

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **2001-08-03** | Period of Report: **2001-06-29**
SEC Accession No. **0000042888-01-500021**

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FILER

GRACO INC

CIK: **42888** | IRS No.: **410285640** | State of Incorporation: **MN** | Fiscal Year End: **1225**
Type: **10-Q** | Act: **34** | File No.: **001-09249** | Film No.: **1696838**
SIC: **3561** Pumps & pumping equipment

Mailing Address	Business Address
<i>C/O CT CORPORATION SYSTEMS INC 405 SECOND AVENUE SOUTH MINNEAPOLIS MN 55401</i>	<i>88 11TH AVENUE NE MINNEAPOLIS MN 55413-1894 6126236000</i>

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 29, 2001

Commission File Number: 001-9249

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

31,109,237 common shares were outstanding as of July 27, 2001.

GRACO INC. AND SUBSIDIARIES

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Letter Agreement with President and Chief Executive Officer, dated June 5, 2001	Exhibit 10.2
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Key Employee Agreement between the Company and one executive officer, dated June 25, 2001	Exhibit 10.4
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Stock Option Agreement. Form of agreement used for award of non-incentive stock options to one executive officer, dated June 25, 2001	Exhibit 10.5
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PART I

Item I. GRACO INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands except per share amounts)

(Unaudited)

<TABLE>

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 29, 2001	June 30, 2000	June 29, 2001	June 30, 2000
<S>	<C>	<C>	<C>	<C>

Net Sales	\$130,873	\$132,768	\$240,687	\$254,995
Cost of products sold	66,620	66,666	121,296	126,764
Gross Profit	64,253	66,102	119,391	128,231
Product development	5,711	4,896	11,998	9,920
Selling, marketing and distribution	20,441	22,360	41,113	46,174
General and administrative	9,597	8,810	17,293	17,454
Operating Earnings	28,504	30,036	48,987	54,683
Interest expense	355	1,302	805	2,537
Other expense	601	803	814	1,240
Earnings Before Income Taxes	27,548	27,931	47,368	50,906
Income taxes	9,300	9,600	16,000	17,600
Net Earnings	\$ 18,248	\$ 18,331	\$ 31,368	\$ 33,306
Basic Net Earnings Per Common Share	\$.59	\$.60	\$ 1.02	\$ 1.09
Diluted Net Earnings Per Common Share	\$.58	\$.59	\$ 1.00	\$ 1.08

</TABLE>

See notes to consolidated financial statements.

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

(Unaudited)

<TABLE>

	June 29, 2001	Dec. 29, 2000
	-----	-----
ASSETS		
<S>	<C>	<C>
Current Assets:		
Cash and cash equivalents	\$ 7,215	\$ 11,071
Accounts receivable, less allowances of \$4,900 and \$4,700	89,555	85,836
Inventories	37,568	33,079
Deferred income taxes	11,286	11,574
Other current assets	2,725	2,182
	-----	-----

Total current assets	148,349	143,742
Property, Plant and Equipment:		
Cost	196,546	186,872
Accumulated depreciation	(107,403)	(102,883)
	-----	-----
	89,143	83,989
Other Assets	20,995	10,245
	-----	-----
	\$258,487	\$237,976
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Notes payable to banks	\$ 11,890	\$ 15,713
Current portion of long-term debt	1,050	1,310
Trade accounts payable	13,847	12,899
Salaries, wages and commissions	8,715	14,532
Accrued insurance liabilities	11,466	10,622
Income taxes payable	7,505	4,642
Other current liabilities	21,814	22,123
	-----	-----
Total current liabilities	76,287	81,841
Long-term Debt, less current portion	11,500	18,050
Retirement Benefits and Deferred Compensation	27,160	27,230
Shareholders' Equity:		
Common stock	31,087	20,274
Additional paid-in capital	50,087	39,954
Retained earnings	63,386	50,233
Other, net	(1,020)	394
	-----	-----
Total shareholders' equity	143,540	110,855
	-----	-----
	\$258,487	\$237,976
	=====	=====

</TABLE>

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

<TABLE>

Twenty-six Weeks

June 29, 2001 June 30, 2000

Cash Flows from Operating Activities:		
<S>	<C>	<C>
Net Earnings	\$31,368	\$33,306
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	8,946	7,996
Deferred income taxes	123	(23)
Loss on sale of fixed assets	148	116
Change in:		
Accounts receivable	(2,520)	(7,014)
Inventories	(2,013)	697
Trade accounts payable	732	(2,197)
Salaries, wages and commissions	(5,716)	(1,538)
Retirement benefits and deferred compensation	(1,040)	(2,035)
Other accrued liabilities	2,421	674
Other	(1,064)	(667)
	-----	-----
	31,385	29,315
	-----	-----
Cash Flows from Investing Activities:		
Property, plant and equipment additions	(12,084)	(5,932)
Proceeds from sale of property, plant and equipment	105	78
Acquisition of business, net of cash acquired	(15,949)	-
	-----	-----
	(27,928)	(5,854)
	-----	-----
Cash Flows from (for) Financing Activities:		
Borrowings on notes payable and lines of credit	106,130	109,026
Payments on notes payable and lines of credit	(109,598)	(110,496)
Borrowings on long-term debt	21,000	24,090
Payments on long-term debt	(27,810)	(31,715)
Common stock issued	10,951	6,949
Retirement of common stock	(2,025)	(18,966)
Cash dividends paid	(6,123)	(5,703)
	-----	-----
	(7,475)	(26,815)
Effect of exchange rate changes on cash	162	1,133
	-----	-----
Net increase (decrease) in cash and cash equivalents	(3,856)	(2,221)
Cash and cash equivalents:		
Beginning of year	11,071	6,588
	-----	-----
End of Period	\$ 7,215	\$ 4,367
	=====	=====

</TABLE>

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 June 29, 2001, and the related statements of earnings for the thirteen and twenty-six weeks ended June 29, 2001 and June 30, 2000,

and cash flows for the twenty-six weeks ended June 29, 2001 and June 30, 2000 have been prepared by the Company without being audited.

In the opinion of management, these consolidated 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 29, 2001, 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 2000 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. Major components of inventories were as follows (in thousands):

	June 29, 2001	Dec. 29, 2000
	-----	-----
Finished products and components	\$27,053	\$26,812
Products and components in various stages of completion	21,508	20,153
Raw materials and purchased components	21,837	19,259
	-----	-----
	70,398	66,224
Reduction to LIFO cost	(32,830)	(33,145)
	-----	-----
	\$37,568	\$33,079
	=====	=====

GRACO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. Other assets consist of the following (in thousands):

	June 29, 2001	Dec. 29, 2000
	-----	-----
Identifiable intangibles, net of accumulated amortization of \$3,828 and \$2,761	\$ 7,609	\$ 5,576
Goodwill, net of accumulated amortization of \$278 and \$67	7,993	52
Prepaid pension	4,541	2,976
Other	852	1,641
	-----	-----
	\$20,995	\$10,245
	=====	=====

4. The Company has three reportable segments; Industrial/Automotive, Contractor and Lubrication. The Company does not identify assets by segment. Sales and operating profit by segment for the thirteen and

twenty-six weeks ended June 29, 2001 and June 30, 2000 were as follows (in thousands):

<TABLE>

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 29, 2001	June 30, 2000	June 29, 2001	June 30, 2000
Net Sales				
<S>	<C>	<C>	<C>	<C>
Industrial/Automotive	\$ 51,449	\$ 55,715	\$ 99,098	\$112,545
Contractor	66,776	66,036	116,677	120,518
Lubrication	12,648	11,017	24,912	21,932
	-----	-----	-----	-----
Consolidated	\$130,873	\$132,768	\$240,687	\$254,995
	=====	=====	=====	=====
Operating Earnings				
Industrial/Automotive	\$ 12,114	\$ 13,760	\$ 21,507	\$ 26,267
Contractor	15,537	14,966	24,157	25,452
Lubrication	3,072	2,409	6,028	4,725
Unallocated Corporate expenses	(2,219)	(1,099)	(2,705)	(1,761)
	-----	-----	-----	-----
Consolidated Operating Earnings	\$ 28,504	\$ 30,036	\$ 48,987	\$ 54,683
	=====	=====	=====	=====

</TABLE>

GRACO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

- There have been no significant changes to the components of comprehensive income from those noted on the 2000 Form 10-K. Total comprehensive income in 2001 was \$17.6 million in the second quarter and \$30.0 million year-to-date. In 2000, comprehensive income was \$18.4 million for the second quarter and \$32.6 million for the six-month period.
- The adoption of Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities" on December 30, 2000, resulted in no transition adjustment. See Note A to financial statements included in the Company's 2000 Form 10-K for a description of the Company's use of derivative instruments and hedging activities.
- On March 19, 2001, the Company purchased ASM Company, Inc. ("ASM") for \$16 million cash. ASM manufactures and markets spray tips, guns, poles and other accessories for the professional painter, and had sales of approximately \$11 million in 2000.

The Company used the purchase method to account for the acquisition. Based on the results of an independent appraisal, the purchase price was allocated to net tangible assets of \$5 million (net of assumed liabilities totaling \$2 million), identifiable intangible assets of \$3 million and

goodwill of \$8 million. Identifiable intangible assets include patents, proprietary technologies, trade names, trademarks, customer list and a non-compete agreement. Intangibles and goodwill are being amortized on a straight-line basis over useful lives ranging from 2 to 10 years.

8. On July 20, 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Goodwill and Other Intangible Assets", which will be effective for the Company in fiscal year 2002. The Company has not yet determined the impact of SFAS 142 on its financial position and results of operations.

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

Results of Operations

For the quarter, lower sales and reduced expenses resulted in net earnings very close to last year's amount. For the six-month period, net earnings were 6 percent lower on a 6 percent decrease in sales. During the first half of 2001 sales were lower than the same period last year due to reduced demand resulting from economic weakness and the adverse impacts of foreign currency exchange rates.

The following table sets forth items from the Company's Consolidated Statements of Earnings as percentages of net sales:

<TABLE>

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 29, 2001	June 30, 2000	June 29, 2001	June 30, 2000
<S>	<C>	<C>	<C>	<C>
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	50.9	50.2	50.4	49.7
Product development	4.4	3.7	5.0	3.9
Selling, marketing and distribution	15.6	16.9	17.1	18.1
General and administrative	7.3	6.6	7.2	6.8
Operating Earnings	21.8	22.6	20.3	21.5
Interest expense	0.3	1.0	0.3	1.0
Other (income) expense, net	0.5	0.6	0.3	0.5
Earnings Before Income Taxes	21.0	21.0	19.7	20.0
Income taxes	7.1	7.2	6.7	6.9
Net Earnings	13.9%	13.8%	13.0%	13.1%

</TABLE>

Net Sales

Weak economic conditions in North America led to reduced demand and lower sales in the Industrial / Automotive segment during the first half of 2001. In the Contractor segment, a second quarter increase in the paint store channel more than offset a decrease in home center channel sales, which included more initial stocking orders in 2000. Sales in the Lubrication segment exceeded 2000 sales for both the three-month and six-month periods due mostly to large sales to key customers and increased market share. Price increases have not had a significant impact on sales during the first half of 2001.

Sales by geographic area were as follows:

<TABLE>

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 29, 2001	June 30, 2000	June 29, 2001	June 30, 2000
<S>	<C>	<C>	<C>	<C>
Americas	\$ 97,095	\$ 98,749	\$ 76,088	\$189,042
Europe	20,857	21,432	41,579	42,996
Asia Pacific	12,921	12,587	23,020	22,957
Consolidated	\$130,873	\$132,768	\$240,687	\$254,995

</TABLE>

Changes in foreign exchange rates have adversely impacted sales in 2001. Translated at consistent exchange rates, sales would have been about 2 percent higher for the both the quarter and year-to-date. For the six-month period, Europe would have shown a 3 percent increase in sales compared to last year and Asia Pacific region would have shown a 7 percent increase over prior year sales.

Gross Profit

Gross profit as a percentage of quarterly net sales dropped to 49.1 percent from 49.8 percent. For the six-month period, gross profit percentage decreased to 49.6 percent from 50.3 percent. The decrease was due mostly to the negative impact of changes in exchange rates.

Operating Expenses

Total operating expenses for the quarter and year-to-date were lower than last year. Product development expenses were up due to spending for significant new product launches in the first part of the year. The Company has taken actions to reduce the running rate of product development expense. Selling, marketing and distribution expenses were down from prior year due in part to lower sales-based incentives. In addition, the first half of last year included costs related to the launch of Contractor products in the home center channel. General and administrative expenses are up due mostly to the acquisition of ASM.

Interest Expense and Other Expense

Interest expense decreased due to reduced debt levels.

Liquidity and Capital Resources

The Company generated \$31 million of cash flow from operating activities in the first six months of 2001, compared to \$29 million for the same period last year. Significant uses of cash in 2001 include the construction of expanded manufacturing, warehouse and office facilities in Minneapolis and the acquisition of ASM.

The Company plans to move ASM operations from their current location in California to expanded facilities in Sioux Falls, South Dakota. Estimated incremental costs associated with the move, that would not benefit continuing activities, were recognized as liabilities assumed in the acquisition and included in the allocation of acquisition cost. Additional costs associated with the move, that will benefit continuing operations, will be expensed as incurred.

The Company also plans to restructure the operations of its German subsidiary, Graco Verfahrenstechnik (GV), including termination of approximately 50 employees, consolidation of product lines, termination of leases, and relocation of operations to other Company facilities in Belgium and the U.S. No expense has been recognized in connection with this plan because the amount of benefits to be paid to terminating employees has not been established.

The Company estimates the costs of relocating ASM and GV will total approximately \$4 million, of which \$1.5 million will be a restructuring charge in the third quarter, with the remainder charged to operations as incurred over the next twelve months. These moves are expected to enhance operating profit beginning in the second half of 2002.

The Company had unused lines of credit available at June 29, 2001 totaling \$67 million. The available credit facilities and internally generated funds provide the Company with the financial flexibility to meet liquidity needs.

Outlook

The Company is concerned about the weak North American economy and an economic slowdown in Europe. While internal sales growth will be challenged in difficult economic conditions, the Company remains committed to maintaining a high level of profitability through efficient manufacturing processes and cost containment.

SAFE HARBOR CAUTIONARY STATEMENT

The information in this 10-Q contains "forward-looking statements" about the Company's expectations of the future, which are subject to certain risk factors that could cause actual results to differ materially from those expectations. These factors include economic conditions in the United States and other major world economies, currency exchange fluctuations and additional factors identified in Exhibit 99 to the Company's Report on Form 10-K for fiscal year 2000.

PART II

Item 4. Submission of Matters to a Vote of Security Holders

At the Annual Meeting of Shareholders held on May 1, 2001, William G. Van Dyke, Mark H. Rauenhorst and J. Kevin Gilligan were elected to the Office of Director with the following votes:

	FOR	WITHHELD
William G. Van Dyke	27,817,805	457,062

Mark H. Rauenhurst	27,807,475	467,392
J. Kevin Gilligan	27,805,087	469,778

At the same meeting, the following matters were also voted upon with the votes as indicated:

The adoption of the Graco Inc. Stock Incentive Plan was approved, with the following votes:

FOR ---	AGAINST -----	ABSTENTIONS -----	BROKER NON-VOTE -----
19,118,308	9,007,784	142,025	6,750

The selection of Deloitte & Touche LLP as independent auditors for the current year was approved and ratified, with the following votes:

FOR ---	AGAINST -----	ABSTENTIONS -----	BROKER NON-VOTE -----
27,844,282	354,013	76,572	0

No other matters were voted on at the meeting.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit Number -----	Description -----
10.1	Graco Inc. Stock Incentive Plan, dated May 1, 2001
10.2	Letter Agreement with President and Chief Executive Officer, dated June 5, 2001
10.3	Executive Long Term Incentive Agreement. Form of agreement used for award of restricted stock to one executive officer, dated June 25, 2001
10.4	Key Employee Agreement between the Company and one executive officer, dated June 25, 2001
10.5	Stock Option Agreement. Form of agreement used for award of non-incentive stock options to one executive officer, dated June 25, 2001
11	Computation of Net Earnings per Common Share

(b) No reports on Form 8-K have been filed during the quarter for which this report is filed.

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 31, 2001

By: /s/David A. Roberts

David A. Roberts
Chief Executive Officer

Date: July 31, 2001

By: /s/James A. Graner

James A. Graner
Vice President & Controller
("duly authorized officer")

GRACO INC.
STOCK INCENTIVE PLAN

Section 1. Purpose; Effect on Prior Plans.

(a) Purpose. The purpose of the Plan is to promote the interests of the Company and its shareholders by aiding the Company in attracting and retaining employees, officers and non-employee Directors capable of assuring the future success of the Company, to offer such persons incentives to put forth maximum efforts for the success of the Company's business and to provide such persons with opportunities for stock ownership in the Company, thereby aligning the interests of such persons with the Company's shareholders.

(b) Effect on Prior Plans. After the date of shareholder approval of this Plan, no awards shall be granted under the Company's Long-Term Stock Incentive Plan or the Company's Non-Employee Directors Stock Option Plan, but all outstanding awards granted under either of those two plans prior to or on the date of shareholder approval of this Plan shall remain outstanding in accordance with the terms thereof. The Company's Employee Stock Incentive Plan shall remain in effect, and awards will continue to be granted under that plan.

Section 2. Definitions.

As used in the Plan, the following terms shall have the meanings set forth below:

(a) "Affiliate" shall mean (i) any entity that, directly or indirectly through one or more intermediaries, is controlled by the Company and (ii) any entity in which the Company has a significant equity interest, in each case as determined by the Committee.

(b) "Award" shall mean any Option, Stock Appreciation Right, Restricted Stock, Restricted Stock Unit, Performance Award, Dividend Equivalent or Other Stock-Based Award granted under the Plan.

(c) "Award Agreement" shall mean any written agreement, contract or other instrument or document evidencing an Award granted under the Plan. Each Award Agreement shall be subject to the applicable terms and conditions of the Plan and any other terms and conditions (not inconsistent with the Plan) determined by the Committee.

(d) "Board" shall mean the Board of Directors of the Company.

(e) "Code" shall mean the Internal Revenue Code of 1986, as amended from time to time, and any regulations promulgated thereunder.

(f) "Committee" shall mean a committee of Directors designated by the Board to administer the Plan. The Committee shall be comprised of not less than such number of Directors as shall be required to permit Awards granted under the Plan to qualify under Rule 16b-3, and each member of the Committee shall be a "Non-Employee Director" within the meaning of Rule 16b-3 and an "outside director" within the meaning of Section 162(m) of the Code. The Company expects to have the Plan administered in accordance with requirements for the award of "qualified performance-based compensation" within the meaning of Section 162(m) of the Code.

(g) "Company" shall mean Graco Inc., a Minnesota corporation, and any successor corporation.

(h) "Director" shall mean a member of the Board.

(i) "Dividend Equivalent" shall mean any right granted under Section 6(e) of the Plan.

(j) "Eligible Person" shall mean any employee, officer, consultant, independent contractor or non-employee Director providing services to the Company or any Affiliate whom the Committee determines to be an Eligible Person.

(k) "Exchange Act" shall mean the Securities Exchange Act of 1934, as amended.

(l) "Fair Market Value" shall mean, with respect to any property (including, without limitation, any Shares or other securities), the fair market value of such property determined by such methods or procedures as shall be established from time to time by the Committee. Notwithstanding the foregoing, unless otherwise determined by the Committee, the Fair Market Value of Shares for purposes of the Plan shall be the last sale price of the Shares as reported on the composite tape by the New York Stock Exchange on the date immediately preceding the date as of which fair market value is being determined or, if there were no sales of Shares reported on the composite tape on such date, on the most recent preceding date on which there were sales.

(m) "Incentive Stock Option" shall mean an option granted under Section 6(a) of the Plan that is intended to meet the requirements of Section 422 of the Code or any successor provision.

(n) "Non-Qualified Stock Option" shall mean an option granted under Section 6(a) of the Plan that is not intended to be an Incentive Stock Option.

(o) "Option" shall mean an Incentive Stock Option or a Non-Qualified Stock Option, and shall include Reload Options.

(p) "Other Stock-Based Award" shall mean any right granted under Section 6(f) of the Plan.

(q) "Participant" shall mean an Eligible Person designated to be granted an Award under the Plan.

(r) "Performance Award" shall mean any right granted under Section 6(d) of the Plan.

(s) "Person" shall mean any individual, corporation, partnership, association or trust.

(t) "Plan" shall mean this Graco Inc. Stock Incentive Plan, as amended from time to time.

(u) "Reload Option" shall mean any Option granted under Section 6(a) (iv) of the Plan.

(v) "Restricted Stock" shall mean any Share granted under Section 6(c) of the Plan.

(w) "Restricted Stock Unit" shall mean any unit granted under Section 6(c) of the Plan evidencing the right to receive a Share (or a cash payment equal to the Fair Market Value of a Share) at some future date.

(x) "Rule 16b-3" shall mean Rule 16b-3 promulgated by the Securities and Exchange Commission under the Exchange Act or any successor rule or regulation.

(y) "Shares" shall mean shares of Common Stock, par value \$1.00 per share, of the Company or such other securities or property as may become subject to Awards pursuant to an adjustment made under Section 4(c) of the Plan.

(z) "Stock Appreciation Right" shall mean any right granted under Section 6(b) of the Plan.

Section 3. Administration.

(a) Power and Authority of the Committee. The Plan shall be administered by the Committee. Subject to the express provisions of the Plan and to applicable law, the Committee shall have full power and authority to: (i) designate Participants; (ii) determine the type or types of Awards to be granted to each Participant under the Plan; (iii) determine the number of Shares to be covered by (or the method by which payments or other rights are to be calculated in connection with) each Award; (iv) determine the terms and conditions of any Award or Award Agreement; (v) amend the terms and conditions of any Award or Award Agreement, provided, however, that except as otherwise provided in Section 4(c) hereof, the Committee shall not adjust or amend the exercise price of Options or Stock Appreciation Rights previously awarded to any Participant, whether through amendment, cancellation and replacement grant, or any other means; (vi) accelerate the exercisability of any Award or the lapse of restrictions relating to any Award; (vii) determine whether, to what extent and under what circumstances Awards may be exercised in cash, Shares, promissory notes, other securities, other Awards or other property, or canceled, forfeited or suspended; (viii) determine whether, to what extent and under what

circumstances cash, Shares, promissory notes, other securities, other Awards, other property and other amounts payable with respect to an Award under the Plan shall be deferred either automatically or at the election of the holder thereof or the Committee; (ix) interpret and administer the Plan and any instrument or agreement, including an Award Agreement, relating to the Plan; (x) establish, amend, suspend or waive such rules and regulations and appoint such agents as it shall deem appropriate for the proper administration of the Plan; and (xi) make any other determination and take any other action that the Committee deems necessary or desirable for the administration of the Plan. Unless otherwise expressly provided in the Plan, all designations, determinations, interpretations and other decisions under or with respect to the Plan or any Award shall be within the sole discretion of the Committee, may be made at any time and shall be final, conclusive and binding upon any Participant, any holder or beneficiary of any Award and any employee of the Company or any Affiliate.

(b) Power and Authority of the Board of Directors. Notwithstanding anything to the contrary contained herein, the Board may, at any time and from time to time, without any further action of the Committee, exercise the powers and duties of the Committee under the Plan.

Section 4. Shares Available for Awards.

(a) Shares Available. Subject to adjustment as provided in Section 4(c) of the Plan, the aggregate number of Shares which may be issued under all Awards under the Plan shall be 1,500,000; provided, however, that a maximum of 1,500,000 Shares shall be available for issuance pursuant to Awards of Restricted Stock and Restricted Stock Units. Shares to be issued under the Plan will be authorized but unissued Shares. If any Shares covered by an Award or to which an Award relates are not purchased or are forfeited, or if an Award otherwise terminates without delivery of any Shares, then the number of Shares counted against the aggregate number of Shares available under the Plan with respect to such Award, to the extent of any such forfeiture or termination, shall again be available for granting Awards under the Plan. Notwithstanding the foregoing, the number of Shares available for granting Incentive Stock Options under the Plan shall not exceed 1,500,000, subject to adjustment as provided in the Plan and subject to the provisions of Section 422 or 424 of the Code or any successor provision.

(b) Accounting for Awards. For purposes of this Section 4, if an Award entitles the holder thereof to receive or purchase Shares, the number of Shares covered by such Award or to which such Award relates shall be counted on the date of grant of such Award against the aggregate number of Shares available for granting Awards under the Plan.

(c) Adjustments. In the event that the Committee shall determine that any dividend or other distribution (whether in the form of cash, Shares, other securities or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase or exchange of Shares or other securities of the Company, issuance of warrants or other rights to purchase Shares or other

securities of the Company or other similar corporate transaction or event affects the Shares such that an adjustment is determined by the Committee to be appropriate in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan, then the Committee shall, in such manner as it may deem equitable, adjust any or all of (i) the number and type of Shares (or other securities or other property) that thereafter may be made the subject of Awards, (ii) the number and type of Shares (or other securities or other property) subject to outstanding Awards and (iii) the purchase or exercise price with respect to any Award; provided, however, that the number of Shares covered by any Award or to which such Award relates shall always be a whole number.

(d) Award Limitations Under the Plan. No Eligible Person may be granted any Award or Awards under the Plan, the value of which Award or Awards is based solely on an increase in the value of the Shares after the date of grant of such Award or Awards, for more than 200,000 Shares (subject to adjustment as provided in Section 4(c) of the Plan) in the aggregate in any calendar year. The foregoing annual limitation specifically includes the grant of any Award or Awards representing "qualified performance-based compensation" within the meaning of Section 162(m) of the Code.

Section 5. Eligibility.

Any Eligible Person shall be eligible to be designated a Participant. In determining which Eligible Persons shall receive an Award and the terms of any Award, the Committee may take into account the nature of the services rendered by the respective Eligible Persons, their present and potential contributions to the success of the Company or such other factors as the Committee, in its discretion, shall deem relevant. Notwithstanding the foregoing, an Incentive Stock Option may only be granted to full-time or part-time employees (which term as used herein includes, without limitation, officers and Directors who are also employees), and an Incentive Stock Option shall not be granted to an employee of an Affiliate unless such Affiliate is also a "subsidiary corporation" of the Company within the meaning of Section 424(f) of the Code or any successor provision.

Section 6. Awards.

(a) Options. The Committee is hereby authorized to grant Options to Eligible Persons with the following terms and conditions and with such additional terms and conditions not inconsistent with the provisions of the Plan as the Committee shall determine:

(i) Exercise Price. The purchase price per Share purchasable under an Option shall be determined by the Committee; provided, however, that such purchase price shall not be less than 100% of the Fair Market Value of a Share on the date of grant of such Option.

(ii) Option Term. The term of each Option shall be fixed by

the Committee.

(iii) Time and Method of Exercise. The Committee shall determine the time or times at which an Option may be exercised in whole or in part and the method or methods by which, and the form or forms (including, without limitation, cash, Shares, promissory notes, other securities, other Awards or other property, or any combination thereof, having a Fair Market Value on the exercise date equal to the applicable exercise price) in which, payment of the exercise price with respect thereto may be made or deemed to have been made.

(iv) Reload Options. The Committee may grant Reload Options, separately or together with another Option, pursuant to which, subject to the terms and conditions established by the Committee, the Participant would be granted a new Option when the payment of the exercise price of a previously granted option is made by the delivery of Shares owned by the Participant pursuant to Section 6(a)(iii) hereof or the relevant provisions of another plan of the Company, and/or when Shares are tendered or withheld as payment of the amount to be withheld under applicable income tax laws in connection with the exercise of an Option, which new Option would be an Option to purchase the number of Shares not exceeding the sum of (A) the number of Shares so provided as consideration upon the exercise of the previously granted option to which such Reload Option relates and (B) the number of Shares, if any, tendered or withheld as payment of the amount to be withheld under applicable tax laws in connection with the exercise of the option to which such Reload Option relates pursuant to the relevant provisions of the plan or agreement relating to such option. Reload Options may be granted with respect to Options previously granted under the Plan or any other stock option plan of the Company or may be granted in connection with any Option granted under the Plan or any other stock option plan of the Company at the time of such grant. Such Reload Options shall have a per share exercise price equal to the Fair Market Value of one Share as of the date of grant of the new Option. Any Reload Option shall be subject to availability of sufficient Shares for grant under the Plan. Shares surrendered as part or all of the exercise price of the Option to which it relates that have been owned by the optionee less than six months will not be counted for purposes of determining the number of Shares that may be purchased pursuant to a Reload Option.

(b) Stock Appreciation Rights. The Committee is hereby authorized to grant Stock Appreciation Rights to Eligible Persons subject to the terms of the Plan and any applicable Award Agreement. A Stock Appreciation Right granted under the Plan shall confer on the holder thereof a right to receive upon exercise thereof the excess of (i) the Fair Market Value of one Share on the date of exercise (or, if the Committee shall so determine, at any time during a specified period before or after the date of exercise) over (ii) the grant price of the Stock Appreciation Right as specified by the Committee, which price shall not be less than 100% of the Fair Market Value of one Share on the date of grant of the Stock Appreciation Right. Subject to the terms of the Plan and any applicable Award Agreement, the grant price, term, methods of exercise, dates of exercise, methods of settlement and any other terms and conditions of any Stock Appreciation Right shall be as determined by the Committee. The Committee may

impose such conditions or restrictions on the exercise of any Stock Appreciation Right as it may deem appropriate.

(c) Restricted Stock and Restricted Stock Units. The Committee is hereby authorized to grant Awards of Restricted Stock and Restricted Stock Units to Eligible Persons with the following terms and conditions and with such additional terms and conditions not inconsistent with the provisions of the Plan as the Committee shall determine:

(i) Restrictions. Shares of Restricted Stock and Restricted Stock Units shall be subject to such restrictions as the Committee may impose (including, without limitation, any limitation on the right to vote a Share of Restricted Stock or the right to receive any dividend or other right or property with respect thereto), which restrictions may lapse separately or in combination at such time or times, in such installments or otherwise as the Committee may deem appropriate.

(ii) Stock Certificates; Delivery of Shares. Any Restricted Stock granted under the Plan shall be evidenced by issuance of a stock certificate or certificates, which certificate or certificates shall be held by the Company. Such certificate or certificates shall be registered in the name of the Participant and shall bear an appropriate legend referring to the restrictions applicable to such Restricted Stock. Stock certificates registered in the name of the Participant shall be delivered to the Participant promptly after the applicable restrictions lapse or are waived. In the case of Restricted Stock Units, no Shares shall be issued at the time such Awards are granted. Upon the lapse or waiver of restrictions and the restricted period relating to Restricted Stock Units evidencing the right to receive Shares, such Shares shall be issued and delivered to the holder of the Restricted Stock Units.

(iii) Forfeiture. Except as otherwise determined by the Committee, upon a Participant's termination of employment (as determined under criteria established by the Committee) during the applicable restriction period, all Shares of Restricted Stock and all Restricted Stock Units held by the Participant at such time shall be forfeited and reacquired by the Company; provided, however, that the Committee may, when it finds that a waiver would be in the best interest of the Company, waive in whole or in part any or all remaining restrictions with respect to Shares of Restricted Stock or Restricted Stock Units.

(d) Performance Awards. The Committee is hereby authorized to grant Performance Awards to Eligible Persons subject to the terms of the Plan and any applicable Award Agreement. A Performance Award granted under the Plan (i) may be denominated or payable in cash, Shares (including, without limitation, Restricted Stock and Restricted Stock Units), other securities, other Awards or other property and (ii) shall confer on the holder thereof the right to receive payments, in whole or in part, upon the achievement of such performance goals during such performance periods as the Committee shall establish. Subject to the terms of the Plan and any applicable Award Agreement, the performance goals to be achieved during any performance period, the length of any performance period, the amount of any Performance Award granted, the amount of any payment or

transfer to be made pursuant to any Performance Award and any other terms and conditions of any Performance Award shall be determined by the Committee.

(e) Dividend Equivalents. The Committee is hereby authorized to grant Dividend Equivalents to Eligible Persons under which the Participant shall be entitled to receive payments (in cash, Shares, other securities, other Awards or other property as determined in the discretion of the Committee) equivalent to the amount of cash dividends paid by the Company to holders of Shares with respect to a number of Shares determined by the Committee. Subject to the terms of the Plan and any applicable Award Agreement, such Dividend Equivalents may have such terms and conditions as the Committee shall determine.

(f) Other Stock-Based Awards. The Committee is hereby authorized to grant to Eligible Persons, subject to the terms of the Plan and any applicable Award Agreements, such other Awards that are denominated or payable in, valued in whole or in part by reference to, or otherwise based on or related to, Shares (including, without limitation, securities convertible into Shares), as are deemed by the Committee to be consistent with the purpose of the Plan. Shares, or other securities delivered pursuant to a purchase right granted under this Section 6(f) shall be purchased for such consideration, which may be paid by such method or methods and in such form or forms (including, without limitation, cash, Shares, promissory notes, other securities, other Awards or other property, or any combination thereof), as the Committee shall determine, the value of which consideration, as established by the Committee, shall not be less than 100% of the Fair Market Value of such Shares or other securities as of the date such purchase right is granted.

(g) General.

(i) No Cash Consideration for Awards. Awards may be granted for no cash consideration or for such other consideration as may be determined by the Committee or required by applicable law.

(ii) Awards May Be Granted Separately or Together. Awards may, in the discretion of the Committee, be granted either alone or in addition to, in tandem with or in substitution for any other Award or any award granted under any plan of the Company or any Affiliate other than the Plan. Awards granted in addition to or in tandem with other Awards or in addition to or in tandem with awards granted under any such other plan of the Company or any Affiliate may be granted either at the same time as or at a different time from the grant of such other Awards or awards.

(iii) Forms of Payment under Awards. Subject to the terms of the Plan and of any applicable Award Agreement, payments or transfers to be made by the Company or an Affiliate upon the grant, exercise or payment of an Award may be made in such form or forms as the Committee shall determine (including, without limitation, cash, Shares, promissory notes, other securities, other Awards or other property, or any combination thereof), and may be made in a single payment or transfer, in installments or on a deferred basis, in each case in accordance with rules and procedures established by the Committee. Such rules and procedures may include, without limitation, provisions for the payment or

crediting of reasonable interest on installment or deferred payments or the grant or crediting of Dividend Equivalents with respect to installment or deferred payments.

(iv) Limits on Transfer of Awards. No Award (other than Non-Qualified Stock Options, as hereinafter set forth) and no right under any such Award shall be transferable by a Participant other than by will or by the laws of descent and distribution; provided, however, that, if so determined by the Committee, a Participant may, in the manner established by the Committee, designate a beneficiary or beneficiaries to exercise the rights of the Participant and receive any property distributable with respect to any Award upon the death of the Participant. Each Award or right under any such Award shall be exercisable during the Participant's lifetime only by the Participant or, if permissible under applicable law, by the Participant's guardian or legal representative. No Award or right under any such Award may be pledged, alienated, attached or otherwise encumbered, and any purported pledge, alienation, attachment or encumbrance thereof shall be void and unenforceable against the Company or any Affiliate.

(v) Term of Awards. The term of each Award shall be for such period as may be determined by the Committee.

(vi) Restrictions; Securities Exchange Listing. All Shares or other securities delivered under the Plan pursuant to any Award or the exercise thereof shall be subject to such restrictions as the Committee may deem advisable under the Plan, applicable federal or state securities laws and regulatory requirements, and the Committee may cause appropriate entries to be made or legends to be placed on the certificates for such Shares or other securities to reflect such restrictions. If the Shares or other securities are traded on a securities exchange, the Company shall not be required to deliver any Shares or other securities covered by an Award unless and until such Shares or other securities have been admitted for trading on such securities exchange.

Section 7. Amendment and Termination; Adjustments.

(a) Amendments to the Plan. The Board of Directors of the Company may amend, alter, suspend, discontinue or terminate the Plan; provided, however, that, notwithstanding any other provision of the Plan or any Award Agreement, prior approval of the shareholders of the Company shall be required for any amendment to the Plan that:

(i) requires shareholder approval under the rules or regulations of the New York Stock Exchange, any other securities exchange or the National Association of Securities Dealers, Inc. that are applicable to the Company;

(ii) permits repricing of Options or Stock Appreciation Rights which is prohibited by Section 3(a) (v) of the Plan;

(iii) increases the number of shares authorized under the Plan as specified in Section 4(a);

(iv) permits the award of Options or Stock Appreciation Rights at a price less than 100% of the Fair Market Value of a Share on the date of grant of such Option or Stock Appreciation Right, as prohibited by Sections 6(a)(i), 6(a)(iv) and 6(b)(ii) of the Plan; or

(v) without such shareholder approval, would cause the Company to be unable, under the Code, to grant Incentive Stock Options under the Plan.

(b) Amendments to Awards. Subject to the provisions of the Plan, the Committee may waive any conditions of or rights of the Company under any outstanding Award, prospectively or retroactively. Except as otherwise provided herein or in an Award Agreement, the Committee may not amend, alter, suspend, discontinue or terminate any outstanding Award, prospectively or retroactively, if such action would adversely affect the rights of the holder of such Award, without the consent of the Participant or holder or beneficiary thereof.

(c) Correction of Defects, Omissions and Inconsistencies. The Committee may correct any defect, supply any omission or reconcile any inconsistency in the Plan or any Award in the manner and to the extent it shall deem desirable to carry the Plan into effect.

Section 8. Income Tax Withholding.

In order to comply with all applicable federal, state or local income tax laws or regulations, the Company may take such action as it deems appropriate to ensure that all applicable federal, state or local payroll, withholding, income or other taxes, which are the sole and absolute responsibility of a Participant, are withheld or collected from such Participant. In order to assist a Participant in paying all or a portion of the federal and state taxes to be withheld or collected upon exercise or receipt of (or the lapse of restrictions relating to) an Award, the Committee, in its discretion and subject to such additional terms and conditions as it may adopt, may permit the Participant to satisfy such tax obligation by (a) electing to have the Company withhold a portion of the Shares otherwise to be delivered upon exercise or receipt of (or the lapse of restrictions relating to) such Award with a Fair Market Value equal to the minimum statutory amount of such taxes required to be withheld by the Company or (b) delivering to the Company Shares other than Shares issuable upon exercise or receipt of (or the lapse of restrictions relating to) such Award and owned by the Participant for more than (6) months with a Fair Market Value equal to the amount of such taxes. The election, if any, must be made on or before the date that the amount of tax to be withheld is determined.

Section 9. General Provisions.

(a) No Rights to Awards. No Eligible Person, Participant or other

Person shall have any claim to be granted any Award under the Plan, and there is no obligation for uniformity of treatment of Eligible Persons, Participants or holders or beneficiaries of Awards under the Plan. The terms and conditions of Awards need not be the same with respect to any Participant or with respect to different Participants.

(b) Award Agreements. No Participant shall have rights under an Award granted to such Participant unless and until an Award Agreement shall have been duly executed on behalf of the Company and, if requested by the Company, signed by the Participant.

(c) No Rights of Shareholders. Except with respect to Restricted Stock, neither a Participant nor the Participant's legal representative shall be, or have any of the rights and privileges of, a shareholder of the Company with respect to any Shares issuable upon the exercise or payment of any Award, in whole or in part, unless and until the Shares have been issued.

(d) No Limit on Other Compensation Plans or Arrangements. Nothing contained in the Plan shall prevent the Company or any Affiliate from adopting or continuing in effect other or additional compensation plans or arrangements, and such plans or arrangements may be either generally applicable or applicable only in specific cases.

(e) No Right to Employment. The grant of an Award shall not be construed as giving a Participant the right to be retained as an employee of the Company or any Affiliate, or a non-employee Director to be retained as a Director, nor will it affect in any way the right of the Company or an Affiliate to terminate such employment at any time, with or without cause. In addition, the Company or an Affiliate may at any time dismiss a Participant from employment free from any liability or any claim under the Plan or any Award, unless otherwise expressly provided in the Plan or in any Award Agreement.

(f) Governing Law. The internal law, and not the law of conflicts, of the State of Minnesota, shall govern all questions concerning the validity, construction and effect of the Plan or any Award, and any rules and regulations relating to the Plan or any Award.

(g) Severability. If any provision of the Plan or any Award is or becomes or is deemed to be invalid, illegal or unenforceable in any jurisdiction or would disqualify the Plan or any Award under any law deemed applicable by the Committee, such provision shall be construed or deemed amended to conform to applicable laws, or if it cannot be so construed or deemed amended without, in the determination of the Committee, materially altering the purpose or intent of the Plan or the Award, such provision shall be stricken as to such jurisdiction or Award, and the remainder of the Plan or any such Award shall remain in full force and effect.

(h) No Trust or Fund Created. Neither the Plan nor any Award shall create or be construed to create a trust or separate fund of any kind or a fiduciary relationship between the Company or any Affiliate and a Participant or any other Person. To the extent that any Person acquires a right to receive

payments from the Company or any Affiliate pursuant to an Award, such right shall be no greater than the right of any unsecured general creditor of the Company or any Affiliate.

(i) No Fractional Shares. No fractional Shares shall be issued or delivered pursuant to the Plan or any Award, and the Committee shall determine whether cash shall be paid in lieu of any fractional Share or whether such fractional Share or any rights thereto shall be canceled, terminated or otherwise eliminated.

(j) Headings. Headings are given to the Sections and subsections of the Plan solely as a convenience to facilitate reference. Such headings shall not be deemed in any way material or relevant to the construction or interpretation of the Plan or any provision thereof.

Section 10. Effective Date of the Plan.

The Plan shall be subject to approval by the shareholders of the Company at the annual meeting of shareholders of the Company to be held in 2001 and the Plan shall be effective as of the date of such shareholder approval.

Section 11. Term of the Plan.

Awards shall only be granted under the Plan during a 10-year period beginning on the effective date of the Plan, unless the Plan is terminated earlier pursuant to Section 7(a) of the Plan. However, unless otherwise expressly provided in the Plan or in an applicable Award Agreement, any Award theretofore granted may extend beyond the end of such 10-year period, and the authority of the Committee provided for hereunder with respect to the Plan and any Awards, and the authority of the Board of Directors of the Company to amend the Plan, shall extend beyond the termination of the Plan.

June 5, 2001

Mr. David A. Roberts
3115 Aviara Court
Naperville, IL 60564

Dear Dave:

On behalf of the Board of Directors, we are extremely pleased to extend to you the following offer to become the President and Chief Executive Officer of Graco Inc., as follows:

- o Duties: You shall be responsible for the general active management of the Company, and have other duties as specified in Graco's bylaws.
- o Base salary: \$36,000 per month. Compensation is reviewed annually by the Management Organization and Compensation Committee of the Board, provided that this salary shall not be reduced.
- o Annual Bonus: Participation in the Annual Bonus Program, with a maximum payment for 2001 of 90% of base salary actually paid during the year. The payment for 2001 will be based on the Company's net sales and net earnings against established targets, weighted 25% on net sales and 75% on net earnings. The targets and measurements for 2002 and future years will be established by the Management Organization and Compensation Committee.
- o Stock Options: Under our Stock Incentive Plan, an initial option of 50,000 shares will be granted on the first day of your employment. These are 10 year non-ISO options at the closing market price on the business day immediately preceding the date of grant, with 25% vesting on the 1st, 2nd, 3rd and 4th anniversaries. Future grants will be determined annually by the Management Organization and Compensation Committee.
- o Restricted Stock Grant: Under our Stock Incentive Plan, a grant of 3000 shares of restricted stock will be granted on the first day of your employment. This grant is being made to compensate you for the current incentive plan opportunity, retirement and other benefits with your current employer that you will be foregoing in accepting this position with Graco. The restrictions on this stock will be removed on the third anniversary of the date of the grant, provided you are still employed by Graco at that time. The restrictions will also be removed automatically if your employment is involuntarily terminated for other than gross and willful misconduct or by death or disability, all as provided in the restricted stock agreement covering this grant. During the three-year restriction period, you will not be able to dispose of the stock, but you will receive dividends and be able to vote the stock.
- o Severance Pay: In the event that your employment is terminated involuntarily for other than gross and willful misconduct, you will be paid an amount equal

to two years of your then base salary. You will also be entitled to a bonus under the bonus program in effect for the year the termination occurs, based on the amount of your base salary earned during your employment and the bonus percentage paid for that year. The bonus will be paid to you (or in the event of your death, to your estate) at the time of the bonus payments for that year. The Company will also reimburse you for any premiums you elect to pay under COBRA. For purposes of this letter, gross and willful misconduct includes wrongful appropriation of Company funds, serious violation of Company policy, breach of fiduciary duty or conviction of a felony. Gross and willful misconduct shall not include any action or inaction by you contrary to the direction of the Board with respect to any initiative, strategy or action of the Company, which action or inaction you believe is in the best interest of the Company. Your employment will be deemed to be involuntarily terminated if you resign because of a reduction of your compensation, perquisites provided in this letter or benefits (other than reductions in benefits resulting from changes in Graco's employee benefit programs affecting officers generally), or your responsibilities, duties or position are diminished.

- o Key Employee Agreement: You will be extended a Key Employee Agreement, with terms no less favorable than similar agreements now in place with other officers of the Company. Your Key Employee Agreement will be effective on the first day of employment. It provides for two years of base salary, expected bonus, and benefits if you are terminated within two years after a change of control of the Company. Also, all stock options and the restricted stock will automatically vest upon a change of control.
- o Vesting of pension benefits. We will amend the supplemental executive retirement plan to provide that, if your employment is terminated involuntarily for other than gross and willful misconduct between the second and fifth anniversary of your start date, you will receive retirement benefits under the terms of both plans as if the vesting period of those plans was two years. This benefit would be paid entirely from the supplemental plan, which is unfunded and a general obligation of Graco. If you are still employed after the fifth anniversary of your start date, you will be vested in both plans in accordance with their normal terms.
- o Benefits: You will participate in Graco's comprehensive employee benefit plans.
- o Relocation: You will receive relocation assistance in accordance with Graco's relocation policy, and will be reimbursed for reasonable commuting expenses incurred prior to such relocation. Steve Bauman will provide additional information on this benefit to you.
- o Club dues: You will receive payment of your regular dues at the Minneapolis Club.
- o Attorneys' fees. Graco will reimburse you for the reasonable fees of your attorneys in connection with your consideration of this offer.

o Vacation: You will receive a vacation accrual yielding three weeks per year.

As we discussed, we anticipate that you will start on or before June 25, 2001. You will be elected to the Board of Directors at the meeting on June 26, 2001.

To accept this offer, please sign the enclosed copy of this letter and return it to me. There are also some routine tests and checks that must be performed, and forms to complete, that have been explained to you by Steve Bauman. He has also provided you with a description of our benefits package.

Dave, we are delighted at the prospect of you joining Graco. We know that with your experience and track record, you are the right person to lead the company to even greater success in the years to come.

Yours very truly,

/s/George Aristides
George Aristides
Chairman and Chief Executive Officer

/s/Marti Morfitt
Marti Morfitt
Chair Management Organization &
Compensation Committee
Board of Directors

Agreed and Accepted:

/s/David A. Roberts

David A. Roberts

GRACO EXECUTIVE
LONG TERM INCENTIVE AGREEMENT

(Restricted Stock Award)

This Agreement is made as of the 25th day of June, 2001, between Graco Inc., a Minnesota corporation (the "Company"), and David A. Roberts ("Mr. Roberts") pursuant to the Graco Inc. Stock Incentive Plan (the "Plan"). Unless otherwise defined herein, terms used herein shall have the meanings assigned to them under the Plan.

WITNESSETH:

WHEREAS, upon the commencement of his employment with the Company as President and Chief Executive Officer, the Board of Directors believes that it is appropriate to make an award of restricted Common Shares to Mr. Roberts; and

WHEREAS, the Plan contemplates that a restricted stock award should be evidenced by a written agreement, executed by the Company and Mr. Roberts containing such restrictions, terms and conditions as may be required by the Plan and the Committee;

NOW THEREFORE, in consideration of the premises and mutual agreements hereinafter set forth, Mr. Roberts and the Company hereby agree as follows:

1. Award.

The Company, effective as of the date of this Agreement, hereby grants to Mr. Roberts an award (the "Award") of 3000 Common Shares, \$1.00 par value, of the Company ("Common Shares") subject to the restrictions, terms and conditions set forth below and in the Plan.

2. Vesting of Stock.

(a) The Common Shares awarded by this Agreement shall vest in Mr. Roberts as of the third anniversary of the date of this Agreement, except as otherwise provided herein.

(b) In the event of a "Change of Control", the Award shall immediately vest in full. A "Change of Control" means:

(i) acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the

beneficial ownership by such Person of 25% or more of either

- A. the then outstanding shares of common stock of the Company (the "Outstanding Company Common Stock") or
- B. the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

- (1) an acquisition directly from the Company,
- (2) an acquisition by the Company,
- (3) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
- (4) an acquisition by any Person who is deemed to have beneficial ownership of the Company common stock or other Company voting securities owned immediately after said acquisition by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 2, a Trust Person shall not be deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by The Graco Foundation or any employee benefit plan of the Company, including without limitation the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,
- (5) an acquisition by Mr. Roberts or any group that includes Mr. Roberts, or
- (6) an acquisition by any corporation pursuant to a transaction that complies with clauses (A), (B) and (C) of Section 2 (a) (iii) below; and

provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (1) or (2) above, and such Person

subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (1) or (2) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

- (ii) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or
- (iii) The commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; or
- (iv) The approval by the shareholders of the Company of a reorganization, merger, consolidation or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation); excluding, however, such a Business Combination pursuant to which
 - A. all or substantially all of the individuals and entities who were the beneficial owners of the

Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,

- B. no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and
 - C. at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or
- (v) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.
 - (vi) A Change of Control shall not be deemed to have occurred with respect to Mr. Roberts if:
 - (A) the acquisition of the 25% or greater interest referred to in Section 2(b) (i) is by a group, acting in concert, that includes Mr. Roberts; or
 - (B) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or

substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subsections (v) and (vi) of this Section 2(b) by a group, acting in concert, that includes Mr. Roberts.

- (c) Until a Common Share vests, Mr. Roberts acknowledges that he may not, and agrees that he shall not, transfer his rights to such Common Share. Until a Common Share vests, no attempt to transfer such Common Share, whether voluntary or involuntary, by operation of law or otherwise, shall vest the transferee with any interest or right in or with respect to such Common Share.

3. Termination. -----

- (a) If Mr. Roberts (i) is terminated by the Company for any reason other than gross and willful misconduct, (ii) quits or resigns because his compensation or benefits are reduced (other than reductions in benefits resulting from changes in Graco's employee benefit programs affecting officers generally), his responsibilities, duties or position are diminished or (iii) dies or becomes disabled (as determined under the Company's Long Term Disability Plan) before the vesting date under Section 2(a), then Mr. Roberts or his estate shall be entitled to receive the remaining unvested portion of the Award.
- (b) If Mr. Roberts terminates employment with the Company for any other reason, including a termination by the Company for gross and willful misconduct, his rights to any unvested portion of this Award shall be immediately and irrevocably forfeited. For purposes of this Agreement, gross and willful misconduct includes wrongful appropriation of Company funds, serious violation of Company policy, breach of fiduciary duty or conviction of a felony. Gross and willful misconduct shall not include any action or inaction by Mr. Roberts contrary to the direction of the Board with respect to any initiative, strategy or action of the Company, which action or inaction Mr. Roberts believes is in the best interest of the Company.

4. Issuance and Custody of Certificate. -----

- (a) The Company shall cause to be issued one or more stock certificates, registered in the name of Mr. Roberts evidencing the restricted Common Shares awarded pursuant to Section 1. Each such certificate shall bear the following legend:

The shares of stock represented by this certificate are

subject to forfeiture and the transferability of this certificate and the shares of stock represented hereby are subject to the restrictions, terms and conditions (including restrictions against transfer) contained in the Graco Inc. Stock Incentive Plan and an Agreement entered into between the registered owner of such shares and Graco Inc. A copy of the Plan and Agreement is on file in the office of the Secretary of Graco Inc., 88-11th Avenue NE, Minneapolis, Minnesota.

- (b) Each certificate issued pursuant to Section 4(a), together with the stock powers relating to such Common Shares, shall be deposited by the Company with the Secretary of the Company or a custodian designated by such Secretary. The Secretary or such custodian shall issue a receipt to Mr. Roberts evidencing the certificates held which are registered in the name of Mr. Roberts.
- (c) Promptly after any Common Shares vest pursuant to Section 3 of this Agreement, the Company shall cause to be issued certificates evidencing such Common Shares, free of the legend provided in Section 4(a) and shall cause such certificates to be delivered to Mr. Roberts (or Mr. Roberts' legal representatives, beneficiaries or heirs).
- (d) Mr. Roberts shall not be deemed for any purpose to be, or have rights as, a shareholder of the Company by virtue of the Award, until a stock certificate is issued therefor pursuant to Section 4(a).

5. Agreements of Mr. Roberts.

Mr. Roberts acknowledges that: (a) this Agreement is not a contract of employment and the terms of Mr. Roberts' employment shall not be affected in any way by this Agreement except as specifically provided in the Agreement; (b) the Award made by this Agreement shall not confer any legal rights upon Mr. Roberts for continuation of employment or interfere with or limit the right of the Company to terminate Mr. Roberts' employment at any time; (c) the Board may amend, suspend or terminate the Plan or any part thereof at any time provided that no amendment, suspension or termination shall be made or effected which would adversely affect any right of Mr. Roberts with respect to the Award made by this Agreement without the written consent of Mr. Roberts unless such amendment, termination or suspension is required by applicable law; (e) and Mr. Roberts shall not make an election pursuant to Section 83(b) of the Internal Revenue Code of 1986, with respect to the Award.

6. Legal Compliance Restrictions.

The Company shall not be obligated to issue or deliver any certificates evidencing Common Shares awarded by this Agreement unless and until the

Company is advised by its counsel that the issuance and delivery of such certificates are in compliance with all applicable laws, regulations of governmental authorities and the requirements of the New York Stock Exchange or any other exchange upon which Common Shares are traded.

The Company shall not be obligated to register any securities pursuant to the Securities Act of 1933 (as now in effect or as hereinafter amended) or to take any other affirmative action in order to cause the issuance and delivery of such certificates to comply with any such law, regulation or requirement. The Committee may require, as a condition of the issuance and delivery of such certificates and in order to ensure compliance with such laws, regulations and requirements, that Mr. Roberts make such agreements and representations as the Committee, in its sole discretion, deems necessary or desirable.

7. Withholding Taxes.

Mr. Roberts agrees to pay or make arrangements for the payment to the Company of the amount of any taxes that the Company is required by law to withhold with respect to the Award made by this Agreement. Such payment shall be due on the date the Company is required to withhold such taxes. In the event that such payment is not made when due, the Company shall have the right (a) to retain, or sell within 10 days notice or such longer notice as may be required by applicable law, a sufficient number of the Common Shares subject to any Award made to Mr. Roberts in order to cover all or part of the amount required to be withheld; (b) to deduct, to the extent permitted by law, from any payment of any kind otherwise due to such person from the Company all or a part of the amount required to be withheld or (c) to pursue any other remedy at law or in equity. Mr. Roberts may satisfy any such tax obligation, in whole or in part, by (i) electing to have the Company withhold Common Shares otherwise to be delivered with a fair market value equal to the amount of such tax obligation, or (ii) electing to surrender to the Company previously owned Common Shares with a fair market value equal to the amount of such tax obligation. The election must be made on or before the date that the amount of tax to be withheld is determined.

8. Stock Splits, Recapitalizations, Acquisitions, etc.

(a) In the event of any change in the number of outstanding Common Shares by reason of any stock dividend or split, recapitalization, merger, consolidation, combination or exchange of shares or similar corporate change, the number and kind of shares subject to this Award shall be appropriately adjusted. If changes in capitalization of the Company other than those referred to above shall occur, the Committee may, but need not, make such adjustments in the number and kind of shares available under this Award as the Committee may deem appropriate.

To the extent permitted by applicable law, the Award of a Common Share shall be adjusted so that Mr. Roberts shall have the right to receive under the Award and subject to the Plan securities and other property (except regular quarterly cash dividends) with respect to the Award as a result of any stock dividend or split, special cash dividend, recapitalization, merger, consolidation, combination of shares or exchange of shares or similar corporate change or otherwise substantially similar to that Mr. Roberts would have received with respect to the Common Shares had Mr. Roberts owned the Common Shares free and clear of the restrictions under this Agreement. Unless the Committee otherwise determines, Mr. Roberts' right in respect of such securities and other property shall not vest until such Common Share would have vested and no such securities or other property shall be issued or delivered until such Common Share would be issued or delivered.

- (b) Unless the Committee otherwise determines, any securities and other property (except regular quarterly cash dividends) received by Mr. Roberts as a result of a corporate change described in Section 8(a) or otherwise with respect to a Common Share prior to the date such Common Share vests shall be promptly deposited with the Secretary or the custodian designated by the Secretary to be held in custody in accordance with Section 4(b) as though such securities and other property were part of such Common Share.

9. Notices.

Any notice which either party hereto or the Committee may be required or permitted to give to the other with respect to the Plan or this Agreement shall be in writing, and may be delivered personally or by mail, postage prepaid, addressed as follows:

- (a) if to the Company:

Graco Inc.
P.O. Box 1441
Minneapolis, MN 55440-1441
Attention: Vice President, Human Resources

- (b) if to the Committee:

Management Organization and Compensation Committee
c/o Vice President, Human Resources
Graco Inc.
P.O. Box 1441
Minneapolis, MN 55440-1441

- (c) if to Mr. Roberts:

Mr. David A. Roberts

Chief Executive Officer
Graco Inc.
P.O. Box 1441
Minneapolis, MN 55440-1441

or to such other address as the person to whom the notice is directed shall have designated in writing to others.

10. Minnesota Law.

This Agreement is made and accepted in the State of Minnesota. The laws of the state of Minnesota shall control the interpretation and performance of the terms of the Plan and of this Agreement.

11. Binding Effect.

This Agreement shall be binding upon, and shall inure to the benefit of, the respective successors, assigns, heirs, executors, administrators and guardians of the parties hereto.

IN WITNESS WHEREOF, the Company and Mr. Roberts have caused this Agreement to be executed and delivered, all as of the day and year first above written.

/s/David A. Roberts

David A. Roberts

GRACO INC.

By /s/George Aristides

George Aristides
Chairman

GRACO INC. KEY EMPLOYEE AGREEMENT

AGREEMENT, by and between Graco Inc., a Minnesota corporation (the "Company") and David A. Roberts (the "Executive"), dated as of the 25th day of June, 2001.

The Board of Directors of the Company (the "Board"), has determined that it is in the best interests of the Company and its shareholders to assure that the Company will have the continued dedication of the Executive, notwithstanding the possibility, threat or occurrence of a Change of Control (as defined in Section 2 below) of the Company. The Board believes it is imperative to diminish the inevitable distraction of the Executive by virtue of the personal uncertainties and risks created by a pending or threatened Change of Control, to encourage the Executive's full attention and dedication to the Company currently and in the event of any threatened or pending Change of Control, to provide inducement for the Executive to remain an employee of the Company in the event of any threatened or pending Change of Control, and to facilitate an orderly transition in the event of a Change of Control. Therefore, in order to accomplish these objectives, the Board has caused the Company to enter into this Agreement.

NOW, THEREFORE, IT IS HEREBY AGREED AS FOLLOWS:

1. Certain Definitions: "Effective Date;" "Change of Control Period;" "Company;" "Affiliated Companies."
 - (a) The "Effective Date" shall mean the first date during the Change of Control Period (as defined in Section 1(b)) on which a Change of Control (as defined in Section 2) occurs. Anything in this Agreement to the contrary notwithstanding, if a Change of Control occurs and if the Executive's employment with the Company is terminated prior to the date on which the Change of Control occurs, and if it is reasonably demonstrated by the Executive that such termination of employment (i) was at the request of a third party who has taken steps reasonably calculated to effect the Change of Control or (ii) otherwise arose in connection with or anticipation of the Change of Control, then for all purposes of this Agreement the "Effective Date" shall mean the date immediately prior to the date of such termination of employment.
 - (b) The "Change of Control Period" shall mean the period commencing on the date hereof and ending on the second anniversary of such date, provided, however, that commencing on the date one year after the date hereof, and on each annual anniversary of such date (such date and each annual anniversary thereof shall be hereinafter referred to as the "Renewal Date"), the Change of Control Period shall be automatically extended so as to terminate two years from such Renewal Date, unless at least 60 days prior to the Renewal Date the Company shall give notice to the

Executive that the Change of Control Period shall not be so extended.

- (c) The "Company" shall mean the Company as hereinbefore defined and any successor to its business and/or assets which assumes or agrees to perform this Agreement by operation of law or otherwise.
- (d) As used in this Agreement, the term "affiliated companies" shall include any company controlled by, controlling or under common control with the Company.

2. Change of Control. For the purpose of this Agreement

(a) A "Change of Control" means:

- (i) acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the beneficial ownership by such Person of 25% or more of either
 - A. the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or
 - B. the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

- (1) an acquisition directly from the Company,
- (2) an acquisition by the Company,
- (3) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
- (4) an acquisition by any Person who is deemed to have beneficial ownership of the Company common stock or other Company voting securities owned immediately after said acquisition by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting

Securities, and provided further that for purposes of this Section 2, a Trust Person shall not be deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by The Graco Foundation or any employee benefit plan of the Company, including without limitation the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,

- (5) an acquisition by the Executive or any group that includes the Executive, or
- (6) an acquisition by any corporation pursuant to a transaction that complies with clauses (A), (B) and (C) of Section 2 (a)(iii) below; and

provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (1) or (2) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (1) or (2) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

- (ii) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board, or

(iii) The approval by the shareholders of the Company of a reorganization, merger, consolidation or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation); excluding, however, such a Business Combination pursuant to which

- A. all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,
- B. no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and
- C. at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

(iv) approval by the stockholders of the Company of a complete

liquidation or dissolution of the Company.

3. Employment Period. For purposes of this Agreement, the term "Employment Period" shall mean the period commencing on the Effective Date and ending on the earlier of (i) the termination by the Company or the Executive of the Executive's employment with the Company, or (ii) the second anniversary of the Effective Date." As provided in Section 10(f), nothing stated in this Agreement shall restrict the right of the Company or the Executive at any time to terminate the Executive's employment with the Company, subject to the obligations of the Company provided for in this Agreement in the event of such termination.

4. Terms of Employment.

(a) Position and Duties.

(i) During the Employment Period, (A) the Executive's position (including offices and titles), duties and responsibilities shall be at least commensurate in all material respects with the most significant of those held, exercised and assigned at any time during the 90-day period immediately preceding the Effective Date and (B) the Executive's services shall be performed at the location where the Executive was employed immediately preceding the Effective Date or any office or location less than 50 miles from such location.

(ii) Except as otherwise expressly provided in this Agreement, during the Employment Period, and excluding any periods of vacation and sick leave to which the Executive is entitled, the Executive agrees to devote reasonable attention and time during normal business hours to the business and affairs of the Company. During the Employment Period it shall not be a violation of this Agreement for the Executive to (A) serve on corporate, civic or charitable boards or committees, (B) deliver lectures, fulfill speaking engagements or teach at educational institutions and (C) manage personal investments, so long as such activities do not significantly interfere with the performance of the Executive's responsibilities as an employee of the Company in accordance with this Agreement. To the extent that any such activities have been conducted by the Executive prior to the Effective Date, the continued conduct of such activities (or the conduct of activities similar in nature and scope thereto) subsequent to the Effective Date shall not thereafter be deemed to interfere with the performance of the Executive's responsibilities to the Company.

(b) Compensation.

(i) Base Salary. During the Employment Period, the Executive

shall receive an annual base salary ("Annual Base Salary") which shall be paid at a monthly rate, at least equal to twelve times the highest monthly base salary paid or payable to the Executive by the Company and its affiliated companies in respect of the twelve-month period immediately preceding the month in which the Effective Date occurs. During the Employment Period, the Annual Base Salary shall be reviewed at least annually and shall be increased at any time and from time to time as shall be substantially consistent with increases in base salary generally awarded in the ordinary course of business to other peer executives of the Company. The term Annual Base Salary as used in this Agreement shall refer to Annual Base Salary as so increased. The Executive's Annual Base Salary shall not be reduced after any such increase. Any increase in Annual Base Salary shall not serve to limit or reduce any other obligation to the Executive under this Agreement.

- (ii) Annual Incentive Payments. In addition to Annual Base Salary, the Executive shall be awarded, for each fiscal year during the Employment Period, an annual bonus ("Annual Bonus") in cash, in accordance with the Company's Annual Bonus Plan, or other plan instituted in lieu of the Annual Bonus Plan which provides for an annual incentive payment in addition to Annual Base Salary ("Substitute Plan"). The Executive shall participate in the Annual Bonus Plan or Substitute Plan at the same level at which the Executive participated immediately prior to the Effective Date, or if more favorable, at the level of other peer executives of the Company and its affiliated companies. Any Substitute Plan instituted by the Company after the Effective Date shall be at least as favorable, in the aggregate, as the most favorable Annual Bonus Plan or Substitute Plan in effect at any time during the 90-day period immediately preceding the Effective Date
- (iii) Savings and Retirement Plans. During the Employment Period, the Executive shall be entitled to participate in all savings and retirement plans, practices, policies and programs applicable generally to other peer executives of the Company and its affiliated companies, but in no event shall such plans, practices, policies and programs provide the Executive with savings opportunities and retirement benefit opportunities, in each case, less favorable, in the aggregate, than the most favorable of those provided by the Company and its affiliated companies for the Executive under such plans, practices, policies and programs as in effect at anytime during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, those provided generally at any time after the Effective Date to other peer executives of the Company and its affiliated companies.

- (iv) Welfare Benefit Plans. During the Employment Period, the Executive and/or the Executive's family, as the case maybe, shall be eligible for participation in and shall receive all benefits under welfare benefit plans, practices, policies and programs provided by the Company and its affiliated companies (including, without limitation, medical, prescription, dental, disability, salary continuance, employee life, group life, accidental death and travel accident insurance plans and programs) to the extent applicable generally to other peer executives of the Company and its affiliated companies, but in no event shall such plans, practices, policies and programs provide the Executive with benefits which are less favorable,, in the aggregate, than the most favorable of such plans, practices, policies and programs in effect for the Executive at anytime during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, those provided generally at any time after the Effective Date to other peer executives of the Company and its affiliated companies.
- (v) Expenses. During the Employment Period, the Executive shall be entitled to receive prompt reimbursement for all reasonable expenses incurred by the Executive in accordance with the most favorable policies, practices and procedures of the Company and its affiliated companies in effect for the Executive at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect generally at any time thereafter with respect to other peer executives of the Company and its affiliated companies.
- (vi) Perquisites. During the Employment Period, the Executive shall be entitled to perquisites in accordance with the most favorable plans, practices, programs and policies of the Company and its affiliated companies in effect for the Executive at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect generally at any time thereafter with respect to other peer executives of the Company and its affiliated companies.
- (vii) Office and Support Staff. During the Employment Period, the Executive shall be entitled to an office or offices of a size and with furnishings and other appointments, and to secretarial and other assistance, at least equal to the most favorable of the foregoing provided to the Executive by the Company at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as provided generally at any time thereafter with respect to other peer executives of the Company.

(viii) Vacation. During the Employment Period, the Executive shall be entitled to paid vacations in accordance with the most favorable plans, policies, programs and practices of the Company and its affiliated companies as in effect for the Executive at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect generally at any time thereafter with respect to other peer Executives of the Company and its affiliated companies.

5. Termination of Employment.

- (a) Death or Disability. The Executive's employment shall terminate automatically upon the Executive's death during the Employment Period. If the Company determines in good faith that the Disability of the Executive has occurred during the Employment Period (pursuant to the definition of Disability set forth below), it may give to the Executive written notice in accordance with Section 10(b) of this Agreement of its intention to terminate the Executive's employment. In such event, the Executive's employment with the Company shall terminate effective on the 30th day after receipt of such notice by the Executive (the "Disability Effective Date"), provided that, within the 30 days after such receipt, the Executive shall not have returned to full-time performance of the Executive's duties. For purposes of this Agreement, "Disability" shall mean the absence of the Executive from the Executive's duties with the Company on a full-time basis for 180 consecutive days as a result of incapacity due to mental or physical illness which is determined to be total and permanent by a physician selected by the Company or its insurers and acceptable to the Executive or the Executive's legal representative (such agreement as to acceptability not to be withheld unreasonably).
- (b) Cause. The Company may terminate the Executive's employment during the Employment Period for Cause. For purposes of this Agreement, "Cause" shall mean (i) repeated violations by the Executive of the Executive's obligations under Section 4(a) of this Agreement (other than as a result of incapacity due to physical or mental illness) which are demonstrably willful and deliberate on the Executive's part, which are committed in bad faith or without the belief on the part of the Executive that such violations are in the best interests of the Company and which are not remedied in a reasonable period of time after receipt of written notice from the Company specifying such violations or (ii) the conviction of the Executive of a felony involving moral turpitude.
- (c) Good Reason. The Executive's employment may be terminated by the Executive for Good Reason. For purposes of this Agreement, "Good Reason" shall mean:

- (i) the assignment to the Executive of any duties materially inconsistent in any respect with the Executive's position (including offices and titles), duties or responsibilities as contemplated by Section 4(a) of this Agreement, or any other action by the Company which results in a material diminution in such position, duties or responsibilities, excluding for this purpose an isolated, insubstantial and inadvertent action not taken in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by the Executive;
- (ii) any failure by the Company to comply with any of the provisions of Section 4(b) of this Agreement, other than an isolated, insubstantial and inadvertent failure not occurring in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by the Executive;
- (iii) the Company's requiring the Executive to be based at any office or location other than that described in Section 4(a)(i)(B) hereof or the Company's requiring the Executive to travel on Company business to a substantially greater extent than required immediately prior to the Effective Date;
- (iv) any purported termination by the Company of the Executive's employment otherwise than as expressly permitted by this Agreement; or
- (v) any failure by the Company to comply with and satisfy Section 9(c) of this Agreement.

For purposes of this Section 5(c), any good faith determination of "Good Reason" made by the Executive shall be conclusive.

- (d) Notice of Termination. Any termination by the Company for Cause, or by the Executive for Good Reason, shall be communicated by Notice of Termination to the other party hereto given in accordance with Section 10(b) of this Agreement. For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) to the extent applicable, sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of the Executive's employment under the provision so indicated and (iii) if the Date of Termination (as defined below) is other than the date of receipt of such notice, specifies the termination date (which date shall be not more than fifteen days after the giving of such notice). The failure by the Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of Good Reason or Cause shall not waive any right of the Executive or the Company hereunder or preclude the Executive

or the Company from asserting such fact or circumstance in enforcing the Executive's or the Company's rights hereunder.

- (e) Date of Termination. "Date of Termination" means (i) if the Executive's employment is terminated by the Company for Cause, or by the Executive for Good Reason, the date of receipt of the Notice of Termination or any later date specified therein, as the case may be, (ii) if the Executive's employment is terminated by the Company other than for Cause or Disability or death, the Date of Termination shall be the date on which the Company notifies the Executive of such termination and (iii) if the Executive's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of the Executive or the Disability Effective Date, as the case may be.

6. Obligations of the Company upon Termination.

- (a) Good Reason; Other Than for Cause, Death or Disability. If, within two years after the Effective Date, the Company shall terminate the Executive's employment other than for Cause, death or Disability, or the Executive shall terminate employment for Good Reason, in lieu of further payments pursuant to Section 4(b) with respect to periods following the Date of Termination:

- (i) except as provided in Section 6(e) below, the Company shall pay to the Executive, in a lump sum in cash, within 30 days (except as provided in subsection 6(a)(i)A below) after the Date of Termination, the aggregate of the following amounts (such aggregate shall be hereinafter referred to as the "Special Termination Amount"):

- A. the sum of (1) the Executive's Annual Base Salary through the Date of Termination to the extent not theretofore paid, and, (2) the product of (x) the higher of (I) the midpoint between the minimum and the maximum bonus payment under the Annual Bonus Plan or Substitute Plan applicable to the Executive for the fiscal year in which the Date of Termination occurs, or (II) the amount that would be payable to the Executive for the fiscal year in which the Date of Termination occurs under the Annual Bonus Plan or Substitute Plan had the termination not so occurred (which amount shall be payable pursuant to this clause 2 within 30 days after it is calculated), and (y) a fraction, the numerator of which is the number of days in the current fiscal year through the Date of Termination, and the denominator of which is 365 (the sum of the amounts described in clauses (1) and (2) shall be hereinafter referred to as the "Accrued Obligations"); and

B. the amount equal to the product of (1) two and (2) the sum of (x) the Executive's Annual Base Salary and (y) the midpoint between the maximum and minimum bonus payment applicable to the Executive for the fiscal year in which the Date of Termination occurs under the Annual Bonus Plan or Substitute Plan; and

(ii) for two years following the Date of Termination or such longer period as any plan, program, practice or policy may provide, the Company shall continue benefits to the Executive and/or the Executive's family at least equal to those which would have been provided to them in accordance with the plans programs, practices and policies described in Section 4(b)(iv) of this Agreement if the Executive's employment had not been terminated, in accordance with the most favorable plans, practices, programs or policies of the Company and its affiliated companies applicable generally to other peer executives and their families during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect generally at any time thereafter with respect to other peer executives of the Company and its affiliated companies and their families, provided, however, that if the Executive becomes re-employed with another employer and is eligible to receive medical or disability welfare benefits under another employer provided plan, the medical and disability welfare benefits described herein shall cease upon the Executive and the Executive's family becoming eligible under such other plan. For purposes of determining eligibility of the Executive for retiree benefits pursuant to such plans, practices, programs and policies, the Executive shall be considered to have remained employed until two years after the Date of Termination and to have retired two years after the Date of Termination.

(b) Death. If the Executive's employment is terminated by reason of the Executive's death within two years after the Effective Date, this Agreement shall terminate without further obligations to the Executive's legal representatives under this Agreement, other than for payment of the Accrued Obligations. The Accrued Obligations shall be paid to the Executive's estate or beneficiary, as applicable, in a lump sum in cash within 30 days of the Date of Termination, or as otherwise provided in Section 6(a)(i)(A). In addition, the Executive's family shall be entitled to receive benefits at least equal to the most favorable benefits provided by the Company and any of its affiliated companies to surviving families of deceased peer executives of the Company and such affiliated companies under such plans, programs, practices and policies relating to family death benefits, if any, as in effect with respect to other deceased peer executives and their families at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the

Executive and/or the Executive's family, as in effect on the date of the Executive's death with respect to other deceased peer executives of the Company and its affiliated companies and their families.

(c) Disability. If the Executive's employment is terminated by reason of the Executive's Disability within two years after the Effective Date, this Agreement shall terminate without further obligations to the Executive, other than for payment of the Accrued Obligations. The Accrued Obligations shall be paid to the Executive in a lump sum in cash within 30 days of the Date of Termination or as otherwise provided in Section 6(a)(i)(A). In addition, the Executive shall be entitled after the Disability Effective Date to receive disability and other benefits at least equal to the most favorable of those generally provided by the Company and its affiliated companies to disabled executives and/or their families in accordance with such plans, programs, practices, and policies relating to disability, if any, as in effect generally with respect to other disabled peer executives and their families at any time during the 90-day period immediately preceding the Effective Date or, if more favorable to the Executive and/or the Executive's family, as in effect at any time thereafter generally with respect to other disabled peer executives of the Company and its affiliated companies and their families.

(d) Cause; Other than for Good Reason. If the Executive's employment shall be terminated for Cause within two years after the Effective Date, this Agreement shall terminate without further obligations to the Executive other than the obligation to pay to the Executive Annual Base Salary through the Date of Termination plus the amount of any compensation previously deferred by the Executive, in each case to the extent theretofore unpaid. If the Executive voluntarily terminates employment within two years after the Effective Date, excluding a termination for Good Reason, this Agreement shall terminate without further obligations to the Executive, other than Annual Base Salary through the Date of Termination plus the amount of any compensation previously deferred by the Executive, in each case to the extent theretofore unpaid, and any payment that may be due under the terms of the Annual Bonus Plan or any Successor Plan. In such case, all such amounts shall be paid to the Executive in a lump sum in cash within 30 days of the Date of Termination or, in the case of any payment under the Annual Bonus Plan or any Successor Plan, pursuant to the terms thereof.

(e) Possible Payment Reduction.

(i) Notwithstanding any provision to the contrary contained in this Agreement, if the lump sum cash payment due and the other benefits to which the Executive shall become entitled under Section 6(a)

hereof, either alone or together with other payments in the nature of compensation to the Executive which are contingent on a change in the ownership or effective control of the Company or in the ownership of a substantial portion of the assets of the Company or otherwise, would constitute a "parachute payment" (as defined in Section 280G of the Internal Revenue Code of 1986, as amended (the "Code") or any successor provision thereto), such lump sum payment shall be reduced (but not below zero) to the largest aggregate amount as will result in no portion thereof being subject to the excise tax imposed under Section 4999 of the Code (or any successor provision thereto) or being non-deductible to the Company for Federal Income Tax purposes pursuant to Section 280G of the Code (or any successor provision thereto), provided, however, that no such reduction shall occur, and this Section 6(e) shall not apply, in the event that the amount of such reduction would be more than \$25,000. The Executive in good faith shall determine the amount of any reduction to be made pursuant to this Section 6(e) and shall select from among the foregoing benefits and payments those which shall be reduced. No modification of, or successor provision to, Section 280G or Section 4999 subsequent to the date of this Agreement shall, however, reduce the benefits to which the Executive would be entitled under this Agreement in the absence of this Section 6(e) to a greater extent than they would have been reduced if Section 280G and Section 4999 had not been modified or superseded subsequent to the date of this Agreement, notwithstanding anything to the contrary provided in the first sentence of this Section 6(e) (i).

(f) Certain Additional Payments by the Company.

(i) Anything in this Agreement to the contrary notwithstanding, in the event it shall be determined that Section 6(e) above does not apply and any payment or distribution by the Company to or for the benefit of the Executive (whether paid or payable or distributed or distributable pursuant to the terms of this Agreement, any stock option, restricted stock agreement or otherwise, but determined without regard to any additional payments required under this Section 16(f)) (a "Payment") would be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code") or any interest or penalties are incurred by the Executive with respect to such excise tax (such excise tax, together with any such interest and penalties, are hereinafter collectively referred to as the "Excise Tax"), then the Executive shall be entitled to receive an additional payment (a "Gross-Up Payment") in an amount such that after payment by the Executive of all taxes (including any interest or penalties imposed with respect to such taxes), including, without limitation, any income taxes (and any interest and penalties imposed with respect thereto) and Excise Tax imposed upon the Gross-Up Payment, the Executive retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payments.

(ii) Subject to the provisions of Section 6(f)(iii), all determinations required to be made under this Section 6(f), including whether and when a Gross-Up Payment is required and the amount of such Gross-Up Payment and the assumptions to be utilized in arriving at such determination, shall be made by Deloitte and Touche LLP or such other certified public accounting firm as may be designated by the Executive (the "Accounting Firm") which shall provide detailed supporting calculations both to the Company and the Executive within 15 business days of the receipt of notice from the Executive that there has been a Payment, or such earlier time as is requested by the Company. In the event that the Accounting Firm is serving as accountant or auditor for the individual, entity or group effecting the Change of Control, the Executive shall appoint another nationally recognized accounting firm to make the determinations required hereunder (which accounting firm shall then be referred to as the Accounting Firm hereunder). All fees and expenses of the Accounting Firm shall be borne solely by the Company. Any Gross-Up Payment, as determined pursuant to this Section 6(f), shall be paid by the Company to the Executive within five days of the receipt of the Accounting Firm's determination. If the Accounting Firm determines that no Excise Tax is payable by the Executive, it shall furnish the Executive with a written opinion that failure to report the Excise Tax on the Executive's applicable federal income tax return would not result in the imposition of a negligence or similar penalty. Any determination by the Accounting Firm shall be binding upon the Company and the Executive. As a result of the uncertainty in the application of Section 4999 of the Code at the time of the initial determination by the Accounting Firm hereunder, it is possible that Gross-Up Payments which will not have been made by the Company should have been made ("Underpayment"), consistent with the calculations required to be made hereunder. In the event that the Company exhausts its remedies pursuant to Section 6(f)(iii) and the Executive thereafter is required to make a payment of any Excise Tax, the Accounting Firm shall determine the amount of the Underpayment that has occurred and any such Underpayment shall be promptly paid by the Company to or for the benefit of the Executive.

(iii) The Executive shall notify the Company in writing of any claim by the Internal Revenue Service that, if successful, would require the payment by the Company of the Gross-Up Payment. Such notification shall be given as soon as practicable but no later than ten business days after the Executive is informed in writing of such claim (provided that any delay in so informing the Company within such ten business day period shall not affect the obligations of the Company under this Section 6(f) except to the extent that such delay materially and adversely affects the Company) and shall apprise the Company of the nature of such claim and the date on which such claim is requested to be paid. The Executive shall not pay such claim prior to the expiration of the 30-day period following the date on which it gives such notice to the Company (or such shorter period ending on the date that any payment of taxes with respect to such

claim is due). If the Company notifies the Executive in writing prior to the expiration of such period that it desires to contest such claim, the Executive shall:

(A) give the Company any information reasonably requested by the Company relating to such claim,

(B) take such action in connection with contesting such claim as the Company shall reasonably request in writing from time to time, including, without limitation, accepting legal representation with respect to such claim by an attorney reasonably selected by the Company,

(C) cooperate with the Company in good faith in order to effectively contest such claim, and

(D) permit the Company to participate in any proceedings relating to such claim;

provided, however, that the Company shall bear and pay directly all costs and expenses (including additional interest and penalties) incurred in connection with such contest and shall indemnify and hold the Executive harmless, on an after-tax basis, for any Excise Tax or income tax (including interest and penalties with respect thereto) imposed as a result of such representation and payment of costs and expenses. Without limitation on the foregoing provisions of this Section 6(f)(iii), the Company shall control all proceedings taken in connection with such contest and, at its sole option, may pursue or forgo any and all administrative appeals, proceedings, hearings and conferences with the taxing authority in respect of such claim and may, at its sole option, either direct the Executive to pay the tax claimed and sue for a refund or contest the claim in any permissible manner, and the Executive agrees to prosecute such contest to a determination before any administrative tribunal, in a court of initial jurisdiction and in one or more appellate courts, as the Company shall determine; provided, however, that if the Company directs the Executive to pay such claim and sue for a refund, the Company shall advance the amount of such payment to the Executive, on an interest-free basis, and shall indemnify and hold the Executive harmless, on an after-tax basis, from any Excise Tax or income tax (including interest or penalties with respect thereto) imposed with respect to such advance or with respect to any imputed income with respect to such advance; and further provided that any extension of the statute of limitations relating to payment of taxes for the taxable year of the Executive with respect to which such contested amount is claimed to be due is limited solely to such contested amount. Furthermore, the Company's control of the contest shall be limited to issues with respect to which a Gross-Up Payment would be payable hereunder and the Executive shall be entitled to settle or contest, as the case may be, any other issue raised by the Internal Revenue Service or any other taxing authority.

(iv) If, after the receipt by the Executive of an amount advanced by the Company pursuant to Section 6(f)(iii), the Executive becomes entitled to receive any refund with respect to such claim,

the Executive shall (subject to the Company's complying with the requirements of Section 6(f)(iii)) promptly pay to the Company the amount of such refund (together with any interest paid or credited thereon after taxes applicable thereto). If, after the receipt by the Executive of an amount advanced by the Company pursuant to Section 6(f)(iii), a determination is made that the Executive shall not be entitled to any refund with respect to such claim and the Company does not notify the Executive in writing of its intent to contest such denial of refund prior to the expiration of 30 days after such determination, then such advance shall be forgiven and shall not be required to be repaid and the amount of such advance shall offset, to the extent thereof, the amount of Gross-Up Payment required to be paid.

7. Non-exclusivity of Rights. Nothing in this Agreement shall prevent or limit the Executive's continuing or future participation in any plan, program, policy or practice provided by the Company or any of its affiliated companies and for which the Executive may qualify, nor shall anything herein limit or otherwise affect such rights as the Executive may have under any contract or agreement with the Company or any of its affiliated companies. Amounts which are vested benefits or which the Executive is otherwise entitled to receive under any plan, policy, practice or program of or any contract or agreement with the Company or any of its affiliated companies at or subsequent to the Date of Termination shall be payable in accordance with such plan, policy, practice or program or contract or agreement except as explicitly modified by this Agreement.

8. Full Settlement; No Mitigation; Legal Fees. The Company's obligation to make the payments provided for in this Agreement and otherwise to perform its obligations hereunder shall not be affected by any set-off, counterclaim, recoupment, defense or other claim, right or action which the Company may have against the Executive or others. In no event shall the Executive be obligated to seek other employment or take any other action by way of mitigation of the amounts payable to the Executive under any of the provisions of this Agreement and such amounts shall not be reduced whether or not the Executive obtains other employment. The Company agrees to pay, to the full extent permitted by law, all legal fees and expenses which the Executive may reasonably incur as a result of any contest (regardless of the outcome thereof) by the Company, the Executive or others of the validity or enforceability of, or liability under, any provision of this Agreement or any guarantee of performance thereof (including as a result of any contest by the Executive about the amount of any payment pursuant to this Agreement), plus in each case interest on any delayed payment at the applicable Federal rate provided for in Section 7872(f)(2)(A) of the Internal Revenue Code of 1986, as amended (the "Code").

9. Successors.

(a) This Agreement is personal to the Executive and without the prior

written consent of the Company shall not be assignable by the Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by the Executive's legal representatives.

- (b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.
- (c) The Company will require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company to assume expressly and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place.

10. Miscellaneous.

- (a) This Agreement shall be governed by and construed in accordance with the laws of the State of Minnesota, without reference to principles of conflict of laws. The captions of this Agreement are not part of the provisions hereof and shall have no force or effect. This Agreement may not be amended or modified otherwise than by a written agreement executed by the parties hereto or their respective successors and legal representatives.
- (b) All notices and other communications hereunder shall be in writing and shall be given by hand delivery to the other party or by registered or certified mail, return receipt requested, postage prepaid, addressed as follows:

If to the Executive:

Mr. David Roberts
c/o Graco Inc.
88 11th Ave. N.E.
Minneapolis, Mn. 55413

If to the Company:

Graco Inc.
88 11th Ave. N.E.
Minneapolis, Mn. 55413
Attention: Vice President, Human Resources

or to such other address as either party shall have furnished to the other in writing in accordance herewith. Notice and communications shall be effective when actually received by the addressee.

- (c) The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision of this Agreement.

- (d) The Company may withhold from any amounts payable under this Agreement such Federal, state or local taxes as shall be required to be withheld pursuant to any applicable law or regulation.
- (e) The Executive's or the Company's failure to insist upon strict compliance with any provision hereof or any other provision of this Agreement or the failure to assert any right the Executive or the Company may have hereunder, including, without limitation, the right of the Executive to terminate employment for Good Reason pursuant to Section 5(c)(i)(v) of this Agreement, shall not be deemed to be a waiver of such provision or right or any other provision or right of this Agreement.
- (f) The Executive and the Company acknowledge that, except as may otherwise be provided under any other written agreement between the Executive and the Company, the employment of the Executive by the Company may be terminated by either the Executive or the Company at any time prior to the Effective Date or, subject to the obligations of the Company provided for in this Agreement in the event of a termination after the Effective Date, at anytime on or after the Effective Date. Moreover, if prior to the Effective Date, the Executive's employment with the Company terminates, then the Executive shall have no further rights under this Agreement. From and after the Effective Date, this Agreement shall supersede any other agreement between the parties with respect to the subject matter hereof.

IN WITNESS WHEREOF, the Executive has hereunto set the Executive's hand and, pursuant to the authorization from its Board of Directors, the Company has caused these presents to be executed in its name on its behalf.

Executive

Graco Inc.

/s/David A. Roberts

/s/ George Aristides

David A. Roberts

By: George Aristides,
Chairman

STOCK OPTION AGREEMENT
(NON-ISO)

THIS AGREEMENT, made this 25th day of June , 2001, by and between Graco Inc., a Minnesota corporation (the "Company") and David A. Roberts, (the "Employee").

WITNESSETH THAT:

WHEREAS, the Company pursuant to its Stock Incentive Plan wishes to grant this stock option to Employee;

NOW THEREFORE, in consideration of the premises and of the mutual covenants herein contained, the parties hereto hereby agree as follows:

1. Grant of Option

The Company hereby grants to Employee, the right and option (hereinafter called the "option") to purchase all or any part of an aggregate of fifty thousand (50,000) shares of Common Stock of the Company, par value \$1.00 per share, at the price of \$31.20 per share on the terms and conditions set forth herein.

2. Duration and Exercisability

A. This option may not be exercised by Employee until the expiration of one (1) year from the date of grant, and this option shall in all events terminate ten (10) years after the date of grant. During the first year from the date of grant of this option, no portion of this option may be exercised. Thereafter this option shall become exercisable in four cumulative installments of 25% as follows:

Date ----	Total Portion of Option Which is Exercisable -----
One Year after Date of Grant	25%
Two Years after Date of Grant	50%
Three Years after Date of Grant	75%
Four Years after Date of Grant	100%

In the event that Employee does not purchase in any one year the full number of shares of Common Stock of the Company to which he is entitled under this option, he may, subject to the terms and conditions of Section 3 hereof, purchase such shares of Common Stock in any subsequent year during the term of this option.

B. During the lifetime of the Employee, the option shall be exercisable only by him/her and shall not be assignable or transferable by him/her otherwise than by will or the laws of descent and distribution.

3. Effect of Termination of Employment

A. In the event that Employee shall cease to be employed by the Company or its subsidiaries for any reason other than his (i) gross and willful misconduct, (ii) death, (iii) retirement (as defined in Section 3.D. below), or (iv) disability (as defined in Section 3. D. below), Employee shall have the right to exercise the option at any time within three (3) months after such termination of employment to the extent of the full number of shares he was entitled to purchase under the option on the date of termination, subject to the condition that no option shall be exercisable after the expiration of the term of the option.

B. In the event that Employee shall cease to be employed by the Company or its subsidiaries by reason of his gross and willful misconduct during the course of his employment, the option granted hereunder shall be terminated as of the date of the misconduct. For purposes of this letter, gross and willful misconduct includes wrongful appropriation of Company funds, serious violation of Company policy, breach of fiduciary duty or conviction of a felony. Gross and willful misconduct shall not include any action or inaction by Mr. Roberts contrary to the direction of the Board with respect to any initiative, strategy or action of the Company, which action or inaction Mr. Roberts believes is in the best interest of the Company.

C. If the Employee shall die while in the employ of the Company or a subsidiary or within one month after termination of employment for any reason other than gross and willful misconduct and shall not have fully exercised the option, all remaining shares shall become immediately exercisable and such option may be exercised at any time within twelve months after his/her death by the executors or administrators of the Employee or by any person or persons to whom the option is transferred by will or the applicable laws of descent and distribution, and subject to the condition that no option shall be exercisable after the expiration of the term of the option.

D. If the Employee's termination of employment is due to retirement (either after attaining age 55 with 10 years of service, or attaining age 65), or due to disability within the meaning of the provisions of the Graco Long-Term Disability Plan, subject to the condition that no option shall be exercisable after the expiration of the terms of the option, all remaining shares

shall become immediately exercisable and the option may be exercised by the Employee at any time within three years of the Employee's retirement, subject to the condition that no option shall be exercisable after the expiration of the term of the option. In the event of the death of the Employee within the three-year period after retirement, the option may be exercised at any time within twelve months after his/her death by the executors or administrators of the Employee or by any person or persons to whom the option is transferred by will or the applicable laws of descent and distribution, to the extent of the full number of shares he was entitled to purchase under the option on the date of death, and subject to the condition that no option shall be exercisable after the expiration of the term of the option.

4. Manner of Exercise

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- A. The option can be exercised only by Employee or other proper party within the option period delivering written notice to the Company at its principal office in Minneapolis, Minnesota, stating the number of shares as to which the option is being exercised and, except as provided in Section 4. C., accompanied by payment-in-full of the option price for all shares designated in the notice.
 - B. The Employee may, at Employee's election, pay the option price either by check (bank check, certified check, or personal check) or by delivering to the Company for cancellation shares of Common Stock of the Company which have been held by the Employee for not less than six (6) months with a fair market value equal to the option price. For these purposes, the fair market value of the Company's Common Stock shall be the closing price of the Common Stock on the date of exercise on the New York Stock Exchange (the "NYSE") or on the principal national securities exchange on which such shares are traded if the shares are not then traded on the NYSE. If there is not a quotation available for such day, then the closing price on the next preceding day for which such a quotation exists shall be determinative of fair market value. If the shares are not then traded on an exchange, the fair market value shall be the average of the closing bid and asked prices of the Common Stock as reported by the National Association of Securities Dealers Automated Quotation System. If the Common Stock is not then traded on NASDAQ or on an exchange, then the fair market value shall be determined in such manner as the Company shall deem reasonable.
 - C. The Employee may, with the consent of the Company, pay the option price by arranging for the immediate sale of some or all of the shares issued upon exercise of the option by a securities dealer and the payment to the Company by the securities dealer of the

option exercise price.

5. Payment of Withholding Taxes

Upon exercise of any portion of this option, Employee shall pay to the Company an amount sufficient to satisfy any federal, state, or local withholding tax requirements which arise as a result of the exercise of the option or provide the Company with satisfactory indemnification for such payment. Such amount may be paid by the Employee by delivering to the Company for cancellation shares of Common Stock of the Company with a fair market value equal to the minimum amount of such withholding tax requirement by (i) electing to have the Company withhold common shares otherwise to be delivered with a fair market value equal to the minimum statutory amount of such taxes required to be withheld by the Company, or (ii) electing to surrender to the Company previously owned common shares with a fair market value equal to the amount of such minimum tax obligation.

6. Change of Control

A. Notwithstanding Section 2(a) hereof, the entire option shall become immediately and fully exercisable on the day following a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:

(1) acquisition by any individual, entity, or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the beneficial ownership by such Person of 25% or more of either

(a) the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or

(b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

- (i) an acquisition directly from the Company,
- (ii) an acquisition by the Company,
- (iii) an acquisition by an employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the

Company,

- (iv) an acquisition by any Person who is deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 6, a Trust Person shall not be deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by The Graco Foundation or any employee benefit plan of the Company, including, without limitations, the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,
- (v) an acquisition by the Employee or any group that includes the Employee, or
- (vi) an acquisition by any corporation pursuant to a transaction that complies with clauses (a), (b), and (c) of subsection (4) below; and

provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (i) or (ii) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (i) or (ii) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

- (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such

individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or

- (3) The commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; or
- (4) The approval by the shareholders of the Company of a reorganization, merger, consolidation, or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation) excluding, however, such a Business combination pursuant to which
 - (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,
 - (b) no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined

voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and

(c) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial Agreement, or of the action of the Board, providing for such Business Combination; or

(5) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

B. A Change of Control shall not be deemed to have occurred with respect to an Employee if:

(1) the acquisition of the 25% or greater interest referred to in subparagraph A.(1) of this Section 6 is by a group, acting in concert, that includes the Employee or

(2) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding Company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subsections (4) or (5) of this section by a group, acting in concert, that includes that Employee.

7. Adjustments

If there shall be any change in the number or character of the Common Stock of the Company through merger, consolidation, reorganization, recapitalization, dividend in the form of stock (of whatever amount), stock split or other change in the corporate structure of the Company, and all or any portion of the option shall then be unexercised and not yet expired, appropriate adjustments in the outstanding option shall be made by the Company, in order to prevent dilution or enlargement of option rights. Such adjustments shall include, where appropriate, changes in the number of shares of Common Stock and the price per share subject to the outstanding option.

8. Miscellaneous

A. This option is issued pursuant to the Company's Stock Incentive

Plan and is subject to its terms. A copy of the Plan has been given to the Employee. The terms of the Plan are also available for inspection during business hours at the principal offices of the Company.

- B. This Agreement shall not confer on Employee any right with respect to continuance of employment by the Company or any of its subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time. Employee shall have none of the rights of a shareholder with respect to shares subject to this option until such shares shall have been issued to him/her upon exercise of this option.
- C. The Company shall at all times during the term of the option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed on the day and year first above written.

GRACO INC.

By:/s/George Aristide

George Aristides
Chairman of the Board

/s/David A. Roberts

Employee

GRACO INC. AND SUBSIDIARIES
COMPUTATION OF NET EARNINGS PER COMMON SHARE

(Unaudited)

<TABLE>

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 29, 2001	June 30, 2000	June 29, 2001	June 30, 2000
	(in thousands except per share amounts)			
<S>	<C>	<C>	<C>	<C>
Net earnings applicable to common shareholders for basic and diluted earnings per share	\$18,248	\$18,331	\$31,368	\$33,306
Weighted average shares outstanding for basic earnings per share	30,853	30,369	30,707	30,480
Dilutive effect of stock options computed using the treasury stock method and the average market price	592	486	580	482
Weighted average shares outstanding for diluted earnings per share	31,445	30,855	31,287	30,962
Basic earnings per share	\$ 0.59	\$ 0.60	\$ 1.02	\$ 1.09
Diluted earnings per share	\$ 0.58	\$ 0.59	\$ 1.00	\$ 1.08

</TABLE>