GRACO INC
Form 10-Q
July 21, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
Quarterly Report Pursuant to Section 13 or 15 (d) of the
Securities Exchange Act of 1934

For the quarterly period ended **June 25, 2010**
Commission File Number: 001-09249

GRACO INC.
(Exact name of registrant as specified in its charter)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, 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 such shorter period that the registrant was required to submit and post such files).

Yes __X__ No _____

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

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

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

Yes _____ No __X__

60,248,000 shares of the Registrant s Common Stock, $1.00 par value, were outstanding as of July 16, 2010.

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PART I

Item 1.

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

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 25, 2010	June 26, 2009	June 25, 2010	June 26, 2009
Net Sales	$ 192,088	$ 147,712	$ 356,809	$ 285,592
Cost of products sold	90,168	74,704	165,594	148,256
Gross Profit	101,920	73,008	191,215	137,336
Product development	9,472	9,781	18,946	19,832
Selling, marketing and distribution	32,647	28,292	61,807	60,225
General and administrative	20,592	16,489	38,547	32,704
Operating Earnings	39,209	18,446	71,915	24,575
Interest expense	1,041	1,221	2,121	2,587
Other expense (income), net	(268)	91	(107)	686
Earnings Before Income Taxes	38,436	17,134	69,901	21,302
Income taxes	13,600	5,500	24,500	6,900
Net Earnings	$ 24,836	$ 11,634	$ 45,401	$ 14,402
Basic Net Earnings per Common Share	$ 0.41	$ 0.19	$ 0.75	$ 0.24
Diluted Net Earnings per Common Share	$ 0.41	$ 0.19	$ 0.74	$ 0.24
Cash Dividends Declared per Common Share	$ 0.20	$ 0.19	$ 0.40	$ 0.38

See notes to consolidated financial statements.

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

	June 25, 2010	December 25, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	$ 4,878	$ 5,412
Accounts receivable, less allowances of $6,400 and $6,500	138,279	100,824
Inventories	76,198	58,658
Deferred income taxes	20,408	20,380
Other current assets	3,535	3,719
Total current assets	243,298	188,993
Property, Plant and Equipment		
Cost	337,848	334,440
Accumulated depreciation	(204,041)	(195,387)
Property, plant and equipment, net	133,807	139,053
Goodwill	91,740	91,740
Other Intangible Assets, net	34,229	40,170
Deferred Income Taxes	11,776	8,372
Other Assets	8,273	8,106
Total Assets	$ 523,123	$ 476,434
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Notes payable to banks	$ 13,599	$ 12,028
Trade accounts payable	33,780	17,983
Salaries and incentives	21,611	14,428
Dividends payable	12,053	12,003
Other current liabilities	45,338	47,373
Total current liabilities	126,381	103,815
Long-term debt	80,000	86,260
Retirement Benefits and Deferred Compensation	74,651	73,705
Uncertain Tax Positions	3,000	3,000
Shareholders Equity		
Common stock	60,314	59,999
Additional paid-in-capital	203,716	190,261

Retained earnings	23,892	11,121
Accumulated other comprehensive income (loss)	(48,831)	(51,727)
Total shareholders equity	239,091	209,654
Total Liabilities and Shareholders Equity	$ 523,123	$ 476,434

See notes to consolidated financial statements.

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

	Twenty-six Weeks Ended June 25, 2010	Twenty-six Weeks Ended June 26, 2009
Cash Flows From Operating Activities		
Net Earnings	$ 45,401	$ 14,402
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	17,319	16,953
Deferred income taxes	(5,247)	(696)
Share-based compensation	5,127	5,209
Excess tax benefit related to share-based payment arrangements	(900)	(300)
Change in		
Accounts receivable	(40,392)	15,370
Inventories	(17,742)	22,691
Trade accounts payable	9,552	(3,218)
Salaries and incentives	7,624	(6,015)
Retirement benefits and deferred compensation	4,996	7,215
Other accrued liabilities	1,287	(2,135)
Other	1,020	16
Net cash provided by operating activities	28,045	69,492
Cash Flows From Investing Activities		
Property, plant and equipment additions	(5,932)	(9,129)
Proceeds from sale of property, plant and equipment	123	495
Investment in life insurance	(1,499)	(1,499)
Capitalized software and other intangible asset additions	(193)	(200)
Net cash used in investing activities	(7,501)	(10,333)
Cash Flows From Financing Activities		
Net borrowings (payments) on short-term lines of credit	3,004	(3,621)
Borrowings on long-term line of credit	-	68,126
Payments on long-term line of credit	(6,260)	(104,211)
Excess tax benefit related to share-based payment arrangements	900	300
Common stock issued	8,815	5,289
Common stock retired	(3,462)	(141)
Cash dividends paid	(24,122)	(22,686)
Net cash provided by (used in) financing activities	(21,125)	(56,944)
Effect of exchange rate changes on cash	47	(425)
Net increase (decrease) in cash and cash equivalents	(534)	1,790
Cash and cash equivalents:		

Beginning of year		5,412		12,119
End of period	$	4,878	$	13,909

See notes to consolidated financial statements

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

1. The consolidated balance sheet of Graco Inc. and Subsidiaries (the Company) as of June 25, 2010 and the related statements of earnings for the thirteen and twenty-six weeks ended June 25, 2010 and June 26, 2009, and cash flows for the twenty-six weeks ended June 25, 2010 and June 26, 2009 have been prepared by the Company and have not been audited.

   In the opinion of management, these consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of Graco Inc. and Subsidiaries as of June 25, 2010, and the results of operations and cash flows for all periods presented.

   Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. Therefore, these statements should be read in conjunction with the financial statements and notes thereto included in the Company s 2009 Annual Report on Form 10-K.

   The results of operations for interim periods are not necessarily indicative of results that will be realized for the full fiscal year.

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

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 25, 2010	June 26, 2009	June 25, 2010	June 26, 2009
Net earnings available to common shareholders	$ 24,836	$ 11,634	$ 45,401	$ 14,402
Weighted average shares outstanding for basic earnings per share	60,597	59,903	60,402	59,770
Dilutive effect of stock options computed using the treasury stock method and the average market price	587	280	546	273
Weighted average shares outstanding for diluted earnings per share	61,184	60,183	60,948	60,043
Basic earnings per share	$ 0.41	$ 0.19	$ 0.75	$ 0.24
Diluted earnings per share	$ 0.41	$ 0.19	$ 0.74	$ 0.24

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Stock options to purchase 2,987,000 and 3,920,000 shares were not included in the 2010 and 2009 computations of diluted earnings per share, respectively, because they would have been anti-dilutive.

3. Information on option shares outstanding and option activity for the twenty-six weeks ended June 25, 2010 is shown below (in thousands, except per share amounts):

	Option Shares	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
Outstanding, December 25, 2009	4,813	$ 28.98	2,445	$ 28.38
Granted	827	27.80		
Exercised	(203)	11.67		
Canceled	(31)	32.23		
Outstanding, June 25, 2010	5,406	$ 29.43	2,901	$ 30.21

The Company recognized year-to-date share-based compensation of $5.1 million in 2010 and $5.2 million in 2009. As of June 25, 2010, there was $8.8 million of unrecognized compensation cost related to unvested options, expected to be recognized over a weighted average period of 2.1 years.

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

	Twenty-six Weeks Ended	
	June 25, 2010	June 26, 2009
Expected life in years	6.0	6.0
Interest rate	2.7%	2.1%
Volatility	34.0%	30.1%
Dividend yield	3.0%	3.7%
Weighted average fair value per share	$ 7.38	$ 4.27

Under the Company s Employee Stock Purchase Plan, the Company issued 436,000 shares in 2010 and 312,000 shares in 2009. The fair value of the employees purchase rights under this Plan was estimated on the date of grant. The benefit of the 15 percent discount from the lesser of the fair market value per common share on the first day and the last day of the plan year was added to the fair value of the employees purchase rights determined using the Black-Scholes option-pricing model with the following assumptions and results:

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	Twenty-six Weeks Ended	
	June 25, 2010	June 26, 2009
Expected life in years	1.0	1.0
Interest rate	0.3%	0.7%
Volatility	42.8%	51.5%
Dividend yield	2.9%	4.5%
Weighted average fair value per share	$ 8.48	$ 5.60

4. The components of net periodic benefit cost for retirement benefit plans were as follows (in thousands):

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 25, 2010	June 26, 2009	June 25, 2010	June 26, 2009
Pension Benefits				
Service cost	$ 894	$ 1,141	$ 2,135	$ 2,420
Interest cost	3,138	3,115	6,415	6,335
Expected return on assets	(3,325)	(2,850)	(6,800)	(5,550)
Amortization and other	1,548	2,313	3,052	4,727
Net periodic benefit cost	$ 2,255	$ 3,719	$ 4,802	$ 7,932
Postretirement Medical				
Service cost	$ 150	$ 100	$ 275	$ 250
Interest cost	295	300	620	650
Amortization	(95)	-	(95)	-
Net periodic benefit cost	$ 350	$ 400	$ 800	$ 900

The Company paid $1.5 million in June 2010 and $1.5 million in June 2009 for contracts insuring the lives of certain employees who are eligible to participate in certain non-qualified pension and deferred compensation plans. These insurance contracts will be used to fund the non-qualified pension and deferred compensation arrangements. The insurance contracts are held in a trust and are available to general creditors in the event of the Company s insolvency. Cash surrender value of $5.9 million and $4.4 million is included in other assets in the consolidated balance sheet as of June 25, 2010 and December 25, 2009, respectively.

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5. Total comprehensive income was as follows (in thousands):

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 25, 2010	June 26, 2009	June 25, 2010	June 26, 2009
Net earnings	$ 24,836	$ 11,634	$ 45,401	$ 14,402
Cumulative translation adjustment	-	-	-	234
Pension and postretirement medical liability adjustment	1,491	2,422	2,959	4,751
Gain (loss) on interest rate hedge contracts	933	364	1,638	291
Income taxes	(896)	(1,030)	(1,701)	(1,866)
Comprehensive income	$ 26,364	$ 13,390	$ 48,297	$ 17,812

Components of accumulated other comprehensive income (loss) were (in thousands):

	June 25, 2010	December 25, 2009
Pension and postretirement medical liability adjustment	$ (46,696)	$ (48,560)
Gain (loss) on interest rate hedge contracts	(1,312)	(2,344)
Cumulative translation adjustment	(823)	(823)
Total	$ (48,831)	$ (51,727)

6. The Company has three reportable segments: Industrial, Contractor and Lubrication. The Company does not track assets by segment. Sales and operating earnings by segment for the thirteen and twenty-six weeks ended June 25, 2010 and June 26, 2009 were as follows (in thousands):

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 25, 2010	June 26, 2009	June 25, 2010	June 26, 2009
Net Sales				
Industrial	$ 100,461	$ 73,334	$ 197,253	$ 148,566
Contractor	73,782	60,386	124,579	107,834
Lubrication	17,845	13,992	34,977	29,192
Total	$ 192,088	$ 147,712	$ 356,809	$ 285,592
Operating Earnings				
Industrial	$ 29,565	$ 13,435	$ 60,039	$ 24,930
Contractor	13,203	12,043	18,086	13,282
Lubrication	1,868	(1,745)	3,575	(3,181)
Unallocated corporate (expense)	(5,427)	(5,287)	(9,785)	(10,456)

Total	$ 39,209	$ 18,446	$ 71,915	$ 24,575

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

	June 25, 2010	December 25, 2009
Finished products and components	$ 42,251	$ 36,665
Products and components in various stages of completion	27,270	22,646
Raw materials and purchased components	39,597	31,826
	109,118	91,137
Reduction to LIFO cost	(32,920)	(32,479)
Total	$ 76,198	$ 58,658

8. Information related to other intangible assets follows (dollars in thousands):

	Estimated Life (years)	Original Cost	Accumulated Amortization	Foreign Currency Translation	Book Value
June 25, 2010					
Customer relationships	3 - 8	$ 41,075	$ (21,748)	$ (181)	$ 19,146
Patents, proprietary technology and product documentation	3 - 10	21,072	(13,548)	(85)	7,439
Trademarks, trade names and other	3 - 10	8,154	(3,690)	-	4,464
		70,301	(38,986)	(266)	31,049
Not Subject to Amortization:					
Brand names		3,180	-	-	3,180
Total		$ 73,481	$ (38,986)	$ (266)	$ 34,229
December 25, 2009					
Customer relationships	3 - 8	$ 41,075	$ (18,655)	$ (181)	$ 22,239
Patents, proprietary technology and product documentation	3 - 10	22,862	(13,708)	(87)	9,067
Trademarks, trade names and other	3 - 10	8,154	(2,470)	-	5,684
		72,091	(34,833)	(268)	36,990
Not Subject to Amortization:					
Brand names		3,180	-	-	3,180
Total		$ 75,271	$ (34,833)	$ (268)	$ 40,170

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Amortization of intangibles was $2.9 million in the second quarter of 2010 and $5.9 million year-to-date. Estimated annual amortization expense is as follows: $11.2 million in 2010, $10.7 million in 2011, $9.1 million in 2012, $4.3 million in 2013, $0.9 million in 2014 and $0.7 million thereafter.

9. Components of other current liabilities were (in thousands):

	June 25, 2010	December 25, 2009
Accrued self-insurance retentions	$ 7,650	$ 7,785
Accrued warranty and service liabilities	6,882	7,437
Accrued trade promotions	4,108	2,953
Payable for employee stock purchases	2,420	5,115
Income taxes payable	2,433	1,550
Other	21,845	22,533
Total other current liabilities	$ 45,338	$ 47,373

A liability is established for estimated future warranty and service claims that relate to current and prior period sales. The Company estimates warranty costs based on historical claim experience and other factors including evaluating specific product warranty issues. Following is a summary of activity in accrued warranty and service liabilities (in thousands):

	Twenty-six Weeks Ended June 25, 2010	Year Ended December 25, 2009
Balance, beginning of year	$ 7,437	$ 8,033
Charged to expense	1,385	4,548
Margin on parts sales reversed	1,295	2,876
Reductions for claims settled	(3,235)	(8,020)
Balance, end of period	$ 6,882	$ 7,437

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

As part of its risk management program, the Company may periodically use forward exchange contracts and interest rate swaps to manage known market exposures. Terms of derivative instruments are structured to match the terms of the risk being managed and are generally held to maturity. The Company does not hold or issue derivative financial instruments for trading purposes. All other contracts that contain provisions meeting the definition of a derivative also meet the requirements of, and have

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been designated as, normal purchases or sales. The Company s policy is to not enter into contracts with terms that cannot be designated as normal purchases or sales.

In 2007, the Company entered into interest rate swap contracts that effectively fix the rates paid on a total of $80 million of variable rate borrowings. One contract fixed the rate on $40 million of borrowings at 4.7 percent plus the applicable spread (depending on cash flow leverage ratio) until December 2010. The second contract fixed an additional $40 million of borrowings at 4.6 percent plus the applicable spread until January 2011. Both contracts have been designated as cash flow hedges against interest rate volatility. Consequently, changes in the fair market value are recorded in accumulated other comprehensive income (loss) (AOCI). Amounts included in AOCI will be reclassified to earnings as interest rates increase and as the swap contracts approach their expiration dates. Net amounts paid or payable under terms of the contracts were charged to interest expense and totaled $1.8 million in the first half of 2010.

The Company periodically evaluates its monetary asset and liability positions denominated in foreign currencies. The Company enters into forward contracts or options, or borrows in various currencies, in order to hedge its net monetary positions. These instruments are recorded at current market values and the gains and losses are included in other expense (income), net. There were seven contracts outstanding as of June 25, 2010, with notional amounts totaling $18 million. The Company believes it uses strong financial counterparts in these transactions and that the resulting credit risk under these hedging strategies is not significant.

The Company uses significant other observable inputs to value the derivative instruments used to hedge interest rate volatility and net monetary positions. The fair market value and balance sheet classification of such instruments follows (in thousands):

	Balance Sheet Classification	June 25, 2010	December 25, 2009
Gain (loss) on interest rate hedge contracts	Other current liabilities	$ (2,084)	$ (3,722)
Gain (loss) on foreign currency forward contracts			
Gains		$ 84	$ 207
Losses		(431)	(249)
Net	Other current liabilities	$ (347)	$ (42)

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Item 2. **GRACO INC. AND SUBSIDIARIES**
MANAGEMENT S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The Company designs, manufactures and markets systems and equipment to move, measure, control, dispense and spray fluid materials. Management classifies the Company s business into three reportable segments: Industrial, Contractor and Lubrication. Key strategies include developing and marketing new products, expanding distribution globally, opening new markets with technology and channel expansion and completing strategic acquisitions.

The following Management s Discussion and Analysis reviews significant factors affecting the Company s results of operations and financial condition. This discussion should be read in conjunction with the financial statements and the accompanying notes to the financial statements.

Results of Operations

Net sales, net earnings and earnings per share were as follows (in millions except per share amounts and percentages):

	Thirteen Weeks Ended			Twenty-six Weeks Ended		
	June 25, 2010	June 26, 2009	% Change	June 25, 2010	June 26, 2009	% Change
Net Sales	$ 192.1	$ 147.7	30%	$ 356.8	$ 285.6	25%
Net Earnings	$ 24.8	$ 11.6	113%	$ 45.4	$ 14.4	215%
Diluted Net Earnings per Common Share	$ 0.41	$ 0.19	116%	$ 0.74	$ 0.24	208%

Sales, gross profit margins and net earnings for the quarter and year-to-date improved significantly compared to last year. Sales increased in all segments and geographic regions. Currency translation had a favorable effect on year-to-date sales ($6 million) and net earnings ($3 million) but there was no significant effect on consolidated results for the quarter.

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Consolidated Results

Sales by geographic area were as follows (in millions):

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 25, 2010	June 26, 2009	June 25, 2010	June 26, 2009
Americas[1]	$ 110.2	$ 88.3	$ 196.9	$ 168.5
Europe[2]	44.0	34.6	85.8	70.4
Asia Pacific	37.9	24.8	74.1	46.7
Consolidated	$ 192.1	$ 147.7	$ 356.8	$ 285.6

[1] North and South America, including the U.S.

[2] Europe, Africa and Middle East

Sales for the quarter increased 25 percent in the Americas, 27 percent in Europe (33 percent at consistent translation rates) and 53 percent in Asia Pacific (47 percent at consistent translation rates). Translation rates did not have a significant impact on the overall sales increase of 30 percent. Year-to-date sales increased 17 percent in the Americas, 22 percent in Europe and 59 percent in Asia Pacific (51 percent at consistent translation rates). The overall year-to-date growth rate of 25 percent included 2 percentage points from translation.

Gross profit margin, expressed as a percentage of sales, was 53 percent for the quarter and 53 1/2 percent year-to-date, up from 49 1/2 percent and 48 percent, for the comparable periods last year, respectively. Higher production volume in 2010 was the major factor in the improvement in both the quarter and year-to-date rates. Costs related to workforce reductions lowered the 2009 first-half gross margin rate and the favorable effects of currency translation contributed to the increase in the 2010 year-to-date rate. Selling price increases, lower material and pension costs, and divisional mix also contributed to the increase in margin rates.

Total operating expenses were up $7 million year-to-date. Improved results drove the increase, mainly from higher incentives expense, partially offset by lower pension expense.

The year-to-date effective income tax rate of 35 percent for 2010 was higher than the 32 percent rate for the comparable period of 2009. The federal R&D credit has not been renewed for 2010, so no credit is included in the 2010 rate.

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Segment Results

Certain measurements of segment operations compared to last year are summarized below:

Industrial

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 25, 2010	June 26, 2009	June 25, 2010	June 26, 2009
Net sales (in millions)				
Americas	$ 45.5	$ 35.5	$ 87.4	$ 71.3
Europe	27.1	19.8	55.0	43.7
Asia Pacific	27.9	18.0	54.9	33.6
Total	$ 100.5	$ 73.3	$ 197.3	$ 148.6
Operating earnings as a percentage of net sales	29 %	18 %	30 %	17 %

The Industrial segment had strong sales increases in all regions. For the quarter, sales increased 28 percent in the Americas, 37 percent in Europe (43 percent at consistent translation rates) and 54 percent in Asia Pacific (50 percent at consistent translation rates). Year-to-date sales increased 23 percent in the Americas, 26 percent in Europe and 63 percent in Asia Pacific (57 percent at consistent translation rates).

Higher volume and lower costs and expenses (from actions taken in 2009 and 2008), along with price increases, contributed to the improvement in operating earnings as a percentage of sales.

Contractor

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 25, 2010	June 26, 2009	June 25, 2010	June 26, 2009
Net sales (in millions)				
Americas	$ 51.6	$ 41.0	$ 83.5	$ 72.8
Europe	15.2	14.0	27.8	24.8
Asia Pacific	7.0	5.4	13.3	10.2
Total	$ 73.8	$ 60.4	$ 124.6	$ 107.8
Operating earnings as a percentage of net sales	18 %	20 %	15 %	12 %

For the quarter, Contractor segment sales increased 26 percent in the Americas, 10 percent in Europe (15 percent at consistent translation rates) and 29 percent in Asia Pacific (22 percent at consistent translation rates). Year-to-date sales increased 15 percent in the Americas, 12 percent in Europe and 29 percent in Asia Pacific (21 percent at consistent translation rates).

Stocking shipments of new products contributed to strong second quarter sales, but costs and expenses related to the new product introduction resulted in a small decrease in operating earnings as a percentage of sales.

Lubrication

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 25, 2010	June 26, 2009	June 25, 2010	June 26, 2009
Net sales (in millions)				
Americas	$ 13.2	$ 11.8	$ 26.0	$ 24.4
Europe	1.5	0.8	2.9	1.9
Asia Pacific	3.1	1.4	6.0	2.9
Total	$ 17.8	$ 14.0	$ 34.9	$ 29.2
Operating earnings as a percentage of net sales	10 %	(12)%	10 %	(11)%

For the quarter, Lubrication segment sales increased 12 percent in the Americas. From small bases, sales approximately doubled in Europe and Asia Pacific. Year-to-date, sales increased 7 percent in the Americas, 55 percent in Europe and 108 percent in Asia Pacific.

Higher volume and lower costs and expenses (from actions taken in 2009 and 2008) contributed to the improvement in operating earnings as a percentage of sales.

Liquidity and Capital Resources

In the first half of 2010, the Company used cash to reduce borrowings under its long-term line of credit by $6 million and paid dividends of $24 million. The Company also purchased $10 million of its common stock, of which $6 1/2 million settled in the third quarter and is included in trade accounts payable as of June 25, 2010. Significant uses of cash in the first half of 2009 included $36 million for reduction of borrowings under the long-term line of credit and $23 million for payment of dividends.

Since the end of 2009, inventories increased by $18 million to meet higher demand. Accounts receivable increased by $37 million due to higher sales levels.

At June 25, 2010, the Company had various lines of credit totaling $269 million, of which $178 million was unused. Internally generated funds and unused financing sources are expected to provide the Company with the flexibility to meet its liquidity needs in 2010.

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Outlook

Investments in new product development, international sales people and global distribution channel are paying off in the form of improved results. While second quarter is generally the strongest quarter for the Contractor business, management expects modest improvement in end markets in the Americas and Europe over the last half of 2010, and anticipates that activity in Asia Pacific will remain strong.

SAFE HARBOR CAUTIONARY STATEMENT

A forward-looking statement is any statement made in this report and other reports that the Company files periodically with the Securities and Exchange Commission, or in press or earnings releases, analyst briefings and conference calls, which reflects the Company s current thinking on market trends and the Company s future financial performance at the time they are made. All forecasts and projections are forward-looking statements.

The Company desires to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 by making cautionary statements concerning any forward-looking statements made by or on behalf of the Company. The Company cannot give any assurance that the results forecasted in any forward-looking statement will actually be achieved. 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: economic conditions in the United States and other major world economies, currency fluctuations, political instability, changes in laws and regulations, and changes in product demand. Please refer to Item 1A of, and Exhibit 99 to, the Company s Annual Report on Form 10-K for fiscal year 2009 for a more comprehensive discussion of these and other risk factors.

Investors should realize that factors other than those identified above and in Item 1A and Exhibit 99 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 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes related to market risk from the disclosures made in the Company s 2009 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

As of the end of the fiscal quarter covered by this report, the Company carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures. This evaluation was done under the supervision and with the participation of the Company s President and Chief Executive Officer, the Chief Financial Officer and Treasurer, the Vice President and Controller, and the Vice President, General Counsel and Secretary. Based upon that evaluation, they concluded that the Company s disclosure controls and procedures are effective in gathering, analyzing and disclosing information needed to satisfy the Company s disclosure obligations under the Exchange Act.

Changes in internal controls

During the quarter, there was no change in the Company s internal control over financial reporting that has materially affected or is reasonably likely to materially affect the Company s internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes to the Company s risk factors from those disclosed in the Company s 2009 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

On September 18, 2009, the Board of Directors authorized the Company to purchase up to 6,000,000 shares of its outstanding common stock, primarily through open-market transactions. The authorization expires on September 30, 2012.

In addition to shares purchased under the Board authorizations, the Company purchases shares of common stock held by employees who wish to tender owned shares to satisfy the exercise price or tax withholding on option exercises. 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)
Mar 27, 2010	Apr 23, 2010	-	$ -	-	6,000,000
Apr 24, 2010	May 21, 2010	13,891	$ 32.80	10,000	5,990,000
May 22, 2010	Jun 25, 2010	313,589	$ 29.73	313,589	5,676,411

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Item 6. Exhibits

10.1	Executive Officer Stock Holding Policy adopted by the Graco Inc. Board of Directors on April 23, 2010.
31.1	Certification of President and Chief Executive Officer pursuant to Rule 13a-14(a).
31.2	Certification of Chief Financial Officer and Treasurer pursuant to rule 13a-14(a).
32	Certification of President and Chief Executive Officer and Chief Financial Officer and Treasurer pursuant to Section 1350 of Title 18, U.S.C.
99.1	Press Release, Reporting Second Quarter Earnings, dated July 21, 2010.
101	Interactive Data File.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GRACO INC.

Date: July 21, 2010	By:	/s/ Patrick J. McHale
		Patrick J. McHale President and Chief Executive Officer *(Principal Executive Officer)*
Date: July 21, 2010	By:	/s/ James A. Graner
		James A. Graner Chief Financial Officer and Treasurer *(Principal Financial Officer)*
Date: July 21, 2010	By:	/s/ Caroline M. Chambers
		Caroline M. Chambers Vice President and Controller *(Principal Accounting Officer)*