GRACO INC
Form 10-K
February 21, 2017

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

[X] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the fiscal year ended December 30, 2016, 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 X 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 X
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes X No
Indicate by check mark 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. [X]
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer" and "accelerated filer" in Rule 12b-2 of the Exchange Act (Check one):
Large accelerated filer X Accelerated filer Non-accelerated filer Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Act). Yes No X

The aggregate market value of 54,846,659 shares of common stock held by non-affiliates of the registrant was $4,249,519,110 as of June 24, 2016.

56,002,860 shares of common stock were outstanding as of February 1, 2017.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company’s definitive Proxy Statement for its Annual Meeting of Shareholders to be held on April 28, 2017, are incorporated by reference into Part III, as specifically set forth in said Part III.

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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. These reports will be available as soon as reasonably practicable following electronic filing with, or furnishing to, the Securities and Exchange Commission.

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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 both 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 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 59 percent of our Company’s total sales. Sales in EMEA represent approximately 23 percent. Sales in Asia Pacific represent approximately 18 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. 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. 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), Romania (Industrial segment) and Brazil (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.

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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 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 United States, our subsidiaries located in Australia, Belgium, Japan, Italy, Korea, the P.R.C., Singapore and the United Kingdom 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 2016, 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. 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 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 $61 million in 2016, $59 million in 2015 and $54 million in 2014. The amounts invested in product development represented approximately 4½ percent of sales in each of 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 2016. 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.

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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 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. This equipment includes 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.

We make 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 2016. 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.

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### 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, 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 2016. 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 though 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 United States, primarily in the Asia Pacific region.

In 2016, our raw material and purchased component availability was strong, and our costs were relatively flat compared to the prior year. We did see some cost pressure toward the end of 2016, particularly in aluminum, stainless steel, carbon steel bar stock, plastics and copper, which we expect will continue into 2017.

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 United States 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 United States 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 10 percent of the Company’s consolidated sales in both 2016 and 2015.

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## 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 may have to refresh our product line and continue development of our distribution channel to stay competitive. We are also facing 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 30, 2016.

## Employees

As of December 30, 2016, we employed approximately 3,300 persons. Of this total, approximately 1,200 were employees based outside of the United States, and 900 were hourly factory workers in the United States. None of our Company's United States employees are covered by a collective bargaining agreement. Various national industry-wide labor agreements apply to certain employees in various countries outside of the United States. 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

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

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 United States. 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 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 2016, approximately 48 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 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.

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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 continue to source certain of our materials and components from suppliers outside the United States, and from suppliers within the United States 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, 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, 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 impairment analysis in the fourth quarter and recorded adjustments to reduce goodwill by $147 million and other intangible assets by $45 million. The non-cash impairment charges reduced operating earnings by $192 million, created a $31 million deferred tax benefit, and decreased net earnings by $161 million.

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 also may be exposed to litigation, claims for indemnification or other claims relating to acquisitions or the divestiture of the liquid finishing business assets under the asset purchase agreement with Carlisle Companies Incorporated, Carlisle Fluid Technologies, Inc., and Finishing Brands Holdings Inc. as we were required to make certain representations and warranties about a business we never operated based solely on representations made to us in our purchase of that business. We may also need to pursue claims or litigation to protect our interests. The cost of pursuing or defending such matters appears to be increasing, particularly in the United States. 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.

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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 21, 2017, is set forth in the chart below.

| Facility | Owned or Leased | Square Footage | Facility Activities | Operating Segment |
|---|---|---|---|---|
| North America | | | | |
| Indianapolis, Indiana, United States | Owned | 64,000 | Warehouse, office, product development and application laboratory | Industrial segment |
| Dexter, Michigan, United States | Leased | 53,000 | Manufacturing, warehouse, office and product development | Process segment |
| Minneapolis, Minnesota, United States | Owned | 141,000 | Worldwide headquarters, office and product development | Corporate, Industrial and Process segments |

| | | | | |
|---|---|---|---|---|
| Minneapolis, Minnesota, United States | Owned | 42,000 | Corporate office | All segments |
| Minneapolis, Minnesota, United States | Owned | 390,000 | Manufacturing and office | Industrial and Process segments |
| Minneapolis, Minnesota, United States | Owned | 87,000 | Assembly | Industrial and Process segments |
| Anoka, Minnesota, United States | Owned | 208,000 | Manufacturing, warehouse, office and product development | Process segment |
| Rogers, Minnesota, United States | Owned | 325,000 | Manufacturing, office and product development | Contractor segment |
| Rogers, Minnesota, United States | Leased | 100,000 | Warehouse | Contractor segment |
| Rogers, Minnesota, United States | Leased | 225,000 | Distribution center and office | All segments |

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| North Canton, Ohio, United States | Owned | 131,000 | Manufacturing, warehouse, office and application laboratory | Industrial segment |
| Erie, Pennsylvania, United States | Leased | 43,000 | Manufacturing, warehouse, office and product development | Process segment |
| Sioux Falls, South Dakota, United States | Owned | 148,000 | Manufacturing and office | Industrial and Contractor segments |
| Houston, Texas, United States | Leased | 5,000 | Warehouse and office | Process segment |
| Kamas, Utah, United States | Leased | 21,000 | Manufacturing, office and test laboratory | Process segment |
| South America | | | | |
| Porto Alegre, Rio Grande do Sul, Brazil | Leased | 5,000 | Manufacturing, office and product development | Industrial segment |
| Europe | | | | |
| Maasmechelen, Belgium | Owned | 127,000 | EMEA headquarters, warehouse, assembly | All segments |
| Rödermark, Germany | Leased | 41,000 | Warehouse and office | Industrial segment |
| Milan, Italy | Owned | 8,000 | Office and warehouse | Industrial segment |
| Sibiu, Romania | Leased | 31,000 | Manufacturing | Industrial segment |
| St. Gallen, Switzerland | Owned | 82,000 | Manufacturing, warehouse, office, product development and application laboratory | Industrial segment |
| St. Gallen, Switzerland | Leased | 9,000 | Manufacturing | Industrial segment |
| Stoke-on-Trent, Staffordshire, United Kingdom | Leased | 9,000 | Manufacturing, warehouse, office and product development | Process segment |
| Brighouse, West Yorkshire, United Kingdom | Owned | 68,000 | Manufacturing, warehouse, office and product development | Process segment |
| Leaming Spa, Warwickshire, United Kingdom | Leased | 50,000 | Manufacturing, warehouse and office | Process segment |
| Asia Pacific | | | | |
| Derrimut, Australia | Leased | 22,000 | Warehouse | All segments |
| Gurgaon, India | Leased | 18,000 | Office | All segments |
| Yokohama, Japan | Leased | 17,000 | Office | All segments |
| Yasuda, Japan | Leased | 12,000 | Warehouse | 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 | Office and warehouse | Industrial segment |
| Suzhou, P.R.C. | Owned | 80,000 | Manufacturing, warehouse, office and product development | All segments |
| Anyang, South Korea | Leased | 5,000 | Office | All segments |
| Gwangjoo, South Korea | Leased | 11,000 | Warehouse | 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.

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Executive Officers of Our Company

The following are all the executive officers of Graco Inc. as of February 21, 2017:

Patrick J. McHale, 55, 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, 58, 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, 52, 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, 56, 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, 60, 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, 62, 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, 57, 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, 61, 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, 56, 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.

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Peter J. O'Shea, 52, 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, 65, 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, 43, 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, 52, 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, 47, 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.

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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 February 1, 2017, the share price was $90.27 and there were 56,002,860 shares outstanding and 2,250 common shareholders of record, which includes nominees or broker dealers holding stock on behalf of an estimated 60,000 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 |
|---|---|---|---|---|
| 2016 | | | | |
| Stock price per share | | | | |
| High | $ 84.99 | $ 86.62 | $ 81.38 | $ 85.00 |
| Low | 63.05 | 76.94 | 70.47 | 69.33 |
| Dividends declared per share | 0.33 | 0.33 | 0.33 | 0.36 |
| 2015 | | | | |
| Stock price per share | | | | |
| High | $ 82.14 | $ 74.48 | $ 73.49 | $ 77.55 |
| Low | 70.01 | 69.78 | 63.44 | 65.36 |
| Dividends declared per share | 0.30 | 0.30 | 0.30 | 0.33 |

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, 2011, and all dividends were reinvested).

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|
| Dow Jones U.S. Industrial Machinery | 100 | 123 | 179 | 178 | 156 | 211 |
| S&P 500 | 100 | 116 | 154 | 175 | 177 | 198 |
| Graco Inc. | 100 | 127 | 197 | 209 | 192 | 221 |

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Issuer Purchases of Equity Securities

On April 24, 2015, the Board of Directors authorized the purchase of up to 6,000,000 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.

Information on issuer purchases of equity securities follows:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (at end of period) |
|---|---|---|---|---|
| September 24, 2016 - October 28, 2016 | 35,000 | $ 69.93 | 35,000 | 3,817,367 |
| October 29, 2016 - November 25, 2016 | — | $ — | — | 3,817,367 |
| November 26, 2016 - December 30, 2016 | — | $ — | — | 3,817,367 |

Subsequent event: On February 21, 2017, the Company entered into an accelerated share repurchase arrangement (“ASR”) with a financial institution. In exchange for an up-front payment of $90 million, the financial institution will deliver 850,000 shares of Company common stock. The total number of shares ultimately delivered will be determined at the end of the purchase period (up to five months, but not less than two months) based on the volume weighted average price of the Company’s common stock during that period.

Item 6. Selected Financial Data

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

| | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| Net sales | $1,329,293 | $1,286,485 | $1,221,130 | $1,104,024 | $1,012,456 |
| Net earnings | 40,674 | 345,713 | 225,573 | 210,822 | 149,126 |
| Per common share | | | | | |
| Basic net earnings | $0.73 | $6.00 | $3.75 | $3.44 | $2.47 |
| Diluted net earnings | 0.71 | 5.86 | 3.65 | 3.36 | 2.42 |
| Cash dividends declared | 1.35 | 1.23 | 1.13 | 1.03 | 0.93 |
| Total assets | $1,243,109 | $1,391,352 | $1,544,778 | $1,327,228 | $1,321,734 |
| Long-term debt (including current portion) | 305,685 | 392,695 | 615,000 | 408,370 | 556,480 |

Net earnings in 2016 included $161 million of after tax loss from non-cash 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.

Net sales in 2012 included $93 million from Powder Finishing operations acquired in 2012. The Company used long-term borrowings and available cash balances to complete the $668 million purchase of Powder Finishing and Liquid Finishing businesses in 2012.

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

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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

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 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), Romania (Industrial segment) and Brazil (Industrial segment). Our primary distribution facilities are located in the United States, Belgium, Switzerland, United Kingdom, P.R.C., Japan, Korea and Australia.

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. 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.

In October 2014, the Company acquired the stock of Alco Valves Group (“Alco”) for £72 million cash. Alco is a United Kingdom based manufacturer of high quality, high pressure valves used in the oil and natural gas industry and in other industrial processes. Alco’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 Alco operations have been included in the Company's Process segment from the date of acquisition.

In January 2014, the Company paid $65 million cash to acquire QED Environmental Systems ("QED"), a manufacturer of fluid management solutions for environmental monitoring and remediation. Results of QED operations have been included in the Company's Process segment from the date of acquisition.

The Company completed other business acquisitions in 2016, 2015 and 2014 that were not material to the consolidated financial statements.

Impairment

In completing our goodwill impairment analysis in the fourth quarter of 2015, the estimated fair value of all reporting units substantially exceeded carrying value except for our Oil and Natural Gas ("ONG") reporting unit, which exceeded its carrying value by 14 percent. Our financial plan for 2016 anticipated the beginning of a recovery in oil and natural gas markets that would drive improved ONG performance in the second half of the year. After considering third quarter 2016 operating results and preliminary projections from our 2017 planning process, we concluded that the depth and length of industry weakness, and its continuing impact on ONG results, were greater than previously expected. At the end of the third quarter we initiated an impairment analysis. We completed the analysis in the fourth quarter and recorded adjustments to reduce goodwill by $147 million and other intangible assets by $45 million. The non-cash impairment charges reduced operating earnings by $192 million, created a $31 million deferred tax benefit, and decreased net earnings by $161 million.

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.

Results of Operations

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

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Net Sales | $1,329.3 | $1,286.5 | $1,221.1 |
| Operating Earnings | 113.9 | 302.1 | 308.9 |
| Net Earnings | 40.7 | 345.7 | 225.6 |
| Diluted Net Earnings per Common Share | $0.71 | $5.86 | $3.65 |
| Diluted Net Earnings per Common Share, adjusted [1] | $3.55 | $3.46 | $3.65 |

(1) Excludes the effects of non-cash impairment charges recorded in the fourth quarter of 2016 and net investment income from the Liquid Finishing businesses sold in the second quarter of 2015. See adjusted financial results below for a reconciliation of the adjusted non-GAAP financial measures to GAAP.

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Non-cash impairment charges in 2016 and investment income from Liquid Finishing businesses sold in 2015 created large fluctuations in financial results. Excluding those items provides a more consistent comparison of ongoing financial results. A calculation of the non-GAAP measurements of adjusted operating earnings, net earnings and diluted earnings per share, excluding non-cash impairment charges in 2016 and investment income in 2015, follows (in millions except per share amounts):

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Operating Earnings, as reported | $113.9 | $302.1 | $308.9 |
| Impairment | 192.0 | — | — |
| Operating Earnings, adjusted | $305.9 | $302.1 | $308.9 |
| | | | |
| Net Earnings, as reported | $40.7 | $345.7 | $225.6 |
| Impairment | 192.0 | — | — |
| Held separate investment (income), net | — | (191.6 ) | — |
| Income tax effect | (30.6 ) | 50.2 | — |
| Net Earnings, adjusted | $202.1 | $204.3 | $225.6 |
| | | | |
| Weighted Average Diluted Shares | 57.0 | 59.0 | 61.7 |
| Diluted Earnings per Share | | | |
| As reported | $0.71 | $5.86 | $3.65 |
| Adjusted | $3.55 | $3.46 | $3.65 |

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

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Net Sales | 100.0 % | 100.0 % | 100.0 % |
| Cost of products sold | 46.7 | 46.8 | 45.4 |
| Gross profit | 53.3 | 53.2 | 54.6 |
| Product development | 4.6 | 4.5 | 4.4 |
| Selling, marketing and distribution | 16.2 | 15.7 | 16.0 |
| General and administrative | 9.5 | 9.5 | 8.9 |
| Impairment | 14.4 | — | — |
| Operating earnings | 8.6 | 23.5 | 25.3 |
| Interest expense | 1.3 | 1.4 | 1.5 |
| Held separate investment (income), net | — | (14.9 ) | (2.1 ) |
| Other expense (income), net | — | 0.1 | 0.1 |
| Earnings before income taxes | 7.3 | 36.9 | 25.8 |
| Income taxes | 4.2 | 10.0 | 7.3 |
| Net Earnings | 3.1 % | 26.9 % | 18.5 % |

Net Sales

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

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Americas[1] | $777.0 | $759.9 | $684.5 |
| EMEA[2] | 311.1 | 291.4 | 304.7 |
| Asia Pacific | 241.2 | 235.2 | 231.9 |
| Consolidated | $1,329.3 | $1,286.5 | $1,221.1 |

(1) North, South and Central America, including the United States. Sales in the United States were $686 million in 2016, $654 million in 2015 and $577 million in 2014.

(2) Europe, Middle East and Africa

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

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | Volume and Price | Acquisitions | Currency | Total | Volume and Price | Acquisitions | Currency | Total |
| Americas | 1% | 1% | 0% | 2% | 7% | 5% | (1)% | 11% |
| EMEA | 6% | 3% | (2)% | 7% | 1% | 8% | (13)% | (4)% |
| Asia Pacific | 3% | 1% | (1)% | 3% | 0% | 6% | (5)% | 1% |
| Consolidated | 3% | 1% | (1)% | 3% | 4% | 6% | (5)% | 5% |

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.

In 2015, net sales at consistent currency translation rates increased 10 percent, including growth from acquired operations of 6 percentage points and organic growth of 4 percentage points. Incremental sales from operations acquired within the last 12 months totaled $67 million for the year. Changes in currency translation rates reduced sales by approximately $58 million in 2015. More than 90 percent of our organic growth at consistent translation rates in 2015 came from our Contractor and Industrial businesses in the Americas. The Contractor segment continued to benefit from strong residential and commercial construction markets in the United States. Sales growth in western and central Europe was offset by unfavorable currency translation rates for the euro and Swiss franc, and by declines in sales in Russia and the Middle East. While general industry and construction markets were generally stable in western Europe, weakness in oil and natural gas markets continued. Weakness in China offset growth in other Asia Pacific countries, such as Australia, Korea, Japan and India. While general industry and process markets were stable in most of the Asia Pacific region, weakness remained in industries such as mining, marine and general construction.

Gross Profit

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.

In 2015, gross profit margin as a percentage of sales decreased from 2014, mostly due to changes in currency translation rates. Favorable effects of realized pricing and lower material costs offset the impact of lower average gross margin rates of acquired operations.

Operating Expenses

Total operating expenses for 2016 were $212 million higher than 2015, including the non-cash 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.

In 2015, operating expenses were $25 million higher compared to 2014. Incremental expenses from acquired operations totaled $27 million, spending related to regional and product expansion initiatives increased expenses by approximately $4 million, and unallocated corporate expenses (mostly pension and stock compensation) increased $5 million. Currency translation rates reduced operating expenses by approximately $16 million. Investment in new product development was $59 million or 4½ percent of sales in 2015, consistent with 2014 expense as a percentage of sales.

Operating Earnings

Operating earnings in 2016 before non-cash impairment charges 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.

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Operating earnings as a percentage of sales in 2015 were lower than in the prior year, mostly due to changes in currency translation rates and lower margins from acquired operations. Changes in currency translation rates reduced operating earnings by approximately $32 million in 2015.

Held Separate Investment (Income)

There was no held separate investment income in 2016. Held separate investment income in 2015 included $150 million of pre-tax gain on the sale of Liquid Finishing business assets, net of transaction and other related expenses, and dividends of $42 million. Dividends received from Liquid Finishing totaled $28 million in 2014.

Income Taxes

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. Last year's 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.

The effective tax rate for 2015 was 27 percent, down from 28 percent in 2014. A change in the Company's assertion with respect to reinvestment of foreign earnings decreased deferred income taxes related to undistributed foreign earnings by $7 million and reduced the effective tax rate for the year. Higher post-tax dividend income, favorable effects of lower tax rates on foreign earnings, and an additional non-recurring tax benefit of $2 million further reduced the effective tax rate for the year. Those reductions were partially offset by the tax rate effects of the gain on the sale of the Liquid Finishing business assets.

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.

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

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Sales | | | |
| Industrial | $629.6 | $616.1 | $622.3 |
| Process | 266.6 | 273.6 | 223.2 |
| Contractor | 433.1 | 396.8 | 375.6 |
| Total | $1,329.3 | $1,286.5 | $1,221.1 |
| Operating Earnings | | | |
| Industrial | $207.2 | $201.8 | $203.9 |
| Process | 35.8 | 43.8 | 47.8 |
| Contractor | 91.8 | 86.4 | 81.9 |
| Unallocated corporate (expense) [1] | (28.9) | (29.9) | (24.7) |
| Impairment [2] | (192.0) | — | — |
| Total | $113.9 | $302.1 | $308.9 |

(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

certain central warehouse expenses. Unallocated corporate expenses in 2016 were consistent with the prior year. Unallocated corporate expenses increased by $5 million in 2015 compared to 2014, including increases in stock compensation, pension cost and central warehouse expense, partially offset by decreases in acquisition transaction costs and charitable contributions.

(2) The non-cash 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.

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Industrial Segment

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

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Sales | | | |
| Americas | $281.3 | $288.9 | $272.8 |
| EMEA | 184.5 | 173.3 | 196.0 |
| Asia Pacific | 163.8 | 153.9 | 153.5 |
| Total | $629.6 | $616.1 | $622.3 |
| Operating Earnings as a Percentage of Sales | 33 % | 33 % | 33 % |

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

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | Volume and Price | Acquisitions | Currency | Total | Volume and Price | Acquisitions | Currency | Total |
| Americas | (2)% | 0% | (1)% | (3)% | 5% | 2% | (1)% | 6% |
| EMEA | 8% | 0% | (2)% | 6% | 1% | 0% | (13)% | (12)% |
| Asia Pacific | 7% | 1% | (2)% | 6% | 1% | 3% | (4)% | 0% |
| Segment Total | 3% | 0% | (1)% | 2% | 3% | 2% | (6)% | (1)% |

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 2015, the effects of currency translation in EMEA and Asia Pacific offset the increase in Industrial segment sales in the Americas. Acquired operations contributed $10 million (2 percentage points) of growth for the year. Operating margin rates for the Industrial segment were consistent with 2014, with favorable price realization, product mix, and cost and expense management offsetting the unfavorable effect of foreign currency translation rates.

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):

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Sales | | | |
| Americas | $170.4 | $171.8 | $146.6 |
| EMEA | 52.4 | 55.0 | 38.4 |
| Asia Pacific | 43.8 | 46.8 | 38.2 |
| Total | $266.6 | $273.6 | $223.2 |
| Operating Earnings as a Percentage of Sales | 13 % | 16 % | 21 % |

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

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | Volume and Price | Acquisitions | Currency | Total | Volume and Price | Acquisitions | Currency | Total |
| Americas | (5)% | 4% | 0% | (1)% | 1% | 18% | (2)% | 17% |
| EMEA | (12)% | 12% | (5)% | (5)% | 0% | 57% | (14)% | 43% |
| Asia Pacific | (8)% | 4% | (2)% | (6)% | 0% | 30% | (8)% | 22% |
| Segment Total | (7)% | 6% | (2)% | (3)% | 1% | 26% | (4)% | 23% |

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.

In 2015, acquired operations contributed $56 million (26 percentage points of growth) to the Process segment for the year. Results for 2015 included the operations of HiP and White Knight, both acquired in January 2015, and full-year operations of Alco, acquired in October 2014. Operating earnings decreased by 5 percentage points in 2015 due mostly to currency translation, lower margins from acquired operations and incremental investment in product development.

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.

Contractor Segment

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

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Sales | | | |
| Americas | $325.3 | $299.2 | $265.2 |
| EMEA | 74.3 | 63.1 | 70.3 |
| Asia Pacific | 33.5 | 34.5 | 40.1 |
| Total | $433.1 | $396.8 | $375.6 |
| Operating Earnings as a Percentage of Sales | 21 % | 22 % | 22 % |

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

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | Volume and Price | Acquisitions | Currency | Total | Volume and Price | Acquisitions | Currency | Total |
| Americas | 9% | 0% | 0% | 9% | 14% | 0% | (1)% | 13% |
| EMEA | 19% | 0% | (1)% | 18% | 2% | 0% | (12)% | (10)% |
| Asia Pacific | (1)% | 0% | (2)% | (3)% | (9)% | 0% | (5)% | (14)% |
| Segment Total | 10% | 0% | (1)% | 9% | 9% | 0% | (3)% | 6% |

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 2015, strong U.S. residential and commercial construction market drove growth in the Americas, while currency translation created headwinds in EMEA and Asia Pacific. Operating earnings for the year were consistent with 2014, with the unfavorable impact of currency translation rates offset by volume-related increases.

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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):

| | 2016 | 2015 |
|---|---|---|
| Working capital | $325.4 | $314.4 |
| Current ratio | 2.8 | 2.6 |
| Days of sales in receivables outstanding | 61 | 64 |
| Inventory turnover (LIFO) | 3.0 | 3.2 |

The impact on working capital of decreases in notes payable, accrued salaries and incentives and other payables was partially offset by a $7 million decrease in accounts receivable. Inventory levels were steady compared to year-end 2015.

Capital Structure. 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. At December 25, 2015, the Company's capital structure included current notes payable of $16 million, long-term debt of $393 million and shareholders' equity of $636 million.

Shareholders' equity decreased by $62 million in 2016. Decreases from dividends of $75 million, and other comprehensive losses related to currency translation and pension liability adjustments totaling $38 million, more than offset the increase from current year earnings of $41 million. Increases related to shares issued and stock compensation totaling $61 million were mostly offset by a $50 million decrease from share repurchases. Shareholders' equity increased by $40 million in 2015. The increase from 2015 earnings of $346 million offset decreases from share repurchases of $272 million and dividends of $70 million. Increases related to shares issued and stock compensation totaled $39 million.

Liquidity and Capital Resources. The Company had cash held in deposit accounts totaling $52 million at December 30, 2016, and December 25, 2015. As of December 30, 2016, 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 30, 2016, the amount of cash held outside the United States 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 30, 2016, the Company had $544 million in lines of credit, including the $500 million in committed credit facilities described above and $44 million with foreign banks. The unused portion of committed credit lines was $504 million as of December 30, 2016.

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 30, 2016.

Internally generated funds and unused financing sources are expected to provide the Company with the flexibility to meet its liquidity needs in 2017, including its capital expenditure plan of approximately $40 million, planned dividends estimated at $80 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 2016, the Company's Board of Directors increased the Company's regular quarterly dividend to $0.36 from $0.33 per share, an increase of 9 percent.

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

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Operating activities | $269.1 | $189.6 | $241.2 |
| Investing activities | (90.9 ) | 369.9 | (216.7 ) |
| Financing activities | (178.3 ) | (534.4 ) | (23.6 ) |
| Effect of exchange rates on cash | 0.2 | 3.5 | 3.0 |
| Net cash provided (used) | 0.1 | 28.6 | 3.9 |
| Cash and cash equivalents at end of year | $52.4 | $52.3 | $23.7 |

Cash Flows From Operating Activities. Net cash provided by operating activities was $269 million in 2016, up $79 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.

Net cash provided by operating activities was $190 million in 2015, down $51 million compared to 2014, mainly due to transaction costs and income taxes related to the sale of Liquid Finishing business assets. Accounts receivable and inventory balances increased from the end of 2014 due to acquisitions, increases in business activity and inventory increases to improve customer service levels.

Cash Flows Used in Investing Activities. 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. The acquired businesses enhance and complement the Company's position in environmental monitoring and remediation markets, and are included in the Process segment.

Cash inflows from investing activities totaled $370 million in 2015 compared to outflows of $217 million in 2014. Proceeds of $610 million from the sale of the Liquid Finishing business assets were partially offset by cash outflows of $189 million for acquisitions and $42 million for additions to property, plant and equipment. In 2014, cash outflows included acquisitions of $185 million and additions to property plant and equipment of $31 million.

Cash Flows Used in Financing Activities. Cash flows used in financing activities totaled $178 million in 2016, compared to $534 million in 2015. 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 totaled $534 million in 2015, compared to $24 million in 2014. Cash outflows included net payments on outstanding lines of credit of $211 million, share repurchases of $275 million and dividends paid of $69 million. In 2014, cash inflows included net borrowings on lines of credit of $202 million and share issuances of $30 million. Outflows included share repurchases of $195 million and dividends paid of $66 million.

On April 24, 2015, the Board of Directors authorized the purchase of up to 6 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, 3.8 million shares remain available for purchase as of December 30, 2016.

The Company repurchased and retired 0.8 million shares in 2016, compared to 3.9 million shares in 2015 and 2.6 million shares in 2014. Share repurchases are expected to continue in 2017 via open market transactions or short-dated accelerated share repurchase ("ASR") programs.

Subsequent event: On February 21, 2017, the Company entered into an ASR with a financial institution. In exchange for an up-front payment of $90 million, the financial institution will deliver 850,000 shares of Company common stock. The total number of shares ultimately delivered will be determined at the end of the purchase period (up to five months, but not less than two months) based on the volume weighted average price of the Company's common stock during that period.

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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 30, 2016. The Company has also guaranteed the debt of its subsidiaries for up to $9 million. All debt of subsidiaries is reflected in the consolidated balance sheets.

As of December 30, 2016, 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 | $305.7 | $ — | $75.0 | $80.7 | $ 150.0 |
| Interest on long-term debt | 78.8 | 14.5 | 23.8 | 16.7 | 23.8 |
| Other non-current liabilities [1] | 8.7 | — | 7.5 | 0.4 | 0.8 |
| Operating leases | 31.0 | 7.3 | 11.4 | 6.7 | 5.6 |
| Service contracts | 6.9 | 3.5 | 3.1 | 0.3 | — |
| Purchase obligations [2] | 114.6 | 114.6 | — | — | — |
| Unfunded pension and postretirement medical benefits [3] | 33.5 | 2.4 | 5.5 | 6.5 | 19.1 |
| Total | $579.2 | $ 142.3 | $126.3 | $111.3 | $ 199.3 |

(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.

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 market. 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 completing our goodwill impairment testing in the fourth quarter of 2015, the estimated fair value of all reporting units substantially exceeded carrying value except for our ONG reporting unit, which exceeded its carrying value by 14 percent. Our financial plan for 2016 anticipated the beginning of a recovery in oil and natural gas markets that would drive improved ONG performance in the second half of the year. After considering third quarter 2016 operating results and preliminary projections from our 2017 planning process, we concluded that the depth and length of industry weakness, and its continuing impact on ONG results, were greater than previously expected. At the end of the third quarter we initiated an impairment analysis. We completed the analysis in the fourth quarter and recorded adjustments to reduce goodwill by $147 million and other intangible assets by $45 million. The non-cash impairment charges reduced operating earnings by $192 million, created a $31 million deferred tax benefit, and decreased net earnings by $161 million.

We completed our annual impairment testing of goodwill and other intangible assets in the fourth quarter of 2016. No further 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, 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.

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. plan to 7.3 percent for 2017. Mortality rates are based on current common group mortality tables for males and females.

In 2016, net pension cost of $15 million was allocated to cost of products sold and operating expenses based on salaries and wages. At December 30, 2016, a one-half percentage point decrease in the indicated assumptions would have the following effects (in millions):

| Assumption | Funded Status | Expense |
|---|---|---|
| Discount rate | $ (28.3) | $ 2.7 |
| 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.

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## 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 30, 2016, 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 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. In 2014, changes in currency translation rates reduced sales and net earnings by approximately $3 million and $2 million, respectively.

## 2017 Outlook

We are focused on achieving full-year sales growth in all geographic regions and reportable segments in 2017. Our full-year 2017 outlook is for low single-digit organic sales growth on a constant currency basis, with low single-digit growth expected in each geographic region of the world. Our Process segment experienced headwinds throughout 2016 and remains a source of caution as we enter 2017, while the outlook for our Contractor segment is for mid single-digit sales growth in 2017.

At January 2017 exchange rates, assuming the same volumes, mix of products and mix of business by currency as in 2016, the movement in foreign currencies would be a headwind of approximately 1 percent on sales and 3 percent on earnings in 2017.

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 2016 Overview report, press releases, earnings releases, analyst briefings, conference calls and other written documents or oral statements released by our Company, may contain forward-looking statements. Forward-looking statements generally use words such as "expect," "foresee," "anticipate," "believe," "project," "should," "estimate," "will," and similar expressions, and reflect our Company's expectations concerning the future. All forecasts and projections are forward-looking statements. Forward-looking statements are based upon currently available information, but various risks and uncertainties may cause our Company's actual results to differ materially from those expressed in these statements. The Company undertakes no obligation to update these statements in light of new information or future events.

Future results could differ materially from those expressed, due to the impact of changes in various factors. These risk factors include, but are not limited to, 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.

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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 30, 2016. 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 30, 2016.

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.

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Graco Inc.

We have audited the internal control over financial reporting of Graco Inc. and Subsidiaries (the "Company") as of December 30, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. 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 conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel 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 the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 30, 2016, based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 30, 2016, of the Company and our report dated February 21, 2017, expressed an unqualified opinion on those consolidated financial statements and financial statement schedule.

/s/ DELOITTE & TOUCHE LLP

Minneapolis, Minnesota
February 21, 2017

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Graco Inc.

We have audited the accompanying consolidated balance sheets of Graco Inc. and Subsidiaries (the "Company") as of December 30, 2016 and December 25, 2015, and the related consolidated statements of earnings, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 30, 2016. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Graco Inc. and Subsidiaries as of December 30, 2016 and December 25, 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 30, 2016, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 30, 2016, based on the criteria established in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 21, 2017, expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Minneapolis, Minnesota
February 21, 2017

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

| | Years Ended December 30, 2016 | December 25, 2015 | December 26, 2014 |
|---|---|---|---|
| Net Sales | $1,329,293 | $1,286,485 | $1,221,130 |
| Cost of products sold | 621,054 | 601,785 | 554,394 |
| Gross Profit | 708,239 | 684,700 | 666,736 |
| Product development | 60,606 | 58,559 | 54,246 |
| Selling, marketing and distribution | 215,253 | 201,855 | 194,751 |
| General and administrative | 126,481 | 122,161 | 108,814 |
| Impairment | 192,020 | — | — |
| Operating Earnings | 113,879 | 302,125 | 308,925 |
| Interest expense | 17,590 | 17,643 | 18,733 |
| Held separate investment (income), net | — | (191,635) | (25,951) |
| Other expense (income), net | (366) | 1,404 | 1,070 |
| Earnings Before Income Taxes | 96,655 | 474,713 | 315,073 |
| Income taxes | 55,981 | 129,000 | 89,500 |
| Net Earnings | $40,674 | $345,713 | $225,573 |
| Basic Net Earnings per Common Share | $0.73 | $6.00 | $3.75 |
| Diluted Net Earnings per Common Share | $0.71 | $5.86 | $3.65 |
| Cash Dividends Declared per Common Share | $1.35 | $1.23 | $1.13 |

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)

| | Years Ended December 30, 2016 | December 25, 2015 | December 26, 2014 |
|---|---|---|---|
| Net Earnings | $40,674 | $ 345,713 | $ 225,573 |
| Components of other comprehensive income (loss) | | | |
| Cumulative translation adjustment | (31,227) | (10,423) | (27,935) |
| Pension and postretirement medical liability adjustment | (10,715) | 10,372 | (39,164) |
| Income taxes - pension and postretirement medical liability | 4,211 | (3,710) | 12,712 |
| Other comprehensive income (loss) | (37,731) | (3,761) | (54,387) |
| Comprehensive Income | $2,943 | $ 341,952 | $ 171,186 |

See notes to consolidated financial statements.

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GRACO INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)

| | December 30, 2016 | December 25, 2015 |
|---|---|---|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | $52,365 | $52,295 |
| Accounts receivable, less allowances of $12,700 and $10,400 | 218,365 | 225,509 |
| Inventories | 201,609 | 202,136 |
| Other current assets | 31,023 | 29,077 |
| Total current assets | 503,362 | 509,017 |
| Property, Plant and Equipment, net | 189,596 | 178,437 |
| Goodwill | 259,849 | 394,488 |
| Other Intangible Assets, net | 178,336 | 227,987 |
| Deferred Income Taxes | 86,653 | 56,976 |
| Other Assets | 25,313 | 24,447 |
| Total Assets | $1,243,109 | $1,391,352 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Notes payable to banks | $8,913 | $ |