally on the date of shipment, however certain sales have terms requiring recognition when received by the customer. In cases where there are specific customer acceptance provisions, revenue is recognized at the later of customer acceptance or shipment (subject to shipping terms). Payment terms are established based on the type of product, distributor capabilities and competitive market conditions. Rights of return are typically contractually limited, amounts are estimable, and the Company records provisions for anticipated returns and warranty claims at the time revenue is recognized. Historically, sales returns have been less than 3 percent of sales. Provisions for sales returns are recorded as a reduction of net sales, and provisions for warranty claims are recorded in selling, marketing and distribution expenses. From time to time, the Company may promote the sale of new products by agreeing to accept returns of superseded products. In such cases, provisions for estimated returns are recorded as a reduction of net sales.

Trade promotions are offered to distributors and end users through various programs, generally with terms of one year or less. Such promotions include cooperative advertising arrangements, rebates based on annual purchases and sales growth, coupons and reimbursement for competitive products. Payment of incentives may take the form of cash, trade credit, promotional merchandise or free product. Under cooperative advertising arrangements, the Company reimburses the distributor for a portion of its advertising costs related to the Company's products; estimated costs are accrued at the time of sale and classified as selling, marketing and distribution expense. Rebates are accrued based on the program rates and progress toward the estimated annual sales amount and sales growth, and are recorded as a

reduction of sales (cash, trade credit) or cost of products sold (free goods). The estimated costs related to coupon programs are accrued at the time of sale and classified as selling, marketing and distribution expense or cost of products sold, depending on the type of incentive offered.

Shipping and Handling. Shipping and handling costs incurred for the delivery of goods to customers are included in cost of goods sold in the accompanying Consolidated Statements of Earnings. Amounts billed to customers for shipping and handling are included in net sales.



Table of Contents

**Earnings Per Common Share.** Basic net earnings per share is computed by dividing earnings available to common shareholders by the weighted average number of shares outstanding during the year. Diluted net earnings per share is computed after giving effect to the exercise of all dilutive outstanding option grants.

**Comprehensive Income.** Comprehensive income is a measure of all changes in shareholders' equity except those resulting from investments by and distributions to owners, and includes such items as net earnings, certain foreign currency translation items, changes in the value of qualifying hedges and pension liability adjustments.

**Derivative Instruments and Hedging Activities.** The Company accounts for all derivatives, including those embedded in other contracts, as either assets or liabilities and measures those financial instruments at fair value. The accounting for changes in the fair value of derivatives depends on their intended use and designation.

As part of its risk management program, the Company may periodically use forward exchange contracts to manage known market exposures. Terms of derivative instruments are structured to match the terms of the risk being managed and are generally held to maturity. The Company does not hold or issue derivative financial instruments for trading purposes. All other contracts that contain provisions meeting the definition of a derivative also meet the requirements of, and have been designated as, normal purchases or sales. The Company's policy is to not enter into contracts with terms that cannot be designated as normal purchases or sales.

The Company periodically evaluates its monetary asset and liability positions denominated in foreign currencies. The Company enters into forward contracts or options, or borrows in various currencies, in order to hedge its net monetary positions. These instruments are recorded at fair value and the gains and losses are included in other expense, net. The notional amounts of contracts outstanding as of December 29, 2017, totaled \$34 million. The Company believes it uses strong financial counterparties in these transactions and that the resulting credit risk under these hedging strategies is not significant.

The Company uses significant other observable inputs (level 2 in the fair value hierarchy) to value the derivative instruments used to hedge net monetary positions, including reference to market prices and financial models that incorporate relevant market assumptions. Net derivative assets are reported on the balance sheet in accounts receivable and net derivative liabilities are reported as other current liabilities. The fair market value of such instruments follows (in thousands):

	2017	2016
Foreign Currency Contracts		
Assets	\$—	\$621
Liabilities	(517 )	(50 )
Net Assets (Liabilities)	\$(517)	\$571

**Recent Accounting Pronouncements.****Share-based Payments**

A new accounting standard that changed certain aspects of accounting for share-based payments became effective for the Company in the first quarter of 2017. Excess tax benefits on exercised stock options that were previously credited to equity now reduce the current income tax provision. The change in accounting for excess tax benefits decreased the current income tax provision and increased net earnings for the year by \$36.3 million, reduced the effective income tax rate by 10 percentage points and increased diluted earnings per share by \$0.21. Under the new standard, excess tax benefits are no longer reclassified out of cash flows from operating activities to financing activities in the Consolidated Statements of Cash Flows. We elected to apply the cash flow presentation requirements retrospectively to all periods presented, which resulted in an increase in previously reported net cash provided by operating activities and a decrease in net cash provided by financing activities of \$6.9 million for the year ended December 30, 2016 and

\$1.8 million for the year ended December 25, 2015. Also under the new standard, the Company elected to account for share-based grant forfeitures as they occur. The impact of the change in accounting for forfeitures was not significant, and was reflected in share-based compensation cost in the first quarter of 2017.

#### Revenue Recognition

In May 2014, the Financial Accounting Standards Board (FASB) issued a final standard on revenue from contracts with customers, contained in Accounting Standards Codification Topic 606 (“ASC 606”). The new standard sets forth a single comprehensive model for recognizing and reporting revenue. ASC 606 will become effective for the Company beginning with the first quarter of 2018, and the Company plans to adopt the new accounting standard using the modified retrospective transition approach. The modified retrospective transition approach will recognize any changes from the beginning of the year of initial application through retained earnings with no restatement of comparative periods.

## Table of Contents

Because the new standard impacted our business processes, systems and controls, we developed a comprehensive change management project plan to guide the implementation. This project plan included analyzing the standard's impact on our revenue streams and associated contracts, comparing our historical accounting policies and practices to the requirements of the new standard, and identifying differences from applying the requirements of the new standard to our contracts. We developed internal controls to ensure that we adequately evaluated our portfolio of contracts under the five-step model to ensure proper assessment of our operating results under ASC 606. We reported on the progress of the implementation to the Audit Committee and the Board of Directors on a regular basis during the project's duration.

For most of our contracts, we will record revenue under ASC 606 at a single point in time, when control is transferred to the customer, which is consistent with past practice. We have made the necessary changes to our business processes, policies, systems and controls to support recognition and disclosure under the new standard. Further, we will include incremental disaggregated revenue and other disclosures as required in our consolidated financial statements.

Based on the results of the evaluation, nothing has come to our attention that would indicate that adoption of the new standard will have a material impact on our consolidated financial statements. Application of the transition requirements of the new standard will not have a material impact on opening retained earnings.

### Presentation of Pension Cost

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

### Leases

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

Table of Contents

## B. Segment Information

The Company has six operating segments which are aggregated into three reportable segments: Industrial, Process and Contractor.

The Industrial segment includes our Industrial Products and Applied Fluid Technologies divisions. The Industrial segment markets equipment and pre-engineered packages for moving and applying paints, coatings, sealants, adhesives and other fluids. Markets served include automotive and vehicle assembly and components production, wood and metal products, rail, marine, aerospace, farm, construction, bus, recreational vehicles and various other industries.

The Process segment includes our Process, Oil and Natural Gas, and Lubrication divisions. The Process segment markets pumps, valves, meters and accessories to move and dispense chemicals, oil and natural gas, water, wastewater, petroleum, food, lubricants and other fluids. Markets served include food and beverage, dairy, oil and natural gas, pharmaceutical, cosmetics, electronics, wastewater, mining, fast oil change facilities, service garages, fleet service centers, automobile dealerships and industrial lubrication applications.

The Contractor segment markets sprayers for architectural coatings for painting, corrosion control, texture and line striping.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The cost of manufacturing for each segment is based on product cost, and expenses are based on actual costs incurred along with cost allocations of shared and centralized functions based on activities performed, sales or space utilization. Depreciation expense is charged to the manufacturing or operating cost center that utilizes the asset, and is then allocated to segments on the same basis as other expenses within that cost center. Reportable segments are defined by product. Segments are responsible for development, manufacturing, marketing and sales of their products. This allows for focused marketing and efficient product development. The segments share common purchasing, certain manufacturing, distribution and administration functions.

Segments information follows (in thousands):

	2017	2016	2015
Net Sales			
Industrial	\$691,978	\$629,581	\$616,069
Process	294,652	266,630	273,631
Contractor	488,114	433,082	396,785
Total	\$1,474,744	\$1,329,293	\$1,286,485
Operating Earnings			
Industrial	\$237,700	\$207,183	\$201,749
Process	52,216	35,750	43,833
Contractor	113,898	91,837	86,447
Unallocated corporate (expense)	(43,367)	(28,871)	(29,904)
Impairment	—	(192,020)	—
Total	\$360,447	\$113,879	\$302,125
Assets			
Industrial	\$572,436	\$546,366	
Process	345,572	318,444	
Contractor	255,615	208,016	
Unallocated corporate	205,582	170,283	
Total	\$1,379,205	\$1,243,109	

Management assesses performance of segments by reference to operating earnings excluding unallocated corporate expenses and asset impairments. Unallocated corporate (expense) includes such items as stock compensation, divestiture and certain acquisition transaction costs, bad debt expense, charitable contributions, certain portions of pension expense and certain central warehouse expenses. Unallocated assets include cash, allowances and valuation reserves, deferred income taxes, certain capital and other assets.

Table of Contents

Geographic information follows (in thousands):

	2017	2016	2015
Net Sales (based on customer location)			
United States	\$743,344	\$685,981	\$653,534
Other countries	731,400	643,312	632,951
Total	\$1,474,744	\$1,329,293	\$1,286,485
Long-lived Assets			
United States	\$163,416	\$151,911	
Other countries	40,882	37,685	
Total	\$204,298	\$189,596	

Sales to Major Customers. Worldwide sales to one customer in the Contractor and Industrial segments individually represented over 10 percent of the Company's consolidated sales in 2017, 2016 and 2015.

## C. Inventories

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

	2017	2016
Finished products and components	\$124,327	\$113,643
Products and components in various stages of completion	61,274	50,557
Raw materials and purchased components	103,407	84,631
Subtotal	289,008	248,831
Reduction to LIFO cost	(49,659 )	(47,222 )
Total	\$239,349	\$201,609

Inventories valued under the LIFO method were \$135.9 million in 2017 and \$103.2 million in 2016. All other inventory was valued on the FIFO method.

In 2017, there were no reductions in inventory quantities resulting in liquidation of LIFO inventory quantities carried at lower costs from prior years.

## D. Property, Plant and Equipment

Property, plant and equipment were as follows (in thousands):

	2017	2016
Land and improvements	\$24,469	\$23,253
Buildings and improvements	145,009	132,343
Manufacturing equipment	298,719	286,742
Office, warehouse and automotive equipment	41,747	37,940
Additions in progress	18,170	9,364
Total property, plant and equipment	528,114	489,642
Accumulated depreciation	(323,816 )	(300,046 )
Net property, plant and equipment	\$204,298	\$189,596

Depreciation expense was \$29.5 million in 2017, \$28.8 million in 2016 and \$25.7 million in 2015.



Table of Contents

## E. Income Taxes

Passage of the 2017 Tax Cuts and Jobs Act (the "Tax Act") required a revaluation of net deferred tax assets that increased the 2017 tax provision by \$29.0 million and instituted a transition tax on un-repatriated foreign earnings that increased the tax provision by \$6.6 million. Those adjustments increased the effective income tax rate by 10 percentage points. Adjustments recorded in 2017 were prepared on a provisional basis using estimates based on reasonable and supportable assumptions and available inputs and underlying information. The ultimate impact of the Tax Act may differ from those estimates due to continuing analysis or further regulatory guidance that may be issued. Any adjustments to the provisional amounts recorded as of December 29, 2017 that are identified within one year of the Tax Act enactment date will be included as an adjustment to tax expense in the period the amounts are determined.

Adoption of a new accounting standard, requiring excess tax benefits related to stock option exercises to be credited to the income tax provision (formerly credited to equity), reduced the 2017 tax provision by \$36.3 million, decreasing the effective tax rate by 10 percentage points.

No additional income or withholding taxes have been provided for any remaining undistributed foreign earnings not subject to the transition tax as these amounts continue to be indefinitely reinvested in foreign operations. As of December 29, 2017, the amount of cash held outside the U.S. was not significant to the Company's liquidity and was available to fund investments abroad.

Earnings before income tax expense (income) consist of (in thousands):

	2017	2016	2015
Domestic	\$269,258	\$107,440	\$402,453
Foreign	77,836	(10,785 )	72,260
Total	\$347,094	\$96,655	\$474,713

Income tax expense (income) consists of (in thousands):

	2017	2016	2015
Current			
Federal	\$41,996	\$67,126	\$117,883
State and local	3,088	4,868	4,576
Foreign	19,486	18,195	18,115
Current income tax expense	64,570	90,189	140,574
Deferred			
Domestic	35,782	(27,509 )	(10,175 )
Foreign	(5,670 )	(6,699 )	(1,399 )
Deferred income tax expense (benefit)	30,112	(34,208 )	(11,574 )
Total	\$94,682	\$55,981	\$129,000

Income taxes paid were \$61.0 million in 2017, \$78.6 million in 2016 and \$150.5 million in 2015.

A reconciliation between the U.S. federal statutory tax rate and the effective tax rate follows:

	2017	2016	2015
Statutory tax rate	35 %	35 %	35 %
Tax effect of international operations	(6 )	4	(3 )
State taxes, net of federal effect	1	1	1
U.S. general business tax credits	(1 )	(3 )	(1 )
Domestic production deduction	(2 )	(7 )	(2 )
Stock compensation excess tax benefit	(10)	—	—



Impact of 2017 Tax Cuts and Jobs Act	10	—	—
Impairment	—	28	—
Dividends from Liquid Finishing	—	—	(3)
Effective tax rate	27 %	58 %	27 %

44

---

Table of Contents

Deferred income taxes are provided for temporary differences between the financial reporting and the tax basis of assets and liabilities. The deferred tax assets (liabilities) resulting from these differences were as follows (in thousands):

	2017	2016
Inventory valuations	\$(1,686 )	\$9,845
Self-insurance retention accruals	1,264	1,836
Warranty reserves	1,658	2,390
Vacation accruals	1,942	3,343
Bad debt reserves	2,620	3,824
Excess of tax over book depreciation and amortization	(30,381 )	(31,849 )
Pension liability	31,220	43,924
Postretirement medical	4,313	6,856
Acquisition costs	680	1,052
Stock compensation	14,185	24,521
Deferred compensation	1,801	1,495
Foreign tax credit carryforward	5,000	—
Other	1,047	1,744
Net deferred tax assets	\$33,663	\$68,981

Total deferred tax assets were \$68.8 million and \$103.4 million, and total deferred tax liabilities were \$35.1 million and \$34.5 million on December 29, 2017 and December 30, 2016. The difference between the deferred income tax provision and the change in net deferred income taxes is due to the change in other comprehensive income (loss) items.

The Company files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2011.

The Company records penalties and accrued interest related to uncertain tax positions in income tax expense. Total reserves for uncertain tax positions were not material.

## F. Debt

A summary of debt follows (dollars in thousands):

	Average Interest Rate		2017	2016
	December 29, 2017	Maturity		
Private placement unsecured fixed-rate notes				
Series A	4.00%	March 2018	\$—	\$75,000
Series B	5.01%	March 2023	75,000	75,000
Series C	4.88%	January 2020	75,000	75,000
Series D	5.35%	July 2026	75,000	75,000
Unsecured revolving credit facility	2.56%	December 2021	1,035	5,685
Notes payable to banks	0.77%	2018	6,578	8,913
Total debt			\$232,613	\$314,598

The estimated fair value of the fixed interest rate private placement debt was \$245 million on December 29, 2017 and \$325 million on December 30, 2016. The fair value of variable rate borrowings approximates carrying value. The

Company uses significant other observable inputs to estimate fair value (level 2 of the fair value hierarchy) based on the present value of future cash flows and rates that would be available for issuance of debt with similar terms and remaining maturities.

On December 15, 2016, the Company executed an amendment to its revolving credit agreement, extending the expiration date to December 15, 2021 and decreasing certain interest rates and fees. The amended agreement with a syndicate of lenders provides up to

45

---

Table of Contents

\$500 million of committed credit, available for general corporate purposes, working capital needs, share repurchases and acquisitions. The Company may borrow up to \$50 million under the swingline portion of the facility for daily working capital needs.

Under terms of the amended revolving credit agreement, borrowings may be denominated in U.S. dollars or certain other currencies. Loans denominated in U.S. dollars bear interest, at the Company's option, at either a base rate or a LIBOR-based rate. Loans denominated in currencies other than U.S. dollars bear interest at a LIBOR-based rate. The base rate is an annual rate equal to a margin ranging from zero percent to 0.75 percent, depending on the Company's cash flow leverage ratio (debt to earnings before interest, taxes, depreciation, amortization and extraordinary non-operating or non-cash charges and expenses) plus the highest of (i) the bank's prime rate, (ii) the federal funds rate plus 0.5 percent, or (iii) one-month LIBOR plus 1.5 percent. In general, LIBOR-based loans bear interest at LIBOR plus 1 percent to 1.75 percent, depending on the Company's cash flow leverage ratio. In addition to paying interest on the outstanding loans, the Company is required to pay a fee on the unused amount of the loan commitments at an annual rate ranging from 0.125 percent to 0.25 percent, depending on the Company's cash flow leverage ratio.

On December 29, 2017, the Company had \$545 million in lines of credit, including the \$500 million in committed credit facilities described above and \$45 million with foreign banks. The unused portion of committed credit lines was \$512 million as of December 29, 2017. In addition, the Company has unused, uncommitted lines of credit with foreign banks totaling \$26 million. Borrowing rates under these credit lines vary with the prime rate, rates on domestic certificates of deposit and the London Interbank market. The Company pays facility fees at an annual rate of up to 0.15 percent on certain of these lines. No compensating balances are required.

Various debt agreements require the Company to maintain certain financial ratios as to cash flow leverage and interest coverage. The Company is in compliance with all financial covenants of its debt agreements as of December 29, 2017.

Annual maturities of debt are as follows (in thousands):

	2018	2019	2020	2021	2022	Thereafter
Maturities of debt	\$ 6,578	\$ —	\$ 75,000	\$ 1,035	\$ —	\$ 150,000

Interest paid on debt was \$16.5 million in 2017, \$17.6 million in 2016 and \$17.5 million in 2015.

### G. Shareholders' Equity

At December 29, 2017, the Company had 22,549 authorized, but not issued, cumulative preferred shares, \$100 par value. The Company also has authorized, but not issued, a separate class of 3 million shares of preferred stock, \$1 par value.

All stock option, share and per share data reflect the three-for-one common stock split distributed on December 27, 2017.

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

	Pension and Postretirement Medical	Cumulative Translation Adjustment	Total
Balance, December 26, 2014	\$ (76,584	) \$ (24,152	) \$ (100,736)
Other comprehensive income (loss) before reclassifications	641	(10,423	) (9,782
Amounts reclassified from accumulated other comprehensive income	6,021	—	6,021
Balance, December 25, 2015	(69,922	) (34,575	) (104,497
Other comprehensive income (loss) before reclassifications	(12,169	) (31,227	) (43,396

Edgar Filing: GRACO INC - Form 10-K

Amounts reclassified from accumulated other comprehensive income	5,665	—	5,665
Balance, December 30, 2016	(76,426	) (65,802	) (142,228 )
Other comprehensive income (loss) before reclassifications	(14,791	) 16,443	1,652
Amounts reclassified from accumulated other comprehensive income	12,787	—	12,787
Balance, December 29, 2017	\$ (78,430	) \$ (49,359	) \$(127,789)

Table of Contents

Amounts related to pension and postretirement medical adjustments are reclassified to pension cost, which is allocated to cost of products sold and operating expenses generally based on salaries and wages. Included in the 2017 reclassification is \$12 million related to a pension settlement loss that was charged to general and administrative expense (see Note J). Amounts allocated, including the pension settlement loss were approximately as follows (in thousands):

	2017	2016	2015
Cost of products sold	\$3,165	\$3,379	\$3,370
Product development	1,307	1,334	1,352
Selling, marketing and distribution	3,085	3,033	3,109
General and administrative	13,635	1,586	1,543
Total before tax	\$21,192	\$9,332	\$9,374
Income tax (benefit)	(8,405 )	(3,667 )	(3,353 )
Total after tax	\$12,787	\$5,665	\$6,021

## H. Share-Based Awards, Purchase Plans and Compensation Cost

**Stock Option and Award Plan.** The Company has a stock incentive plan under which it grants stock options and share awards to directors, officers and other employees. Option price is the market price on the date of grant. Options become exercisable at such time, generally over three or four years, and in such installments as set by the Company, and expire ten years from the date of grant.

Restricted share awards have been made to certain key employees under the plan. The market value of restricted stock at the date of grant is charged to operations over the vesting period. Compensation cost related to restricted shares is not significant.

The Company has a stock appreciation plan that provides for payments of cash to eligible foreign employees based on the change in the market price of the Company's common stock over a period of time. Compensation cost related to the stock appreciation plan was \$4.5 million in 2017 and was not significant in 2016 and 2015.

Individual nonemployee directors of the Company may elect to receive, either currently or deferred, all or part of their retainer in the form of shares of the Company's common stock instead of cash. Under this arrangement, the Company issued 5,975 shares in 2017, 6,882 shares in 2016 and 5,963 shares in 2015. The expense related to this arrangement is not significant.

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 26, 2014	14,925	\$ 14.91	9,954	\$ 11.62
Granted	1,629	24.73		
Exercised	(984 )	12.43		
Canceled	(75 )	24.00		
Outstanding, December 25, 2015	15,495	16.05	10,749	12.83
Granted	3,483	25.53		
Exercised	(2,286 )	13.00		
Canceled	(87 )	23.36		

Edgar Filing: GRACO INC - Form 10-K

Outstanding, December 30, 2016	16,605	18.42	11,016	15.13
Granted	1,725	30.71		
Exercised	(4,903 )	12.86		
Canceled	(137 )	26.63		
Outstanding, December 29, 2017	13,290	\$ 21.99	7,729	\$ 18.33

47

---

Table of Contents

The following table summarizes information for options outstanding and exercisable at December 29, 2017 (in thousands, except exercise prices and contractual term amounts):

Range of Prices	Options Outstanding			Options Exercisable	
	Options Outstanding	Weighted Average Contractual Term in Years	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
\$5 - \$15	2,200	2.2	\$ 10.52	2,200	\$ 10.52
\$15 - \$20	2,795	4.6	18.14	2,795	18.14
\$20 - \$25	4,676	7.3	24.43	2,222	24.62
\$25 - \$30	1,912	8.2	27.07	507	25.51
\$30 - \$38	1,707	9.2	30.71	5	31.44
\$5 - \$38	13,290	6.3	\$ 21.99	7,729	\$ 18.33

The aggregate intrinsic value of exercisable option shares was \$211.0 million as of December 29, 2017, with a weighted average contractual term of 4.7 years. There were approximately 13.3 million vested share options and share options expected to vest as of December 29, 2017, with an aggregate intrinsic value of \$314.2 million, a weighted average exercise price of \$21.99 and a weighted average contractual term of 6.3 years.

Information related to options exercised follows (in thousands):

	2017	2016	2015
Cash received	\$48,833	\$21,142	\$7,720
Aggregate intrinsic value	119,442	30,247	11,851
Tax benefit realized	42,000	9,900	3,600

**Employee Stock Purchase Plan.** Under the Company's Employee Stock Purchase Plan, the purchase price of the shares is the lesser of 85 percent of the fair market value on the first day or the last day of the plan year. Under this plan, the Company issued 499,956 shares in 2017, 510,432 shares in 2016 and 497,691 shares in 2015.

**Authorized Shares.** Shares authorized for issuance under the stock option and purchase plans are shown below (in thousands):

	Total Shares Authorized	Available for Future Issuance as of December 29, 2017
Stock Incentive Plan (2015)	10,500	5,186
Employee Stock Purchase Plan (2006)	21,000	13,775
Total	31,500	18,961

Amounts available for future issuance exclude outstanding options. Options outstanding as of December 29, 2017, include options granted under two plans that were replaced by subsequent plans. No shares are available for future grants under those plans.

**Share-based Compensation.** The Company recognized share-based compensation cost as follows (in thousands):

	2017	2016	2015
Share-based compensation	\$23,652	\$21,134	\$19,224
Tax benefit	5,100	6,100	5,400
Share-based compensation, net of tax	\$18,552	\$15,034	\$13,824



As of December 29, 2017, there was \$10.8 million of unrecognized compensation cost related to unvested options, expected to be recognized over a weighted average period of approximately 2.1 years.

48

---

Table of Contents

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:

	2017	2016	2015
Expected life in years	7.0	6.2	6.5
Interest rate	2.2 %	1.6 %	1.7 %
Volatility	26.7 %	27.5 %	35.0 %
Dividend yield	1.6 %	1.7 %	1.6 %
Weighted average fair value per share	\$8.08	\$5.96	\$7.73

Expected life is estimated based on vesting terms and exercise and termination history. Interest rate is based on the U.S. Treasury rate on zero-coupon issues with a remaining term equal to the expected life of the option. Expected volatility is based on historical volatility over a period commensurate with the expected life of options.

The fair value of employees' purchase rights under the Employee Stock Purchase 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:

	2017	2016	2015
Expected life in years	1.0	1.0	1.0
Interest rate	0.9 %	0.7 %	0.2 %
Volatility	22.3 %	24.6 %	18.9 %
Dividend yield	1.5 %	1.7 %	1.6 %
Weighted average fair value per share	\$7.32	\$6.38	\$5.50

## I. Earnings per Share

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

	2017	2016	2015
Net earnings available to common shareholders	\$252,412	\$40,674	\$345,713
Weighted average shares outstanding for basic earnings per share	167,925	166,851	172,829
Dilutive effect of stock options computed based on the treasury stock method using the average market price	6,393	4,025	4,191
Weighted average shares outstanding for diluted earnings per share	174,318	170,876	177,020
Basic earnings per share	\$1.50	\$0.24	\$2.00
Diluted earnings per share	\$1.45	\$0.24	\$1.95

Stock options to purchase 2.9 million and 4.1 million shares were not included in the 2016 and 2015 computations of diluted earnings per share, respectively, because they would have been anti-dilutive. The number of anti-dilutive options excluded from the 2017 computation of diluted earnings per share was not significant.

## J. Retirement Benefits

The Company has a defined contribution plan, under Section 401(k) of the Internal Revenue Code, which provides retirement benefits to most U.S. employees. For all employees who choose to participate, the Company matches employee contributions at a 100 percent rate, up to 3 percent of the employee's compensation. For employees not covered by a defined benefit plan, the Company contributes an amount equal to 1.5 percent of the employee's compensation. Employer contributions totaled \$7.8 million in 2017, \$6.7 million in 2016 and \$6.3 million in 2015.

The Company's postretirement medical plan provides certain medical benefits for retired U.S. employees. Employees hired before January 1, 2005, are eligible for these benefits upon retirement and fulfillment of other eligibility requirements as specified by the plan.

Table of Contents

The Company has both funded and unfunded noncontributory defined benefit pension plans that together cover most U.S. employees hired before January 1, 2006, certain directors and some of the employees of the Company's non-U.S. subsidiaries. The Company restructured its U.S. qualified defined benefit plan in 2017. Under the restructuring, the plan transferred \$42 million of liabilities and assets associated with certain plan participants to an insurance company via the purchase of a group annuity contract, and the Company recognized a \$12 million settlement loss in 2017 general and administrative expense. Remaining pension plan participants and related liabilities and assets were transferred into one of two newly established, legally separate qualified defined benefit plans, and the former plan was terminated. The benefits offered to the plans' participants were unchanged.

For U.S. plans, benefits are based on years of service and the highest 5 consecutive years' earnings in the 10 years preceding retirement. The Company funds annually in amounts consistent with minimum funding levels and maximum tax deduction limits.

Investment policies and strategies of the U.S. funded pension plans are based on participant demographics of each plan. For the larger of the two plans (the "Blue plan") covering active participants and retirees with higher benefit amounts, investments are based on a long-term view of economic growth and weighted toward equity securities. The primary goal of the plan's investments is to ensure that the plan's liabilities are met over time. In developing strategic asset allocation guidelines, an emphasis is placed on the long-term characteristics of individual asset classes, and the benefits of diversification among multiple asset classes. The plan invests primarily in domestic and international equities, fixed income securities, which include treasuries, highly-rated corporate bonds and high-yield bonds and real estate. Strategic target allocations for Blue plan assets are 54 percent equity securities, 36 percent fixed income securities and 10 percent real estate and alternative investments. For the smaller of the two plans (the "Gray plan") covering retirees with lower benefit amounts, investments are based on a shorter-term, more conservative outlook. The midpoints of the ranges of strategic target allocations for the Gray plan assets are 38 percent equity securities, 53 percent fixed income securities and 9 percent real estate and alternative investments.

Plan assets are held in trusts for the benefit of plan participants and are invested in various commingled funds, most of which are sponsored by the trustee. The fair values for commingled equity, fixed-income and real estate investments are measured using net asset values, which take into consideration the value of underlying fund investments, as well as the other accrued assets and liabilities of a fund, in order to determine a per share market value. Certain trustee-sponsored funds allow redemptions monthly or quarterly, with 10 or 60 days advance notice, while most of the funds allow redemptions daily. The plans had unfunded commitments to make additional investments in certain funds totaling \$3 million as of December 29, 2017 and \$4 million as of December 30, 2016.

The Company maintains a defined contribution plan covering employees of a Swiss subsidiary, funded by Company and employee contributions. Responsibility for pension coverage under Swiss law has been transferred to a Swiss insurance company. Plan assets are invested in an insurance contract that guarantees a federally mandated annual rate of return. The value of the plan assets is effectively the value of the insurance contract. The performance of the underlying assets held by the insurance company has no direct impact on the surrender value of the insurance contract. The insurance backed assets have no active market and are classified as level 3 in the fair value hierarchy.

Assets of all plans by category and fair value measurement level were as follows (in thousands):

	Level	2017	2016
Cash and cash equivalents	1	\$3,254	\$698
Insurance contract	3	26,411	24,287
Investments categorized in fair value hierarchy		29,665	24,985
Equity			
U.S. Large Cap	N/A	55,488	58,236
U.S. Small/Mid Cap	N/A	12,077	10,009

Edgar Filing: GRACO INC - Form 10-K

International	N/A	45,958	40,404
Total Equity		113,523	108,649
Fixed income	N/A	81,358	78,209
Real estate and other	N/A	29,640	44,062
Investments measured at net asset value		224,521	230,920
Total		\$254,186	\$255,905

Table of Contents

The following table is a reconciliation of pension assets measured at fair value using level 3 inputs (in thousands):

	2017	2016
Balance, beginning of year	\$24,287	\$28,080
Purchases	1,934	1,928
Redemptions	(2,150 )	(5,267 )
Unrealized gains (losses)	2,340	(454 )
Balance, end of year	\$26,411	\$24,287

The following provides a reconciliation of the changes in the plans' benefit obligations and fair value of assets over the periods ending December 29, 2017, and December 30, 2016, and a statement of the funded status as of the same dates (in thousands):

	Pension Benefits		Postretirement Medical Benefits			
	2017	2016	2017	2016		
Change in benefit obligation						
Obligation, beginning of year	\$386,373	\$380,672	\$ 26,576	\$ 23,211		
Service cost	7,675	7,834	601	543		
Interest cost	15,044	15,684	1,093	1,084		
Actuarial loss (gain)	37,994	11,012	577	2,840		
Benefit payments	(13,299 )	(20,147 )	(1,076 )	(1,102 )		
Settlements	(43,539 )	(6,817 )	—	—		
Exchange rate changes	3,311	(1,865 )	—	—		
Obligation, end of year	\$393,559	\$386,373	\$ 27,771	\$ 26,576		
Change in plan assets						
Fair value, beginning of year	\$255,905	\$268,258	\$ —	\$ —		
Actual return on assets	32,132	11,397	—	—		
Employer contributions	21,885	4,117	1,076	1,102		
Benefit payments	(13,299 )	(20,147 )	(1,076 )	(1,102 )		
Settlements	(43,539 )	(6,817 )	—	—		
Exchange rate changes	1,102	(903 )	—	—		
Fair value, end of year	\$254,186	\$255,905	\$ —	\$ —		
Funded status	\$(139,373)	\$(130,468)	\$(27,771 )	\$(26,576 )		
Amounts recognized in consolidated balance sheets						
Non-current assets			\$2,538	\$—	\$—	\$—
Current liabilities			1,416	1,030	1,330	1,387
Non-current liabilities			140,495	129,438	26,441	25,189
Net			\$139,373	\$130,468	\$27,771	\$26,576

The accumulated benefit obligation as of year-end for all defined benefit pension plans was \$361 million for 2017 and \$360 million for 2016. Information for plans with an accumulated benefit obligation in excess of plan assets follows (in thousands):

	2017	2016
Projected benefit obligation	\$344,733	\$386,373
Accumulated benefit obligation	311,876	359,854
Fair value of plan assets	202,822	255,905

Table of Contents

The components of net periodic benefit cost for the plans for 2017, 2016 and 2015 were as follows (in thousands):

	Pension Benefits			Postretirement Medical Benefits		
	2017	2016	2015	2017	2016	2015
Service cost-benefits earned during the period	\$7,675	\$7,834	\$8,406	\$ 601	\$ 543	\$ 542
Interest cost on projected benefit obligation	15,044	15,684	14,790	1,093	1,084	954
Expected return on assets	(17,186 )	(18,009 )	(19,442 )	—	—	—
Amortization of prior service cost (credit)	255	269	268	(344 )	(766 )	(676 )
Amortization of net loss (gain)	8,634	7,980	9,036	334	285	323
Settlement loss (gain)	12,313	1,565	423	—	—	—
Cost of pension plans which are not significant and have not adopted ASC 715	122	85	79	N/A	N/A	N/A
Net periodic benefit cost	\$26,857	\$15,408	\$13,560	\$ 1,684	\$ 1,146	\$ 1,143

Amounts recognized in other comprehensive (income) loss in 2017 and 2016 were as follows (in thousands):

	Pension Benefits		Postretirement Medical Benefits	
	2017	2016	2017	2016
Net loss (gain) arising during the period	\$23,936	\$17,208	\$ 577	\$ 2,840
Amortization of net gain (loss)	(8,634 )	(7,980 )	(334 )	(285 )
Settlement gain (loss)	(12,313 )	(1,565 )	—	—
Amortization of prior service credit (cost)	(255 )	(269 )	344	766
Total	\$2,734	\$7,394	\$ 587	\$ 3,321

Amounts included in accumulated other comprehensive (income) loss as of December 29, 2017 and December 30, 2016, that had not yet been recognized as components of net periodic benefit cost, were as follows (in thousands):

	Pension Benefits		Postretirement Medical Benefits	
	2017	2016	2017	2016
Prior service cost (credit)	\$1,746	\$1,920	\$ —	\$ (344 )
Net loss	111,598	108,689	6,836	6,593
Net before income taxes	113,344	110,609	6,836	6,249
Income taxes	(39,289 )	(38,182 )	(2,461 )	(2,250 )
Net	\$74,055	\$72,427	\$ 4,375	\$ 3,999

Amounts included in accumulated other comprehensive (income) loss that are expected to be recognized as components of net periodic benefit cost in 2018 were as follows (in thousands):

	Pension Benefits	Postretirement Medical Benefits
Prior service cost (credit)	\$277	\$ —
Net loss (gain)	7,797	543
Net before income taxes	8,074	543
Income taxes	(1,776 )	(119 )
Net	\$6,298	\$ 424

Table of Contents

Assumptions used to determine the Company's benefit obligations are shown below:

	Pension Benefits		Postretirement		Medical Benefits	
Weighted average assumptions	2017	2016	2017		2016	
U.S. Plans						
Discount rate	3.9 %	4.5 %	3.9 %		4.5 %	
Rate of compensation increase	2.8 %	2.8 %	N/A		N/A	
Non-U.S. Plans						
Discount rate	1.0 %	0.9 %	N/A		N/A	
Rate of compensation increase	0.9 %	1.0 %	N/A		N/A	

Assumptions used to determine the Company's net periodic benefit cost are shown below:

	Pension Benefits			Postretirement		Medical Benefits	
Weighted average assumptions	2017	2016	2015	2017	2016	2015	
U.S. Plans							
Discount rate	4.5%	4.7%	4.2%	4.5 %	4.7 %	4.2 %	
Rate of compensation increase	2.8%	3.0%	3.0%	N/A	N/A	N/A	
Expected return on assets	7.0%	7.5%	7.8%	N/A	N/A	N/A	
Non-U.S. Plans							
Discount rate	0.9%	1.1%	1.4%	N/A	N/A	N/A	
Rate of compensation increase	1.0%	1.3%	1.3%	N/A	N/A	N/A	
Expected return on assets	2.0%	2.0%	2.0%	N/A	N/A	N/A	

Several sources of information are considered in determining the expected rate of return assumption, including the allocation of plan assets, the input of actuaries and professional investment advisors, and historical long-term returns. In setting the return assumption, the Company recognizes that historical returns are not always indicative of future returns and also considers the long-term nature of its pension obligations.

The Company's U.S. retirement medical plan limits the annual cost increase that will be paid by the Company to 3 percent. In measuring the accumulated postretirement benefit obligation (APBO), the annual trend rate for health care costs was assumed to be 6.5 percent for 2018, decreasing each year to a constant rate of 4.5 percent for 2038 and thereafter, subject to the plan's annual increase limitation.

At December 29, 2017, a one percent change in assumed health care cost trend rates would not have a significant impact on the service and interest cost components of net periodic postretirement health care benefit cost or the APBO for health care benefits.

The Company expects to contribute \$1.4 million to its unfunded pension plans and \$1.3 million to the postretirement medical plan in 2018. The Company will not be required to make contributions to the funded pension plans under minimum funding requirements for 2018. Estimated future benefit payments are as follows (in thousands):

	Pension Benefits	Postretirement Medical Benefits
2018	\$ 13,385	\$ 1,330
2019	13,977	1,434
2020	15,584	1,561
2021	16,576	1,635
2022	17,881	1,712
Years 2023-2027	101,558	8,971





Table of Contents

## K. Commitments and Contingencies

Lease Commitments. Aggregate annual rental commitments under operating leases with noncancelable terms of more than one year were as follows at December 29, 2017 (in thousands):

	Buildings	Vehicles & Equipment	Total
2018	\$ 4,911	\$ 3,368	\$8,279
2019	3,659	2,078	5,737
2020	3,113	1,364	4,477
2021	1,923	828	2,751
2022	1,524	646	2,170
Thereafter	4,170	609	4,779
Total	\$ 19,300	\$ 8,893	\$28,193

Total rental expense was \$7.6 million in 2017, \$7.8 million in 2016 and \$6.9 million in 2015.

Other Commitments. The Company is committed to pay suppliers under the terms of open purchase orders issued in the normal course of business totaling approximately \$97 million at December 29, 2017. The Company also has commitments with certain suppliers to purchase minimum quantities, and under the terms of certain agreements, the Company is committed for certain portions of the supplier's inventory. The Company does not purchase, or commit to purchase, quantities in excess of normal usage or amounts that cannot be used within one year. The Company estimates that the maximum commitment amount under such agreements does not exceed \$33 million.

The Company enters into contracts with vendors to receive services. Commitments under these service contracts with noncancelable terms of more than one year include \$3 million in 2018 and \$3 million in 2019.

In addition, the Company could be obligated to perform under standby letters of credit totaling \$2 million at December 29, 2017. The Company has also guaranteed the debt of its subsidiaries for up to \$10 million. All debt of subsidiaries is reflected in the consolidated balance sheets.

Contingencies. The Company is party to various legal proceedings arising in the normal course of business. The Company is actively pursuing and defending these matters and has recorded an estimate of the probable costs where appropriate. Management does not expect that resolution of these matters will have a material adverse effect on the Company, although the ultimate outcome cannot be determined based on available information.

## L. Acquisitions

In January 2016, the Company paid \$48 million cash to acquire two related companies that manufacture and sell portable and fixed gas analyzers for landfill, biogas and medical applications and landfill gas wellhead equipment. The acquisitions enhance and complement the Company's position in environmental monitoring and remediation markets served by its Process segment. The purchase price was allocated based on estimated fair values, including \$28 million of goodwill, \$24 million of other identifiable intangible assets and \$4 million of other net liabilities.

On January 20, 2015, the Company completed the acquisition of High Pressure Equipment Holdings, LLC ("HiP") for \$161 million cash. HiP designs and manufactures valves, fittings and other flow control equipment engineered to perform in ultra-high pressure environments. HiP's products and business relationships enhance Graco's position in the oil and natural gas industry and complement Graco's core competencies of designing and manufacturing advanced flow control technologies. HiP had sales of \$38 million in 2014. Results of HiP operations have been included in the Company's Process segment from the date of acquisition, including sales of \$22 million in 2017, \$22 million in 2016

and \$29 million in 2015.

54

---

Table of Contents

Purchase consideration was allocated to assets acquired and liabilities assumed based on estimated fair values as follows (in thousands):

Cash and cash equivalents	\$1,904
Accounts receivable	4,714
Inventories	7,605
Other current assets	69
Property, plant and equipment	1,962
Deferred income taxes	1,840
Identifiable intangible assets	60,100
Goodwill	86,149
Total assets acquired	164,343
Liabilities assumed	(3,414 )
Net assets acquired	\$160,929

Acquired identifiable intangible assets and estimated useful life were as follows (dollars in thousands):

		Estimated Life (years)
Customer relationships	\$47,100	12
Trade names	13,000	Indefinite
Total identifiable intangible assets	\$60,100	

Approximately two-thirds of the goodwill acquired with HiP is deductible for tax purposes.

On January 2, 2015, the Company acquired White Knight Fluid Handling (“White Knight”) for \$16 million cash and a commitment for additional consideration if future revenues exceed certain thresholds, initially valued at \$8 million. The maximum payout is not limited. White Knight designs and manufactures high purity, metal-free pumps used in the production process of manufacturing semiconductors, solar panels, LED flat panel displays and various other electronics. The products, brands and distribution channels of White Knight expand and complement the offerings of the Company’s Process segment. The purchase price was allocated based on estimated fair values, including \$12 million of goodwill, \$9 million of other identifiable intangible assets and \$3 million of net tangible assets.

The Company completed other business acquisitions in 2017, 2016 and 2015 that were not material to the consolidated financial statements.

#### M. Divestiture

In 2012, the Company purchased the finishing businesses of Illinois Tool Works Inc. The acquisition included finishing equipment operations, technologies and brands of the Powder Finishing and Liquid Finishing businesses. Under terms of a hold separate order from the Federal Trade Commission, the Company did not have the power to direct the activities of the Liquid Finishing businesses that most significantly impacted the economic performance of those businesses. Consequently, we reflected our investment in the Liquid Finishing businesses as a cost-method investment on our balance sheet, and their results of operations were not consolidated with those of the Company.

In 2015, the Company sold the Liquid Finishing business assets for a price of \$610 million cash. Held separate investment income included the pre-tax gain on sale of \$150 million, net of transaction and other related expenses, including a \$7 million contribution to the Company’s charitable foundation. Held separate investment income also included dividends of \$42 million. Net earnings included after-tax gain and dividends totaling \$141 million.



Table of Contents

## N. Quarterly Financial Information (Unaudited)

Unaudited quarterly financial data is summarized below (in thousands, except per share amounts):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	
2017					
Net Sales	\$340,590	\$379,483	\$379,812	\$374,859	
Gross Profit	185,273	203,941	203,465	200,370	
Net Earnings	60,732	79,828	75,460	36,392	(1)
Basic Net Earnings per Common Share	\$0.36	\$0.48	\$0.45	\$0.22	(1)
Diluted Net Earnings per Common Share	0.35	0.46	0.43	0.21	(1)
Cash Dividends Declared per Common Share	0.12	0.12	0.12	0.13	
2016					
Net Sales	\$304,912	\$348,126	\$327,192	\$349,063	
Gross Profit	161,796	185,141	176,598	184,704	
Net Earnings (Loss)	39,552	50,947	54,388	(104,213)	(2)
Basic Net Earnings (Loss) per Common Share	\$0.24	\$0.31	\$0.33	\$(0.62)	(2)
Diluted Net Earnings (Loss) per Common Share	0.23	0.30	0.32	(0.61)	(2)
Cash Dividends Declared per Common Share	0.11	0.11	0.11	0.12	

(1) Net earnings in the fourth quarter of 2017 included income tax charges totaling \$36 million to recognize the effects of U.S. federal income tax reform.

(2) Net earnings (loss) in the fourth quarter of 2016 included \$161 million of after tax loss from non-cash impairment charges in the Company's ONG reporting unit within the Process Segment.

Table of Contents

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the fiscal year covered by this report, the Company carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act)). This evaluation was done under the supervision and with the participation of the Company's President and Chief Executive Officer, the Chief Financial Officer and Treasurer, the Vice President, Corporate Controller and Information Systems, and the Vice President, General Counsel and Secretary. Based upon that evaluation, they concluded that the Company's disclosure controls and procedures are effective.

Management's Annual Report on Internal Control Over Financial Reporting

The information under the heading "Management's Report on Internal Control Over Financial Reporting" in Part II, Item 8, of this 2017 Annual Report on Form 10-K is incorporated herein by reference.

Reports of Independent Registered Public Accounting Firm

The information under the headings "Reports of Independent Registered Public Accounting Firm" and "Opinion on Internal Control Over Financial Reporting" in Part II, Item 8, of this 2017 Annual Report on Form 10-K is incorporated herein by reference.

Changes in Internal Control Over Financial Reporting

During the fourth 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.

Item 9B. Other Information

Not applicable.

Table of Contents

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information under the heading “Executive Officers of Our Company” in Part I of this 2017 Annual Report on Form 10-K and the information under the heading “Board of Directors” in our Company’s Proxy Statement for its 2018 Annual Meeting of Shareholders to be held on April 27, 2018 (the “Proxy Statement”), is incorporated herein by reference.

Audit Committee Members and Audit Committee Financial Expert

The information under the heading “Committees of the Board of Directors” in our Company’s Proxy Statement is incorporated herein by reference.

Corporate Governance Guidelines, Committee Charters and Code of Ethics

Our Company has adopted Corporate Governance Guidelines and Charters for each of the Audit, Governance, and Management Organization and Compensation Committees of the Board of Directors. We have also issued a Code of Ethics and Business Conduct (“Code of Ethics”) that applies to our principal executive officer, principal financial officer, principal accounting officer, all officers, directors, and employees of Graco Inc. and all of its subsidiaries, representative offices and branches worldwide. The Corporate Governance Guidelines, Committee Charters, and Code of Ethics, with any amendments or waivers thereto, may be accessed free of charge by visiting the Graco website at [www.graco.com](http://www.graco.com).

Our Company intends to post on the Graco website any amendment to, or waiver from, a provision of the Code of Ethics that applies to our principal executive officer, principal financial officer, principal accounting officer, controller and other persons performing similar functions within four business days following the date of such amendment or waiver.

Section 16(a) Reporting Compliance

The information under the heading “Section 16(a) Beneficial Ownership Reporting Compliance” in the Company’s Proxy Statement is incorporated herein by reference.

Item 11. Executive Compensation

The information contained under the headings “Director Compensation,” “Executive Compensation,” “Compensation Committee Interlocks and Insider Participation” and “Report of the Management Organization and Compensation Committee” in the Proxy Statement is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information contained under the headings “Equity Compensation Plan Information” and “Beneficial Ownership of Shares” in the Proxy Statement is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information under the headings “Related Person Transaction Approval Policy” and “Director Independence” in the Proxy Statement is incorporated herein by reference.



Item 14. Principal Accountant Fees and Services

The information under the headings “Independent Registered Public Accounting Firm Fees and Services” and “Pre-Approval Policies” in the Proxy Statement is incorporated herein by reference.

58

---

Table of Contents

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) The following documents are filed as part of this report:

	Page
(1) <u>Financial Statements</u>	<u>32</u>
(2) Financial Statement Schedule <u>Schedule II – Valuation and Qualifying Accounts</u>	<u>60</u>

All other schedules are omitted because they are not applicable, or are not required, or because the required information is included in the Consolidated Financial Statements or Notes thereto.

(3) <u>Management Contract, Compensatory Plan or Arrangement. (See Exhibit Index)</u>	<u>61</u>
---	-----------

Those entries marked by an asterisk are Management Contracts, Compensatory Plans or Arrangements.

Table of Contents

## Schedule II - Valuation and Qualifying Accounts

Graco Inc. and Subsidiaries  
(in thousands)

	Allowance for Doubtful Accounts	Allowance for Returns and Credits	Total
Balance, December 26, 2014	\$ 2,400	\$ 5,700	\$ 8,100
Additions charged to costs and expenses	1,500	24,600	26,100
Deductions from reserves <sup>(1)</sup>	(900 )	(23,000 )	(23,900 )
Other additions (deductions) <sup>(2)</sup>	—	100	100
Balance, December 25, 2015	3,000	7,400	10,400
Additions charged to costs and expenses	1,200	27,800	29,000
Deductions from reserves <sup>(1)</sup>	(100 )	(26,400 )	(26,500 )
Other additions (deductions) <sup>(2)</sup>	(200 )	—	(200 )
Balance, December 30, 2016	3,900	8,800	12,700
Additions charged to costs and expenses	1,600	30,600	32,200
Deductions from reserves <sup>(1)</sup>	(1,700 )	(29,500 )	(31,200 )
Other additions (deductions) <sup>(2)</sup>	200	100	300
Balance, December 29, 2017	\$ 4,000	\$ 10,000	\$ 14,000

For doubtful accounts, represents amounts determined to be uncollectible and charged against reserve, net of (1) collections on accounts previously charged against reserves. For returns and credits, represents amounts of credits issued and returns processed.

(2) Includes amounts assumed or established in connection with acquisitions and effects of foreign currency translation.

Table of Contents

Exhibit Index

Exhibit  
Number Description

- 2.1 Asset Purchase Agreement, dated April 14, 2011, by and among Graco Inc., Graco Holdings Inc., Graco Minnesota Inc., Illinois Tool Works Inc. and ITW Finishing LLC (excluding schedules and exhibits, which the Company agrees to furnish supplementally to the Securities and Exchange Commission upon request). (Incorporated by reference to Exhibit 2.1 to the Company's Report on Form 8-K filed April 15, 2011.) First Amendment dated April 2, 2012. (Incorporated by reference to Exhibit 2.1 to the Company's Report on Form 8-K filed April 2, 2012.)
- \*\*2.3 Agreement relating to the sale and purchase of the entire issued share capital of Xamol Limited to acquire Alco Valves Group, dated as of October 1, 2014 (excluding certain schedules and exhibits, which the Company agrees to furnish supplementally to the Securities and Exchange Commission upon request). (Incorporated by reference to Exhibit 2.1 to the Company's Report on Form 10-Q for the thirteen weeks ended September 26, 2014.)
- 2.4 Purchase and Sale Agreement, dated as of December 31, 2014, by and among High Pressure Equipment Holdings LLC, Wasserstein Partners III, LP, Wasserstein Partners III (Offshore), L.P., Wasserstein Partners III (Offshore), LTD, Audax Mezzanine Fund III, L.P., Audax Co-Invest III, L.P., Audax Trust Co-Invest, L.P., certain other Sellers, Wasserstein Partners III (GP), LP, Graco Fluid Handling (C) Inc. and Graco Inc. (excluding certain schedules and exhibits, which the Company agrees to furnish supplementally to the Securities and Exchange Commission upon request). (Incorporated by reference to Exhibit 2.1 to the Company's Report on Form 8-K filed January 6, 2015.)
- 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 Appendix A to the Company's Definitive Proxy Statement on Schedule 14A filed March 7, 2012.)
- \*10.2 Graco Inc. Incentive Bonus Plan. (Incorporated by reference to Appendix A to the Company's Definitive Proxy Statement on Schedule 14A filed March 15, 2017.)
- \*10.3 Graco Inc. Amended and Restated Stock Incentive Plan (2006). (Incorporated by reference to Appendix A to the Company's Definitive Proxy Statement on Schedule 14A filed March 14, 2006.)
- \*10.4 Graco Inc. 2010 Stock Incentive Plan. (Incorporated by reference to Appendix A to the Company's Definitive Proxy Statement on Schedule 14A filed March 11, 2010.)
- \*10.5 Graco Inc. 2015 Stock Incentive Plan. (Incorporated by reference to Appendix A to the Company's Definitive Proxy Statement on Schedule 14A filed on March 11, 2015.)
- \*10.6

Deferred Compensation Plan (2005 Statement) as amended and restated on April 4, 2005. (Incorporated by reference to Exhibit 10.1 of the Company's Report on Form 10-Q for the thirteen weeks ended July 1, 2005.) Second Amendment dated November 1, 2005. (Incorporated by reference to Exhibit 10.8 to the Company's 2005 Annual Report on Form 10-K.) Third Amendment adopted on December 29, 2008. (Incorporated by reference to Exhibit 10.8 to the Company's 2008 Annual Report on Form 10-K.) Second Amendment dated October 25, 2012. (Incorporated by reference to Exhibit 10.9 to the Company's 2012 Annual Report on Form 10-K.)

\*10.7 Graco Restoration Plan (2005 Statement). (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended September 29, 2006.) First Amendment adopted December 8, 2006. (Incorporated by reference to Exhibit 10.12 to the Company's 2006 Annual Report on Form 10-K.) Second Amendment adopted August 15, 2007. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended September 28, 2007.) Third Amendment adopted March 27, 2008. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended March 28, 2008.) Fourth Amendment adopted December 29, 2008. (Incorporated by reference to Exhibit 10.11 to the Company's 2008 Annual Report on Form 10-K.) Fifth Amendment adopted September 16, 2010. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended September 24, 2010.) Sixth Amendment adopted February 15, 2018.

\*10.8 Graco Inc. Retirement Plan for Nonemployee Directors. (Incorporated by reference to Attachment C to Item 5 to the Company's Report on Form 10-Q for the thirteen weeks ended March 29, 1991.) First Amendment adopted on December 29, 2008. (Incorporated by reference to Exhibit 10.10 to the Company's 2008 Annual Report on Form 10-K.)

\*10.9 Form of Amendment to Executive Officer and Non-Employee Director Stock Options to Permit Net Exercises, as adopted by the Board of Directors February 17, 2012. (Incorporated by reference to Exhibit 10.1 of the Company's Report on Form 10-Q for the thirteen weeks ended March 30, 2012.)

Table of Contents

- Stock Option Agreement. Form of agreement used for award of nonstatutory stock options to nonemployee directors under the Graco Inc. Amended and Restated Stock Incentive Plan (2006). (Incorporated by reference to Exhibit 10.3 to the Company's Report on Form 10-Q for the thirteen weeks ended June 29, 2007.) Amended
- \*10.10 form of agreement for awards made to nonemployee directors in 2008. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirteen weeks ended June 27, 2008.) Amended and restated form of agreement for awards made to nonemployee directors in 2009. (Incorporated by reference to Exhibit 10.14 to the Company's 2009 Annual Report on Form 10-K/A.)
- Stock Option Agreement. Form of agreement used for award of nonstatutory stock options to nonemployee directors under the Graco Inc. 2010 Stock Incentive Plan in 2011. (Incorporated by reference to Exhibit 10.16 to the Company's 2010 Annual Report on Form 10-K.) Amended form of agreement for awards made to nonemployee directors commencing in 2012 (and subsequently used for awards made to nonemployee directors under the Graco Inc. 2015 Stock Incentive Plan in 2015). (Incorporated by reference to Exhibit 10.4 of the Company's Report on Form 10-Q for the thirteen weeks ended March 30, 2012.)
- \*10.11
- Stock Option Agreement. Form of agreement used for award of non-incentive stock options to executive officers under the Graco Inc. Amended and Restated Stock Incentive Plan (2006) in 2007. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended March 30, 2007.) Amended form of agreement for awards made to executive officers in 2008, 2009 and 2010. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirteen weeks ended March 28, 2008.)
- \*10.12
- Stock Option Agreement. Form of agreement used for award of non-incentive stock options to Chief Executive Officer under the Graco Inc. Amended and Restated Stock Incentive Plan (2006) in 2007. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended March 30, 2007.) Amended form of agreement for awards made to Chief Executive Officer in 2008, 2009 and 2010. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirteen weeks ended March 28, 2008.)
- \*10.13
- Stock Option Agreement. Form of agreement used for award of non-incentive stock options to executive officers under the Graco Inc. 2010 Stock Incentive Plan in 2011. (Incorporated by reference to Exhibit 10.4 to the Company's Report on Form 10-Q for the thirteen weeks ended April 1, 2011.) Amended form of agreement for awards made to executive officers commencing in 2012. (Incorporated by reference to Exhibit 10.3 of the Company's Report on Form 10-Q for the thirteen weeks ended March 30, 2012.)
- \*10.14
- Stock Option Agreement. Form of agreement used for award of non-incentive stock options to Chief Executive Officer under the Graco Inc. 2010 Stock Incentive Plan in 2011. (Incorporated by reference to Exhibit 10.3 to the Company's Report on Form 10-Q for the thirteen weeks ended April 1, 2011.) Amended form of agreement for awards made to Chief Executive Officer commencing in 2012. (Incorporated by reference to Exhibit 10.2 of the Company's Report on Form 10-Q for the thirteen weeks ended March 30, 2012.)
- \*10.15
- Stock Option Agreement. Form of agreement used for award of non-incentive stock options to Chief Executive Officer under the Graco Inc. 2015 Stock Incentive Plan in 2016. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended March 25, 2016.)
- \*10.16
- Stock Option Agreement. Form of agreement used for award of non-incentive stock options to executive officers under the Graco Inc. 2015 Stock Incentive Plan in 2016. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirteen weeks ended March 25, 2016.)
- \*10.17

- \*10.18 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to nonemployee directors under the Graco Inc. 2015 Stock Incentive Plan in 2016. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended June 24, 2016.)
- \*10.19 Nonemployee Director Stock and Deferred Stock Program. (Incorporated by reference to Exhibit 10.22 to the Company's 2009 Annual Report on Form 10-K/A.)
- \*10.20 Key Employee Agreement. Form of agreement used with Chief Executive Officer. (Incorporated by reference to Exhibit 10.24 to the Company's 2007 Annual Report on Form 10-K.)
- \*10.21 Key Employee Agreement. Form of agreement used with executive officers other than the Chief Executive Officer. (Incorporated by reference to Exhibit 10.25 to the Company's 2007 Annual Report on Form 10-K.)
- 10.22 Executive Group Long-Term Disability Policy as revised in 1995. (Incorporated by reference to Exhibit 10.23 to the Company's 2004 Annual Report on Form 10-K.) Enhanced by Supplemental Income Protection Plan in 2004. (Incorporated by reference to Exhibit 10.28 to the Company's 2007 Annual Report on Form 10-K.)

Table of Contents

- 10.23 Omnibus Amendment, dated June 26, 2014, amending and restating the Credit Agreement among Graco Inc., the borrowing subsidiaries from time to time party thereto, the banks from time to time party thereto and U.S. Bank National Association, as administrative agent. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K filed July 1, 2014.) Third Amendment to Credit Agreement, dated December 15, 2016, amending the Credit Agreement among Graco Inc., the borrowing subsidiaries from time to time party thereto, the banks from time to time party thereto and U.S. Bank National Association, as administrative agent. (Incorporated by reference to Exhibit 10.1 to the Company's Report 8-K filed December 20, 2016.) Fourth amendment to Credit Agreement, dated May 23, 2017, amending the Credit Agreement among Graco Inc., the borrowing subsidiaries from time to time party thereto, the banks from time to time party thereto and U.S. Bank National Association, as administrative agent. (Incorporated by reference to Exhibit 10.2 to the Company's 10-Q filed for the thirteen weeks ended June 30, 2017.)
- 10.24 Note Agreement, dated March 11, 2011, between Graco Inc. and the Purchasers listed on the Purchaser Schedule attached thereto, which includes as exhibits the form of Senior Notes. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K filed March 16, 2011.) Amendment No. 1 dated May 23, 2011. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirteen weeks ended July 1, 2011.) Amendment and Restatement No. 1 to Note Agreement dated as of March 27, 2012. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 8-K filed April 2, 2012.) Amendment No. 2 dated as of June 26, 2014 to Note Agreement dated as of March 11, 2011. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q filed for the thirteen weeks ended June 27, 2014.) Amendment No. 3 dated as of December 15, 2016 to Note Agreement dated as of March 11, 2011. (Incorporated by reference to Exhibit 10.28 to the Company's 2016 Annual Report on Form 10-K.) Amendment No. 4 dated May 23, 2017 to Note Agreement dated as of March 11, 2011. (Incorporated by reference to Exhibit 10.1 to the Company's 10-Q filed for the thirteen weeks ended June 30, 2017.)
- 10.25 Agreement between Graco Inc., Illinois Tool Works Inc., and ITW Finishing LLC, as the Respondents, and Counsel for the Federal Trade Commission. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K filed March 27, 2012.)
- 10.26 Agreement Containing Consent Orders, by and between Graco Inc., Illinois Tool Works Inc., and ITW Finishing LLC, as the Respondents, and Counsel for the Federal Trade Commission. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K filed June 6, 2012.)
- 10.27 Decision and Order by the U.S. Federal Trade Commission in the matter of Graco Inc., Illinois Tool Works Inc. and ITW Finishing LLC. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K filed October 8, 2014.)
- 11 Statement of Computation of Earnings per share included in Note I on page 49
- 21 Subsidiaries of the Company
- 23 Independent Registered Public Accounting Firm's Consent
- 24 Power of Attorney
- 31.1 Certification of President and Chief Executive Officer pursuant to Rule 13a-14(a)
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)



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

101 Interactive Data File

Except as otherwise noted, all documents incorporated by reference above relate to File No. 001-09249.

\* Management Contracts, Compensatory Plans or Arrangements.

\*\* Certain portions of this exhibit have been omitted pursuant to a request for confidential treatment and have been filed separately with the Securities and Exchange Commission.

Pursuant to Item 601(b)(4)(iii) of Regulation S-K, copies of certain instruments defining the rights of holders of certain long-term debt of the Company and its subsidiaries are not filed as exhibits because the amount of debt authorized under any such instrument does not exceed 10 percent of the total assets of the Company and its subsidiaries. The Company agrees to furnish copies thereof to the Securities and Exchange Commission upon request.

63

---

Table of Contents

Signatures

Pursuant to the requirements of Section 13 or 15(d) 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.

/s/ PATRICK J. MCHALE February 20, 2018  
Patrick J. McHale  
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ PATRICK J. MCHALE February 20, 2018  
Patrick J. McHale  
President and Chief Executive Officer  
(Principal Executive Officer)

/s/ CHRISTIAN E. ROTHE February 20, 2018  
Christian E. Rothe  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)

/s/ CAROLINE M. CHAMBERS February 20, 2018  
Caroline M. Chambers  
Vice President, Corporate Controller and Information Systems  
(Principal Accounting Officer)

Lee R. Mitau	Director, Chairman of the Board
William J. Carroll	Director
Eric P. Etchart	Director
Jack W. Eugster	Director
Jody H. Feragen	Director
J. Kevin Gilligan	Director
Patrick J. McHale	Director
Martha A. Morfitt	Director
R. William Van Sant	Director
Emily C. White	Director

Patrick J. McHale, by signing his name hereto, does hereby sign this document on behalf of himself and each of the above named directors of the Registrant pursuant to powers of attorney duly executed by such persons.

/s/ PATRICK J. MCHALE February 20, 2018  
Patrick J. McHale  
(For himself and as attorney-in-fact)