

GRACO INC
Form 10-Q/A
December 22, 2009

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

FORM 10-Q/A
Amendment No. 2

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

For the quarterly period ended September 25, 2009

Commission File Number: 001-09249

GRACO INC.

(Exact name of registrant as specified in its charter)

Minnesota
(State of incorporation)

41-0285640
(I.R.S. Employer Identification Number)

88 - 11th Avenue N.E.
Minneapolis, Minnesota
(Address of principal executive offices)

55413
(Zip Code)

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

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 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

59,972,000 shares of the Registrant's Common Stock, \$1.00 par value, were outstanding as of October 15, 2009.

Explanatory Note

The sole purpose of this Amendment No. 2 to our Quarterly Report on Form 10-Q for the period ended September 25, 2009, as originally filed with the Securities and Exchange Commission on October 21, 2009, is to include the certifications required under Rule 13a-14(a) and Section 1350 currently dated and signed by our principal executive officer and principal financial officer.

No other changes have been made to the Form 10-Q other than those described above. This Amendment No. 2 does not reflect subsequent events occurring after the original filing date of the Form 10-Q or modify or update in any way disclosures made in the Form 10-Q.

GRACO INC. AND SUBSIDIARIES

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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		Thirty-nine Weeks Ended	
	Sep 25, 2009	Sep 26, 2008	Sep 25, 2009	Sep 26, 2008
Net Sales	\$ 147,308	\$ 207,231	\$ 432,900	\$ 650,581
Cost of products sold	69,167	97,071	217,423	299,805
Gross Profit	78,141	110,160	215,477	350,776
Product development	8,752	9,626	28,584	26,605
Selling, marketing and distribution	26,589	32,420	86,814	102,083
General and administrative	16,613	15,585	49,317	50,142
Operating Earnings	26,187	52,529	50,762	171,946
Interest expense	1,148	1,934	3,735	5,443
Other expense, net	203	623	889	606
Earnings Before Income Taxes	24,836	49,972	46,138	165,897
Income taxes	7,500	17,200	14,400	55,100
Net Earnings	\$ 17,336	\$ 32,772	\$ 31,738	\$ 110,797
Basic Net Earnings per Common Share	\$ 0.29	\$ 0.55	\$ 0.53	\$ 1.83
Diluted Net Earnings per Common Share	\$ 0.29	\$ 0.54	\$ 0.53	\$ 1.81
Cash Dividends Declared per Common Share	\$ 0.19	\$ 0.19	\$ 0.57	\$ 0.55

See notes to consolidated financial statements.

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

	Sep 25, 2009	Dec 26, 2008
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 5,064	\$ 12,119
Accounts receivable, less allowances of \$6,400 and \$6,600	106,890	127,505
Inventories	60,581	91,604
Deferred income taxes	19,982	23,007
Other current assets	4,532	6,360
Total current assets	197,049	260,595
Property, Plant and Equipment		
Cost	333,792	326,729
Accumulated depreciation	(191,167)	(176,975)
Property, plant and equipment, net	142,625	149,754
Goodwill	91,740	91,740
Other Intangible Assets, net	43,010	52,231
Deferred Income Taxes	14,425	18,919
Other Assets	8,223	6,611
Total Assets	\$ 497,072	\$ 579,850
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Notes payable to banks	\$ 13,866	\$ 18,311
Trade accounts payable	16,663	18,834
Salaries, wages and commissions	13,477	17,179
Dividends payable	11,398	11,312
Other current liabilities	50,070	55,524
Total current liabilities	105,474	121,160
Long-term Debt	107,364	180,000
Retirement Benefits and Deferred Compensation	97,077	108,656
Uncertain Tax Positions	2,800	2,400
Shareholders' Equity		
Common stock	59,965	59,516
Additional paid-in-capital	187,846	174,161

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Retained earnings	5,900	8,445
Accumulated other comprehensive income (loss)	(69,354)	(74,488)
Total shareholder's equity	184,357	167,634
Total Liabilities and Shareholders' Equity	\$ 497,072	\$ 579,850

See notes to consolidated financial statements.

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

	Thirty-nine Weeks Ended	
	Sep 25, 2009	Sep 26, 2008
Cash Flows From Operating Activities		
Net Earnings	\$ 31,738	\$ 110,797
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation, amortization and impairment	26,200	23,310
Deferred income taxes	4,671	(3,850)
Share-based compensation	7,441	7,072
Excess tax benefit related to share-based payment arrangements	(300)	(2,923)
Change in		
Accounts receivable	22,434	(4,989)
Inventories	30,745	(16,466)
Trade accounts payable	(2,050)	(775)
Salaries, wages and commissions	(3,853)	(1,236)
Retirement benefits and deferred compensation	(4,741)	(2,141)
Other accrued liabilities	(2,437)	788
Other	313	1,114
Net cash provided by operating activities	110,161	110,701
Cash Flows From Investing Activities		
Property, plant and equipment additions	(9,375)	(20,778)
Proceeds from sale of property, plant and equipment	615	1,633
Investment in life insurance	(1,499)	(1,499)
Capitalized software and other intangible asset additions	(501)	(1,130)
Acquisitions of businesses, net of cash acquired	-	(39,780)
Net cash used in investing activities	(10,760)	(61,554)
Cash Flows From Financing Activities		
Net borrowings (payments) on short-term lines of credit	(4,700)	(2,779)

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Borrowings on long-term line of credit	75,491	188,869
Payments on long-term line of credit	(148,127)	(104,074)
Excess tax benefit related to share-based payment arrangements	300	2,923
Common stock issued	6,119	13,528
Common stock retired	(157)	(114,341)
Cash dividends paid	(34,069)	(33,693)
Net cash provided by (used in) financing activities	(105,143)	(49,567)
Effect of exchange rate changes on cash	(1,313)	748
Net increase (decrease) in cash and cash equivalents	(7,055)	328
Cash and cash equivalents		
Beginning of year	12,119	4,922
End of period	\$ 5,064	\$ 5,250

See notes to consolidated financial statements.

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

1. The consolidated balance sheet of Graco Inc. and Subsidiaries (the Company) as of September 25, 2009 and the related statements of earnings for the thirteen and thirty-nine weeks ended September 25, 2009 and September 26, 2008, and cash flows for the thirty-nine weeks ended September 25, 2009 and September 26, 2008 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 September 25, 2009, 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 2008 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		Thirty-nine Weeks Ended	
	Sep 25, 2009	Sep 26, 2008	Sep 25, 2009	Sep 26, 2008
Net earnings available to common shareholders	\$ 17,336	\$ 32,772	\$ 31,738	\$ 110,797

Weighted average shares outstanding for basic earnings per share	59,940	59,769	59,827	60,521
Dilutive effect of stock options computed using the treasury stock method and the average market price	374	596	306	647
Weighted average shares outstanding for diluted earnings per share	60,314	60,365	60,133	61,168
Basic earnings per share	\$ 0.29	\$ 0.55	\$ 0.53	\$ 1.83
Diluted earnings per share	\$ 0.29	\$ 0.54	\$ 0.53	\$ 1.81

Stock options to purchase 2,834,000 and 2,114,000 shares were not included in the 2009 and 2008 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 thirty-nine weeks ended September 25, 2009 is shown below (in thousands, except per share amounts):

	Option Shares	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
Outstanding, December 26, 2008	3,955	\$ 30.77	2,186	\$ 24.98
Granted	1,180	20.74		
Exercised	(131)	10.41		
Canceled	(127)	31.69		
Outstanding, September 25, 2009	4,877	\$ 28.87	2,465	\$ 28.16

The aggregate intrinsic value of exercisable option shares was \$12.2 million as of September 25, 2009, with a weighted average contractual term of 4.4 years. There were approximately 4.8 million share options vested and expected to vest as of September 25, 2009, with an aggregate intrinsic value of \$20.9 million, a weighted average exercise price of \$28.87 and a weighted average contractual term of 6.5 years.

Information related to options exercised in the first nine months of 2009 and 2008 follows (in thousands):

	Thirty-nine Weeks Ended	
	Sep 25, 2009	Sep 26, 2008
Cash received	\$ 1,363	\$ 6,864
Aggregate intrinsic value	1,595	8,645
Tax benefit realized	600	3,100

The Company recognized year-to-date share-based compensation of \$7.7 million in 2009 and \$7.1 million in 2008. As of September 25, 2009, there was \$8.2 million of unrecognized compensation cost related to unvested options, expected to be recognized over a weighted average period of 2.6 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:

	Thirty-nine Weeks Ended			
	Sep 25, 2009		Sep 26, 2008	
Expected life in years	6.0		6.0	
Interest rate	2.1	%	3.2	%
Volatility	30.1	%	25.0	%
Dividend yield	3.7	%	2.1	%
Weighted average fair value per share	\$	4.27	\$	8.43

Under the Company's Employee Stock Purchase Plan, the Company issued 312,000 shares in 2009 and 216,000 shares in 2008. 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:

	Thirty-nine Weeks Ended			
	Sep 25, 2009		Sep 26, 2008	
Expected life in years	1.0		1.0	
Interest rate	0.7	%	1.5	%
Volatility	51.5	%	27.1	%
Dividend yield	4.5	%	2.1	%
Weighted average fair value per share	\$	5.60	\$	8.14

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

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 25, 2009	Sep 26, 2008	Sep 25, 2009	Sep 26, 2008
Pension Benefits				
Service cost	\$ 1,078	\$ 920	\$ 3,498	\$ 3,724
Interest cost	2,926	2,896	9,261	9,186
Expected return on assets	(2,593)	(4,536)	(8,143)	(14,236)
Amortization and other	2,034	233	6,761	528
Net periodic benefit cost (credit)	\$ 3,445	\$ (487)	\$ 11,377	\$ (798)

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Postretirement Medical				
Service cost	\$ 174	\$ 168	\$ 424	\$ 418
Interest cost	335	286	985	1,036
Amortization	(45)	(13)	(45)	(13)
Net periodic benefit cost (credit)	\$ 464	\$ 441	\$ 1,364	\$ 1,441

In the third quarter of 2009, the Company made a voluntary \$15 million tax-deductible contribution to its funded defined benefit pension plan.

The Company paid \$1.5 million in June 2009 and \$1.5 million in June 2008 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 \$4.3 million and \$2.7 million is included in other assets in the consolidated balance sheet as of September 25, 2009 and December 28, 2008, respectively.

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

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 25, 2009	Sep 26, 2008	Sep 25, 2009	Sep 26, 2008
Net earnings	\$ 17,336	\$ 32,772	\$ 31,738	\$ 110,797
Cumulative translation adjustment	-	(346)	234	(377)
Pension and postretirement medical liability adjustment	2,432	164	7,183	353
Gain (loss) on interest rate hedge contracts	303	(211)	594	(634)
Income taxes	(1,011)	23	(2,877)	107
Comprehensive income	\$ 19,060	\$ 32,402	\$ 36,872	\$ 110,246

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

	Sep 25, 2009	Dec 26, 2008
Pension and postretirement medical liability adjustment	\$ (65,796)	\$ (70,322)
Gain (loss) on interest rate hedge contracts	(2,735)	(3,109)
Cumulative translation adjustment	(823)	(1,057)
Total	\$ (69,354)	\$ (74,488)

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 thirty-nine weeks ended September 25, 2009 and September 26, 2008 were as follows (in thousands):

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	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 25, 2009	Sep 26, 2008	Sep 25, 2009	Sep 26, 2008
Net Sales				
Industrial	\$ 78,242	\$ 117,685	\$ 226,808	\$ 365,028
Contractor	55,379	67,751	163,213	215,992
Lubrication	13,687	21,795	42,879	69,561
Consolidated	\$ 147,308	\$ 207,231	\$ 432,900	\$ 650,581
Operating Earnings				
Industrial	\$ 20,332	\$ 35,874	\$ 45,262	\$ 117,847
Contractor	11,138	15,226	24,420	49,663
Lubrication	(167)	3,409	(3,348)	12,333
Unallocated corporate (expense)	(5,116)	(1,980)	(15,572)	(7,897)
Consolidated	\$ 26,187	\$ 52,529	\$ 50,762	\$ 171,946

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

	Sep 25, 2009	Dec 26, 2008
Finished products and components	\$ 38,209	\$ 50,703
Products and components in various stages of completion	24,359	24,938
Raw materials and purchased components	30,952	51,348
	93,520	126,989
Reduction to LIFO cost	(32,939)	(35,385)
Total	\$ 60,581	\$ 91,604

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

	Estimated Life (years)	Original Cost	Accumulated Amortization	Foreign Currency Translation	Book Value
September 25, 2009					
Customer relationships	3 - 8	\$ 41,075	\$ (17,109)	\$ (181)	\$ 23,785
Patents, proprietary technology and product documentation	3 - 15	22,737	(12,899)	(87)	9,751
Trademarks, trade names and other	3 - 10	6,554	(1,860)	-	4,694
		70,366	(31,868)	(268)	38,230
Not Subject to Amortization:					
Brand names		4,780	-	-	4,780
Total		\$ 75,146	\$ (31,868)	\$ (268)	\$ 43,010

December 26, 2008
Customer relationships

3 - 8 \$