

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: 2005-05-02 | Period of Report: 2005-04-01  
SEC Accession No. 0000042888-05-000099

(HTML Version on [secdatabase.com](http://secdatabase.com))

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.: 05789459  
SIC: 3561 Pumps & pumping equipment

Mailing Address  
C/O CORPORATE SERVICE  
COMPANY  
MULTIFOODS TOWER, 33  
SOUTH 6TH STREET  
MINNEAPOLIS MN 55402

Business Address  
88 11TH AVENUE NE  
MINNEAPOLIS MN 55413-1894  
6126236000

**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 **April 1, 2005**

Commission File Number: 001-9249

**GRACO INC.**

(Exact name of registrant as specified in its charter)

Minnesota

(State of incorporation)

41-0285640

(I.R.S. Employer Identification Number)

88 - 11th Avenue N.E.  
Minneapolis, Minnesota

(Address of principal executive offices)

55413

(Zip Code)

(612) 623-6000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

69,190,000 common shares were outstanding as of April 25, 2005.

**GRACO INC. AND SUBSIDIARIES**

**INDEX**

**PART I FINANCIAL INFORMATION**

Item 1.	Financial Statements	
	Consolidated Statements of Earnings	3
	Consolidated Balance Sheets	4
	Consolidated Statements of Cash Flows	5
	Notes to Consolidated Financial Statements	6-12
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	13-15
Item 4.	Controls and Procedures	16

**PART II OTHER INFORMATION**

Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	17
Item 4.	Submission of Matters to a Vote of Security Holders	17
Item 6.	Exhibits	18

**SIGNATURES** 19

**EXHIBITS****PART I**

**GRACO INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF EARNINGS**

(Unaudited)

(In thousands except per share amounts)

	<u>Thirteen Weeks Ended</u>	
	<u>April 1, 2005</u>	<u>March 26, 2004</u>
Net Sales	\$ 170,944	\$ 134,982
Cost of products sold	85,078	61,578
Gross Profit	<u>85,866</u>	<u>73,404</u>
Product development	6,244	5,122
Selling, marketing and distribution	26,407	24,397
General and administrative	12,048	10,443
Operating Earnings	<u>41,167</u>	<u>33,442</u>

Interest expense	339	171
Other expense (income), net	189	(56)
Earnings before Income Taxes	40,639	33,327
Income taxes	13,600	11,000
Net Earnings	\$ 27,039	\$ 22,327
Basic Net Earnings per Common Share	\$ .39	\$ .32
Diluted Net Earnings per Common Share	\$ .38	\$ .32
Cash Dividends Declared per Common Share	\$ .13	\$ .09

See notes to consolidated financial statements.

### GRACO INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

(Unaudited)  
(In thousands)

	<u>April 1, 2005</u>	<u>Dec. 31, 2004</u>
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 12,321	\$ 60,554
Accounts receivable, less allowances of \$6,000 and \$5,600	121,160	109,080
Inventories	63,168	40,219
Deferred income taxes	15,992	15,631
Other current assets	2,077	1,742
Total current assets	<u>214,718</u>	<u>227,226</u>
Property, Plant and Equipment		
Cost	245,956	231,819
Accumulated depreciation	<u>(141,514)</u>	<u>(137,309)</u>
	104,442	94,510
Prepaid Pension	28,006	27,556
Goodwill	49,688	9,199
Other Intangible Assets, net	39,771	8,959
Other Assets	4,070	4,264
Total assets	<u>\$ 440,695</u>	<u>\$ 371,714</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities		
Notes payable to banks	\$ 45,679	\$ 6,021

Trade accounts payable	25,848	18,599
Salaries, wages and commissions	12,119	19,804
Dividends payable	8,983	8,990
Other current liabilities	53,155	43,359
Total current liabilities	145,784	96,773
Retirement Benefits and Deferred Compensation	33,077	33,092
Deferred Income Taxes	11,014	11,012
Shareholders' Equity		
Common stock	69,178	68,979
Additional paid-in capital	108,483	100,180
Retained earnings	74,276	62,773
Other, net	(1,117)	(1,095)
Total shareholders' equity	250,820	230,837
Total Liabilities and Shareholders' Equity	\$ 440,695	\$ 371,714

See notes to consolidated financial statements

## GRACO INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)  
(In thousands)

	<u>Thirteen Weeks Ended</u>	
	<u>April 1, 2005</u>	<u>March 26, 2004</u>
<b>Cash Flows from Operating Activities</b>		
Net Earnings	\$ 27,039	\$ 22,327
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	5,703	4,602
Deferred income taxes	(766)	(901)
Tax benefit related to stock options exercised	1,000	2,500
Change in:		
Accounts receivable	(3,107)	(1,550)
Inventories	(2,329)	(3,949)
Trade accounts payable	1,824	3,717
Salaries, wages and commissions	(9,472)	(4,911)
Retirement benefits and deferred compensation	(86)	(424)
Other accrued liabilities	6,182	6,361
Other	(186)	83
<b>Net cash provided by operating activities</b>	<u>25,802</u>	<u>27,855</u>
<b>Cash Flows from Investing Activities</b>		
Property, plant and equipment additions	(3,735)	(3,838)
Proceeds from sale of property, plant and equipment	32	14
Capitalized software additions	--	(785)

Acquisition of businesses, net of cash acquired	(102,534)	--
<b>Net cash used in investing activities</b>	<u>(106,237)</u>	<u>(4,609)</u>
<b>Cash Flows from Financing Activities</b>		
Borrowings on notes payable and lines of credit	45,816	7,592
Payments on notes payable and lines of credit	(6,062)	(2,123)
Common stock issued	7,946	8,652
Common stock retired	(7,017)	(15,202)
Cash dividends paid	(8,969)	(110,590)
<b>Net cash used in financing activities</b>	<u>31,714</u>	<u>(111,671)</u>
Effect of exchange rate changes on cash	488	(5)
Net increase (decrease) in cash and cash equivalents	(48,233)	(88,430)
<b>Cash and cash equivalents</b>		
Beginning of year	60,554	112,118
End of period	<u>\$ 12,321</u>	<u>\$ 23,688</u>

See notes to consolidated financial statements.

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

- The consolidated balance sheet of Graco Inc. and Subsidiaries (the Company) as of April 1, 2005 and the related statements of earnings and cash flows for the thirteen weeks then ended 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 April 1, 2005, 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 2004 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.

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

	<u>Thirteen Weeks Ended</u>	
	<u>April 1, 2005</u>	<u>March 26, 2004</u>
Net earnings available to common shareholders	\$27,039	\$22,327
Weighted average shares outstanding for basic earnings per share	69,074	69,082
Dilutive effect of stock options computed based on the treasury stock method using the average market price	1,200	1,160
Weighted average shares outstanding for diluted earnings per share	70,274	70,242
Basic earnings per share	\$ .39	\$ .32
Diluted earnings per share	\$ .38	\$ .32

Stock options to purchase 311,800 shares are not included in the 2005 calculation of diluted earnings per share because they would have been anti-dilutive.

3. The Company accounts for its stock option and purchase plans using the intrinsic value method and has adopted the “disclosure only” provisions of Statement of Financial Accounting Standards (SFAS) No. 123, as amended by SFAS No. 148, “Accounting for Stock-Based Compensation – Transition and Disclosure.” No compensation cost has been recognized for the Employee Stock Purchase Plan and stock options granted under the various stock incentive plans.

Had compensation cost been determined based upon fair value (using the Black-Scholes option-pricing method) at the grant date for awards under these plans, the Company’s net earnings and earnings per share would have been reduced as follows (in thousands, except per share amounts):

	<u>Thirteen Weeks Ended</u>	
	<u>April 1, 2005</u>	<u>March 26, 2004</u>
<b>Net earnings</b>		
As reported	\$27,039	\$22,327
Stock-based compensation, net of related tax effects	1,058	873
Pro forma	<u>\$25,981</u>	<u>\$21,454</u>
<b>Net earnings per common share</b>		
Basic as reported	\$ .39	\$ .38
Basic pro forma	.38	.31
Diluted as reported	.38	.32
Diluted pro forma	.37	.31

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (Revised 2004), "Share-Based Payment" that requires compensation costs related to share-based payment transactions to be recognized in the financial statements. This standard will be effective for the Company starting with the first quarter of 2006. Annual compensation cost, net of tax effects, related to unvested stock compensation as of April 1, 2005 is approximately \$4.6 million in 2005, \$2.5 million in 2006, \$1.7 million in 2007 and \$0.6 million in 2008 (as valued and calculated under SFAS 123 pro forma disclosures.) The Company has not yet determined how it will value future grants or whether it will elect to adjust prior periods upon adoption of SFAS No. 123 (Revised 2004).

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

	<u>Thirteen Weeks Ended</u>	
	<u>April 1, 2005</u>	<u>March 26, 2004</u>
<b>Pension Benefits</b>		
Service Cost	\$ 1,251	\$ 1,060
Interest Cost	2,489	2,179
Expected return on assets	(3,950)	(3,525)
Amortization and other	157	146
Net periodic benefit cost (credit)	<u>\$ (53)</u>	<u>\$ (140)</u>
<b>Postretirement Medical</b>		
Service Cost	\$ 225	\$ 250
Interest Cost	410	388
Amortization of net loss	115	112
Net periodic benefit cost	<u>\$ 750</u>	<u>\$ 750</u>

5. Total comprehensive income for the quarter was \$26.9 million in 2005 and \$22.0 million in 2004. There have been no significant changes to the components of comprehensive income from those noted on the 2004 Form 10-K.

6. The Company has three reportable segments; Industrial/Automotive, Contractor and Lubrication. The Company does not identify assets by segment. Sales and operating earnings by segment for the thirteen weeks ended April 1, 2005 and March 26, 2004 were as follows (in thousands):

	<u>Thirteen Weeks Ended</u>	
	<u>April 1, 2005</u>	<u>March 26, 2004</u>
<b>Net Sales</b>		
Industrial/Automotive	\$ 87,869	\$ 63,251
Contractor	67,780	58,975
Lubrication	15,295	12,756
Consolidated	<u>\$170,944</u>	<u>\$134,982</u>
<b>Operating Earnings</b>		



Industrial/Automotive	\$ 21,964	\$ 20,265
Contractor	15,086	11,925
Lubrication	4,199	3,002
Unallocated corporate expense	<u>(82)</u>	<u>(1,750)</u>
Consolidated	<u>\$ 41,167</u>	<u>\$ 33,442</u>

Segment operating earnings for 2004 have been restated to conform to 2005, which includes amortization of intangibles formerly classified as unallocated corporate expense.

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

	<u>April 1, 2005</u>	<u>Dec. 31, 2004</u>
Finished products and components	\$ 46,321	\$ 29,263
Products and components in various stages of completion	22,604	18,656
Raw materials and purchased components	<u>22,689</u>	<u>19,929</u>
	91,614	67,848
Reduction to LIFO cost	<u>(28,446)</u>	<u>(27,629)</u>
Total	<u>\$ 63,168</u>	<u>\$ 40,219</u>

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

	<u>Estimated Life (Years)</u>	<u>Original Cost</u>	<u>Amorti- zation</u>	<u>Foreign Currency Translation</u>	<u>Book Value</u>
<u>April 1, 2005</u>					
Customer relationships and distribution network	4 - 8	\$20,365	\$(2,203)	\$(22)	\$18,140
Patents, proprietary technology and product documentation	3 - 15	10,871	(915)	(10)	9,946
Trademarks, trade names favorable lease and other	3 - 10	<u>1,774</u>	<u>(602)</u>	<u>--</u>	<u>1,172</u>
		33,010	(3,720)	(32)	29,258
Not Subject to Amortization:					
Brand names		<u>10,550</u>	<u>--</u>	<u>(37)</u>	<u>10,513</u>
Total		<u>\$43,560</u>	<u>\$(3,720)</u>	<u>\$(69)</u>	<u>\$39,771</u>
<u>December 31, 2004</u>					

Customer relationships and distribution network	5	\$ 3,765	\$(1,543)	\$ --	\$ 2,222
Patents, proprietary technology and product documentation	3 - 15	1,241	(611)	--	630
Trademarks, trade names and other	2 - 10	<u>1,494</u>	<u>(667)</u>	--	<u>827</u>
		<u>6,500</u>	<u>(2,821)</u>	--	<u>3,679</u>
Not Subject to Amortization:					
Brand names		<u>5,280</u>	--	--	<u>5,280</u>
Total		<u>\$11,780</u>	<u>\$(2,821)</u>	<u>\$ --</u>	<u>\$ 8,959</u>

Amortization of intangibles during the first quarter of 2005 was \$1.0 million. Estimated annual amortization is as follows: \$4.5 million in 2005, \$4.6 million in 2006, \$4.6 million in 2007, \$3.9 million in 2008, \$3.5 million in 2009 and \$9.2 million thereafter.

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

	<u>April 1, 2005</u>	<u>Dec. 31, 2004</u>
Accrued insurance liabilities	\$ 9,207	\$ 9,139
Accrued warranty and service liabilities	9,022	9,409
Accrued trade promotions	3,218	6,574
Payable for employee stock purchases	995	4,913
Income taxes payable	13,553	2,188
Other	<u>17,160</u>	<u>11,136</u>
	<u>\$53,155</u>	<u>\$43,359</u>

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

	Thirteen Weeks Ended <u>April 1, 2005</u>	Year Ended <u>Dec. 31, 2004</u>
Balance, beginning of year	\$ 9,409	\$ 9,227
Charged to expense	1,712	8,066
Margin on parts sales reversed	328	2,516
Reductions for claims settled	<u>(2,427)</u>	<u>(10,400)</u>
Balance, end of period	<u>\$ 9,022</u>	<u>\$ 9,409</u>

10. Effective January 1, 2005, the Company purchased the stock of Liquid Control Corporation, Inc. and its affiliated company Profill Corp. for approximately \$35 million cash. Liquid Control designs and manufactures highly engineered precision resin dispensing equipment, which will expand and complement the Company's Industrial/Automotive business. Liquid Control

had sales of approximately \$26 million in 2004. Results of Liquid Control' s operations have been included in the Industrial/Automotive segment since the date of acquisition.

The purchase price was allocated based on estimated fair values as follows (in thousands):

Accounts receivable and prepaid expenses	\$ 2,900
Inventories	4,900
Property, plant and equipment	7,800
Identifiable intangible assets	16,100
Goodwill	8,600
Total purchase price	<u>40,300</u>
Liabilities assumed	<u>(4,900)</u>
Net assets acquired	<u>\$ 35,400</u>

Identifiable intangible assets and weighted average estimated useful life are as follows (dollars in thousands):

Customer relationships (8 years)	\$10,100
Proprietary technology (8 years)	<u>3,500</u>
Total (8 years)	13,600
Brand names (indefinite useful life)	<u>2,500</u>
Total identifiable intangible assets	<u>\$16,100</u>

For tax purposes, the transaction will be treated as a purchase of assets and goodwill is expected to be fully deductible.

Effective February 4, 2005, the Company purchased the stock of Gusmer Corporation Inc. and Gusmer Europe, S.L. for approximately \$68 million cash. Gusmer designs and manufactures specialized two-component dispense equipment systems, which will expand and complement the Company' s Industrial/Automotive business. Gusmer had sales of approximately \$43 million in 2004. Results of Gusmer' s operations have been included in the Industrial/Automotive segment since the date of acquisition.

The purchase price has not been finalized and is subject to agreement on closing asset and liability balances. The preliminary purchase price was allocated based on estimated fair values as follows (in thousands):

Cash and cash equivalents	\$ 500
Accounts receivable	7,400
Inventories	15,600
Property, plant and equipment	2,900
Identifiable intangible assets	15,800
Goodwill	31,900

Total purchase price	74,100
Liabilities assumed	(6,500)
Net assets acquired	<u>\$67,600</u>

Identifiable intangible assets and weighted average estimated useful life are as follows (dollars in thousands):

Customer relationships (7 years)	\$ 6,500
Proprietary technology (8 years)	4,400
Product documentation (5 years)	1,800
Favorable lease (3 years)	<u>400</u>
Total (7 years)	13,100
Brand names (indefinite useful life)	<u>2,700</u>
Total identifiable intangible assets	<u>\$15,800</u>

For tax purposes, the transaction will be treated as a purchase of assets and goodwill is expected to be fully deductible.

The following pro forma information assumes the acquisitions of Liquid Control and Gusmer occurred as of the beginning of each quarter presented. The pro forma information is not necessarily indicative of what would have actually occurred or of future results (in thousands, except per share amounts).

	<u>Thirteen Weeks Ended</u>	
	<u>April 1, 2005</u>	<u>March 26, 2004</u>
Net sales	\$175,600	\$152,500
Net earnings	26,500	20,300
Basic earnings per share	.38	.29
Diluted earnings per share	.38	.29

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

**Item 2.**

**Results of Operations**

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

	<u>Thirteen Weeks Ended</u>	
	<u>April 1, 2005</u>	<u>March 26, 2004</u>
Net Sales	100.0%	100.0%
Cost of products sold	<u>49.8</u>	<u>45.6</u>
Gross Profit	50.2	54.4
Product development	3.7	3.8
Selling, marketing and distribution	15.4	18.1
General and administrative	<u>7.0</u>	<u>7.7</u>

Operating Earnings	24.1	24.8
Interest expense	.2	0.1
Other (income) expense, net	.1	--
Earnings before Income Taxes	23.8	24.7
Income taxes	8.0	8.2
Net Earnings	15.8%	16.5%

## Net Sales

Sales by segment and geographic area were as follows (in thousands):

	Thirteen Weeks Ended	
	April 1, 2005	March 26, 2004
<b>By Segment</b>		
Industrial/Automotive	\$ 87,869	\$ 63,251
Contractor	67,780	58,975
Lubrication	15,295	12,756
Consolidated	<u>\$170,944</u>	<u>\$134,982</u>
<b>By Geographic Area</b>		
Americas <sup>1</sup>	\$114,019	\$ 89,275
Europe <sup>2</sup>	35,709	27,914
Asia Pacific	21,216	17,793
Consolidated	<u>\$170,944</u>	<u>\$134,982</u>

<sup>1</sup>North and South America, including the U.S.

<sup>2</sup>Europe, Africa and Middle East

Consolidated sales increased by 27 percent compared to the first quarter last year. Sales from acquired businesses contributed 11 percentage points of the increase. All operating segments and geographic regions experienced double-digit percentage growth in sales.

Industrial/Automotive sales increased by 39 percent, 15 percent before sales from acquired operations. Demand for this segment's products remained strong in all major product categories and in all geographic regions.

Contractor segment sales increased by 15 percent. In the Americas, there was double-digit percentage growth in both the professional paint store channel and the home center channel. Sales of larger paint sprayers were particularly strong in the professional paint store channel. The rollout of texture sprayers contributed to the increase in home center channel sales.

Lubrication segment sales increased by 20 percent. Sales were strong in all geographic regions and major product categories. Re-introduction of the Matrix™ fluid management system in the second quarter should have a positive impact on future sales.

## Gross Profit

Gross profit as a percentage of sales was 50.2 percent compared to 54.4 percent for the first quarter last year. Approximately 3 percentage points of the decline was due to the impact of acquisitions, including lower margins on acquired products and the recognition of costs assigned to inventories as part of the valuation of assets acquired. The remainder of the decrease is due to several factors, including mix of products sold and higher material costs, offset somewhat by favorable effects of higher volume and process improvements.

### **Operating Expenses**

Total operating expenses increased due to the expenses of the acquired operations. Expenses as a percentage of sales decreased to 26.1 percent from 29.6 percent.

General and administrative expense includes approximately \$1 million from the amortization of intangible assets related to the businesses acquired in 2005. The annual recurring non-cash expense associated with amortization of intangible assets from those acquired companies is expected to be approximately \$4 million.

### **Liquidity and Capital Resources**

During the quarter, significant uses of cash included \$103 million for acquisitions of businesses, \$9 million of dividends paid and \$7 million for purchases and retirement of Company common stock. The Company used cash on hand and a \$40 million advance from a line of credit to fund the acquisitions. During the first quarter of 2004, significant uses of cash included \$111 million of dividends paid (including \$104 million for a one-time special dividend) and \$15 million for purchases and retirement of Company common stock.

The Company had unused lines of credit available at April 1, 2005 totaling \$80 million. Cash balances of \$12 million at April 1, 2005, internally generated funds and unused financing sources provide the Company with the financial flexibility to meet liquidity needs.

### **Outlook**

Results for the first quarter were in line with management's expectations. While management's vision is limited due to the short cycle nature of the business, the sales tempo experienced throughout the quarter was good and management continues to expect growth this year. Management expects that the businesses acquired in the first quarter will begin to contribute to net earnings in the second half of this year.

### **SAFE HARBOR CAUTIONARY STATEMENT**

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

The Company desires to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 by making cautionary statements concerning any forward-looking statements made by or on behalf of the Company. The Company cannot give any assurance that the results forecasted in any forward-looking statement will actually be achieved. Future results could differ materially from those expressed, due to the impact of changes in various factors. These risk factors include, but are not limited to: economic conditions in the United States and other major world economies, currency fluctuations, political instability, changes in laws and regulations, and changes in product demand. Please refer to Exhibit 99 to the Company's Annual Report on Form 10-K for fiscal year 2004 for a more comprehensive discussion of these and other risk factors.

Investors should realize that factors other than those identified above and in Exhibit 99 might prove important to the Company's future results. It is not possible for management to identify each and every factor that may have an impact on the Company's operations in the future as new factors can develop from time to time.

Item 4.

## CONTROLS AND PROCEDURES

### Evaluation of disclosure controls and procedures

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

### Changes in internal controls

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

## PART II

### Item 2      **Unregistered Sales of Equity Securities and Use of Proceeds**

#### Issuer Purchases of Equity Securities

On February 22, 2002, the Board of Directors authorized a plan for the Company to purchase up to a total of 2,700,000 shares of its outstanding common stock, primarily through open-market transactions. This plan effectively expired upon approval of a new plan on February 20, 2004, authorizing the purchase of up to 3,000,000 shares and expiring on February 28, 2006.

In addition to shares purchased under the plan, the Company purchases shares of common stock held by employees who wish to tender owned shares to satisfy the exercise price or tax withholding on option exercises.

Information on issuer purchases of equity securities follows:

<u>Period</u>	(a) Total Number of Shares <u>Purchased</u>	(b) Average Price Paid <u>per Share</u>	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or <u>Programs</u>	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or

				<u>Programs (at end of period)</u>
Jan 1, 2005 - Jan 28, 2005	--	--	--	1,969,400
Jan 29, 2005 - Feb 25, 2005	53,200	\$37.50	53,200	1,916,200
Feb 26, 2005 - Apr 1, 2005	127,500	\$39.39	127,500	1,788,700

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

None

**Item 6. Exhibits**

- 10.1 Long Term Stock Incentive Plan, as amended and restated June 18, 2004
- 10.2 Graco Inc. Stock Incentive Plan, as amended and restated June 18, 2004
- 10.3 Employee Stock Incentive Plan, as amended and restated June 18, 2004
- 10.4 Graco Inc. Nonemployee Director Stock Option Plan, as amended and restated June 18, 2004
- 31.1 Certification of President and Chief Executive Officer pursuant to Rule 13a-14(a)
- 31.2 Certification of Vice President and Controller pursuant to Rule 13a-14(a)
- 31.3 Certification of Vice President and Treasurer pursuant to Rule 13a-14(a)
- 32 Certification of President and Chief Executive Officer, Vice President and Controller, and Vice President and Treasurer pursuant to Section 1350 of Title 18, U.S.C.

**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: April 29, 2005

By: /s/David A. Roberts  
David A. Roberts  
President and Chief Executive Officer

Date: April 29, 2005

By: /s/James A. Graner  
James A. Graner  
Vice President and Controller

Date: April 29, 2005

By: /s/Mark W. Sheahan  
Mark W. Sheahan  
Vice President and Treasurer

## LONG TERM STOCK INCENTIVE PLAN

**1. Purpose.** The purpose of the Graco Inc. Long Term Stock Incentive Plan (the "Plan") is to further the growth in earnings and market appreciation of Graco Inc. (the "Company"). The Plan provides substantial contributions to the Company through ability, performance, industry and invention. The Company intends that the Plan will thereby facilitate securing, retaining and motivating officers and key employees of high caliber and good potential.

**2. Administration.** The Plan shall be administered by a committee (the "Committee") selected by the Board of Directors of the Company (the "Board"). The Committee shall consist of two or more members who are members of the Board and who are "Non-Employee Directors" within the meaning of Rule 16b-3 promulgated by the Securities and Exchange Commission under the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), which term "Non-Employee Director" is defined in this paragraph for purposes of describing the members of the Committee only and is not intended to define such term as it may be used elsewhere in the Plan. The Committee may delegate to one or more officers of the Company or a committee of such officers the authority, subject to such terms and limitations as the Committee shall determine to grant awards to employees of the Company who are not officers or directors of the Company for purposes of Section 16 of the Exchange Act.

The Committee shall have full and final authority, in its discretion, to interpret the provisions of the Plan and to decide all questions of fact arising in its application; to determine the employees to whom awards shall be made under the Plan; to determine the type of award to be made and the amount, size, terms and conditions of each such award; to determine and establish additional terms and conditions not inconsistent with the Plan and for any agreements entered into with participants in connection with the Plan; to determine the time when awards will be granted and when rights may be exercised, which may be after termination of employment; and to make all other determinations necessary or advisable for the administration of the Plan.

The Committee shall select one of its members as its Chairman and shall hold its meetings at such times and places as it may determine. A majority of its members shall constitute a quorum. All determinations of the Committee shall be made by not less than a majority of its members. Any decision or determination reduced to writing and signed by all of the members of the Committee shall be fully effective as if it had been made by a majority vote at a meeting duly called and held. The granting of a stock option or restricted stock award pursuant to the Plan shall be effective only if a written agreement shall have been duly executed and delivered by and on behalf of the Company and, in the case of a restricted stock award, by the employee to whom such right is granted. The Committee may appoint a Secretary and may make such rules and regulations for the conduct of its business as it shall deem advisable.

**3. Participants.** Persons eligible to participate in the Plan shall be those officers and key employees of the Company or its subsidiaries who are in positions in which their decisions, actions and counsel significantly impact the performance of the Company or its subsidiaries. Directors of the Company who are not otherwise salaried employees of the Company shall not be eligible to receive awards under the Plan. For the purpose of awards of incentive stock options (as hereinafter defined) made under the Plan, the term "subsidiary" shall have the meaning given to it by Section 424 of the Internal Revenue Code of 1986, as amended (the "Code"). For the purpose of all other awards made under the Plan, the term "subsidiary" shall have the meaning given to it by Rule 405 promulgated under the Securities Act of 1933, as amended. References to "the Company" in this Plan or in any option or other award granted pursuant to the Plan shall be deemed references to a subsidiary if appropriate.

**4. Awards under the Plan.** Awards by the Committee under the Plan may be in the form of stock options intended to qualify as "incentive stock options" under the provision of Section 422 of the Code, stock options which do not qualify for special tax treatment under Section 422, restricted stock and other stock awards pursuant to such bonus and incentive plans as the Committee may deem appropriate.

**4.1 Award Limitation.** In any calendar year beginning with January 31, 1997, the Committee may not award stock options or stock appreciation rights on more than 300,000 Shares in the aggregate to any Participant who is an employee of the Company at the time of such award. This award limit may be adjusted in accordance with the provisions of Section 15. This limitation is intended to qualify the award of options and stock appreciation rights as performance-based compensation within the meaning of Section 162(m) of the Code.

**5. Shares Subject to Plan.** The shares that may be issued under the Plan shall not exceed in the aggregate 5,212,500 common shares, \$1.00 par value, of the Company. Except as otherwise provided herein, any shares subject to an option or right or other awards which for any reason expires or terminates without issuance or final vesting of such shares shall again be available under the Plan. No fractional shares shall be issued under the Plan.

**6. Stock Options.** Stock options shall be evidenced by stock option agreements in such form not inconsistent with the Plan as the Committee shall approve from time to time, which agreements shall contain in substance the following terms and conditions.

**6.1. Option Price.** The purchase price per common share deliverable upon the exercise of an option shall not be less than 100% of the fair market value of the stock on the day the option is granted, as determined by the Committee.

**6.2. Exercise of Option.** Each stock option agreement shall state the period or periods of time within which the option may be exercised by the participant, in whole or in part, which shall be such period or periods of time as may be determined by the Committee, provided that the option period shall not end later than ten years after the date of the grant of the option.

**6.3. Payment of Shares.** An optionee electing to exercise an option shall give written notice to the Company of such election and of the number of shares subject to such exercise. The full purchase price of such shares shall be tendered with such notice of exercise or, at the discretion of the Committee, pursuant to any arrangements satisfactory to the Committee which provide that the Company will be paid at the time the shares are delivered to the optionee or his designee. Payment shall be made either in cash (including check, bank draft or money order) or, at the discretion of the Committee, (i) by delivering the Company's common shares already owned by the optionee having a fair market value equal to the full purchase price of the shares, or (ii) a combination of cash and such shares.

**6.4. Special Rule for Incentive Stock Options.** The aggregate fair market value (determined as of the time the option is granted) of the common shares with respect to which all incentive stock options granted after January 1, 1987 are exercisable for the first time by any individual during any calendar year (under all option plans of the Company and its parent and subsidiary corporations) shall not exceed \$100,000.

**7. Restricted Stock Awards.** Restricted stock awards shall be evidenced by restricted stock agreements in such form not inconsistent with the Plan as the Committee shall approve from time to time, which agreements shall contain in substance the following terms and conditions.

**7.1. Restriction Period.** Shares awarded pursuant to restricted stock awards shall be subject to such conditions, terms and restrictions (including continued employment, achievement of performance targets, forfeiture and transfer) and for such period or periods as shall be determined by the Committee. The Committee shall have the power, in its discretion, to permit an acceleration of the expiration of the applicable restriction period with respect to any part of all of the shares awarded to a participant.

**7.2 Restrictions Upon Transfer.** The common shares subject to an award, may not be sold, assigned, transferred, exchanged, pledged, hypothecated, or otherwise encumbered, except as herein provided, during the restriction period applicable to such shares, but a participant shall have all the other rights of a stockholder, including the right to receive cash dividends and the right to vote such shares, until such time as the restrictions have lapsed or the shares have been forfeited.

**7.3 Certificates.** Each certificate issued in respect of common shares awarded to a participant shall be deposited with the Company, or its designee, and shall bear an appropriate legend noting the existence of restrictions upon the transfer of such Common Stock.

**7.4 Lapse of Restrictions.** The agreement governing the awards shall specify the conditions and terms upon which any restrictions upon shares awarded under the Plan shall lapse, as determined by the Committee. Upon lapse of such restrictions, common shares free of any restrictive legend, other than as may be required under Section 9 hereof, shall be issued and delivered to the participant of his legal representative.

**8. Fair Market Value.** The fair market value of a share of the Company's common stock is the last sale price reported on the composite tape by the New York Stock Exchange on the business day immediately preceding the date as of which fair market value is being determined or, if there were no sales of shares of the Company's common stock reported on the composite tape on such day, on the most recently preceding day on which there were sales, or if the shares of the Company's stock are not listed or admitted to trading on the New York Stock Exchange on the day as of which the determination is made, the amount determined by the Board or its delegate to be the fair market value of a share on such day.

**9. General Restrictions.** Each award under the Plan shall be subject to the requirement that, if at anytime the Committee shall determine that (a) the listing, registration or qualification of the common shares subject or related thereto upon any securities exchange or under any state or federal law, or (b) the consent or approval of any government regulatory body, or (c) an agreement by the recipient of an award with respect to the disposition of common shares, is necessary or desirable in connection with, the granting of such award or the issue or purchase of common shares thereunder, such award may not be consummated in whole or in part unless such listing, registration, qualification, consent, approval or agreement shall have been effected or obtained free of any conditions not acceptable to the Committee. A participant shall agree, as a condition of receiving any award under the Plan, to execute any documents, make any representations, agree to restrictions on stock transferability and take any actions which in the opinion of legal counsel to the Company is required by any applicable law, ruling or regulation.

**10. Rights of a Shareholder.** The recipient of any award under the Plan, unless otherwise provided by the Plan, shall have no rights as a shareholder with respect thereto unless and until, either (i) an entry reflecting the issuance of the common shares to the recipient is made on the books of the Company (or its transfer agent), or (ii) a certificate or certificates representing the common shares is delivered to the recipient.

**11. Right to Terminate Employment.** Nothing in the Plan or in any agreement entered into pursuant to the Plan shall confer upon any participant the right to continue in the employment of the Company or its subsidiaries, or affect any right which the Company or such subsidiaries may have to terminate the employment of the participant.

**12. Withholding.**

**12.1. Payment of Withholding Taxes.** Whenever the Company proposes or is required to issue or transfer common shares under the Plan, the Company shall have the right to require the recipient to remit to the Company, or provide indemnification satisfactory to the Company for, an amount sufficient to satisfy any federal, state or local withholding tax requirements before an entry is made in the books of the Company (or its transfer agent) reflecting the issuance of the common shares or any certificate or certificates representing such shares is delivered to the recipient.

**12.2. Use of Common Shares to Satisfy Tax Obligation.** In order to assist an optionee or grantee in paying all federal, state and local taxes to be withheld or collected upon exercise of an option or the grant of a stock award or the lapse of restrictions relating to a restricted stock award hereunder, the Committee in its sole discretion and subject to such rules as it may adopt, may permit the optionee or grantee to satisfy 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.

**13. Non-Assignability.** No award under the Plan shall be assignable or transferable by the participant except by will or by laws of descent and distribution. During the life of a participant, such award shall be exercisable only by the participant or by the participant's guardian or legal representative.

**14. Non-Uniform Determinations.** The Committee's determinations under the Plan (including, without limitation, determinations of the persons to receive awards, the form, amount and timing of such awards, the terms and provisions of awards and the agreements evidencing the awards, and the establishment of values and performance targets) need not be uniform and may be made by it selectively among persons who receive, or are eligible to receive, awards under the Plan whether or not such persons are similarly situated.

**15. Adjustments in Shares.** In the event of any change in the outstanding common shares of the Company by reason of a stock dividend or distribution, recapitalization, merger, consolidation, split-up, combination, exchange of shares or otherwise, the Board shall adjust the number of shares which may be issued under the Plan and the Board shall provide for an equitable adjustment of any shares issuable pursuant to awards outstanding under the Plan.

**16. Adoption, Amendment and Termination.**

**16.1. Adoption.** This Plan was originally adopted in February 1982 as the Graco Inc. Incentive Stock Option Plan. The Plan was amended and restated as the Graco Inc. Long Term Stock Incentive Plan by the Board of Directors on March 4, 1988 and was further amended by the Board on December 13, 1991, February 21, 1992, February 23, 1996 and May 7, 1996, which amendments requiring shareholder approval were approved by the shareholders on May 5, 1992 and May 7, 1996, respectively.

**16.2. Amendment.** The Board may amend, suspend, or terminate the Plan at any time, but without shareholder approval, no amendment shall materially increase the maximum number of shares which may be issued under the Plan (other than increases pursuant to Section 15 hereof), materially increase the benefits accruing to participants under the Plan, materially modify the requirements as to eligibility for participation, or extend the term of the Plan.

**16.3. Termination.** Unless the Plan shall have been discontinued at an earlier date, the Plan shall terminate on December 13, 2001. No option, restricted stock award or stock awards may be granted after such termination, but termination of the Plan shall not, without the consent of the optionee or grantee, alter or impair any rights or obligations under any award theretofore granted.

**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 3,375,000; provided, however, that a maximum of 3,375,000 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 3,375,000, 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. After the restrictions lapse or are waived, the legended stock certificates will be returned to the Company (or its transfer agent) for cancellation and an entry reflecting the issuance of the Shares to the Participant without restrictions will be made on the books of the Company (or its transfer agent). 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, thereby evidencing the right to receive Shares, an entry reflecting the issuance of such Shares without restrictions to the holder of the Restricted Stock Units will be made on the books of the Company (or its transfer agent).

(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) by delivering to the Company certificated Shares from the Participant's account on the books of the Company (or its transfer agent) to the Company, 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 six (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 to be 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.

## EMPLOYEE STOCK INCENTIVE PLAN

**1. Purpose.** The purpose of the Graco Inc. Employee Stock Incentive Plan (the “Plan”) is to promote the best interests of Graco Inc. (the “Company”) and its shareholders by providing employees of the Company and its subsidiaries the opportunity to acquire a proprietary interest in the Company and thus develop a strong incentive to put forth their best efforts and support changes to further the growth in earnings and market appreciation of the Company. The Company intends that the Plan will thereby facilitate securing, retaining and motivating employees of high caliber.

**2. Administration.** (a) The Plan shall be administered by a committee (the “Committee”) selected by the Board of Directors of the Company (the “Board”) and consisting of members of the Board. The Committee shall have full and final authority, in its discretion, to interpret the provisions of the Plan and to decide all questions of fact arising in its application; to determine the employees to whom awards shall be made under the Plan; to determine the type of award to be made and the amount, size, terms and conditions of each such award; to determine and establish additional terms and conditions not inconsistent with the Plan and any agreements entered into with participants in connection with the Plan or any stock option award document issued pursuant to the Plan; to determine the time when awards will be granted and when rights may be exercised, which may be after termination of employment; and to make all other determinations necessary or advisable for the administration of the Plan.

(b) The Committee shall select one of its members as its Chairman and shall hold its meetings at such times and places as it may determine. A majority of its members shall constitute a quorum. All determinations of the Committee shall be made by not less than a majority of its members. Any decision or determination reduced to writing and signed by all of the members of the Committee shall be fully effective as if it had been made by a majority vote at a meeting duly called and held. The Committee may appoint a Secretary and may make such rules and regulations for the conduct of its business as it shall deem advisable.

(c) The Committee may delegate all or any part of its authority under this Plan to the Chief Executive Officer of the Company for purposes of making the determinations set forth in subparagraph (a) above and elsewhere in the Plan. The Chief Executive Officer may, in turn, delegate such authority to such other executive officer of the Company as the Chief Executive Officer may determine.

**3. Participants.** Persons eligible to participate in the Plan shall be those employees of the Company or its subsidiaries who are not officers of the Company, as officer is defined in Section 16 of the Securities Exchange Act of 1934 and the rules thereunder. Such officers shall not be eligible to receive awards under the Plan. For the purpose of all awards made under the Plan, the term “subsidiary” shall have the meaning given to it by Rule 405 promulgated under the Securities Act of 1933, as amended. References to “the Company” in this Plan or in any option or other award granted pursuant to the Plan shall be deemed to include a reference to subsidiaries if appropriate.

**4. Awards under the Plan.** Awards by the Committee under the Plan shall be in the form of stock options which do not qualify for special tax treatment under Section 422 of the Internal Revenue Code of 1986, as amended from time to time.

**5. Shares Subject to the Plan.** The shares that may be issued under the Plan shall not exceed in the aggregate 3,375,000 common shares, \$1.00 par value, of the Company. Except as otherwise provided herein, any shares subject to an option which for any reason expires or terminates without issuance or final vesting of such shares shall again be available under the Plan. No fractional shares shall be issued under the Plan.

**6. Stock Options.** Stock options shall be evidenced by a stock option award document in such form not inconsistent with the Plan as the Committee shall approve from time to time, which document shall contain in substance the following terms and conditions.

**6.1. Option Price.** The purchase price per common share deliverable upon the exercise of an option shall not be less than 100% of the fair market value of the stock on the day the option is granted, as determined by the Committee.

**6.2. Exercise of Option.** Each stock option document shall state the period or periods of time within which the option may be exercised by the participant, in whole or in part, which shall be such period or periods of time as may be determined by the Committee, provided that the option period shall not end later than ten years after the date of the grant of the option.

**6.3. Payment of Shares.** A person holding an option ("optionee") awarded under the plan shall notify the Company in writing when the person wishes to exercise the option and designate the number of shares the person wishes to exercise. The full purchase price of such shares shall be tendered with such notice of exercise or, at the discretion of the Committee, pursuant to any arrangements satisfactory to the Committee which provide that the Company will be paid at the time the shares are delivered to the optionee or his or her designee. Payment shall be made either in cash (including check, bank draft or money order) or, at the discretion of the Committee, (i) by delivering the Company's common shares already owned by the optionee having a fair market value equal to the full purchase price of the shares, or (ii) by a reduction in the number of shares delivered upon exercise of the option (iii) a combination of cash and such shares (in each case such shares having an aggregate fair market value on the date of exercise equal to the amount of the purchase price being paid through such delivery or reduction of shares).

**7. Fair Market Value.** The fair market value of a share of the Company's common stock is the last sale price reported on the composite tape by the New York Stock Exchange on the business day immediately preceding the date as of which fair market value is being determined or, if there were no sales of shares of the Company's common stock reported on the composite tape on such day, on the most recently preceding day on which there were sales, or if the shares of the Company's stock are not listed or admitted to trading on the New York Stock Exchange on the day as of which the determination is made, the amount determined by the Committee to be the fair market value of a share on such day.

**8. General Restrictions.** Each award under the Plan shall be subject to the requirement that if, at anytime the Committee shall determine that (a) the listing, registration or qualification of the common shares subject or related thereto upon any securities exchange or under any state or federal law, or (b) the consent or approval of any government regulatory body, or (c) an agreement by the recipient of an award with respect to the disposition of common shares, is necessary or desirable in connection with the granting of such award or the issue or purchase of common shares thereunder, such award may not be consummated in whole or in part unless such listing, registration, qualification, consent, approval or agreement shall have been effected or obtained free of any conditions not acceptable to the Committee. A participant shall, as a condition of receiving any award under the Plan, execute any documents, make any representations, comply with restrictions on stock transferability and take any actions which in the opinion of legal counsel to the Company is required by any applicable law, ruling or regulation.

**9. Rights of a Shareholder.** The recipient of any award under the Plan, unless otherwise provided by the Plan, shall have no rights as a shareholder with respect thereto unless and until either (i) an entry reflecting the issuance of the common shares to the recipient is made on the books of the Company (or its transfer agent), or (ii) a certificate or certificates representing the common shares is delivered to the recipient.

**10. Right to Terminate Employment.** Nothing in the Plan or in any agreement entered into pursuant to the Plan, or in any stock option award document, shall confer upon any participant the right to continue in the employment of the Company or its subsidiaries, or affect any right which the Company or such subsidiaries may have to terminate the employment of the participant.

**11. Withholding.**

**11.1. Payment of Withholding Taxes.** Whenever the Company proposes or is required to issue or transfer common shares under the Plan, the Company shall have the right to require the recipient to remit to the Company, or provide indemnification satisfactory to the Company for, an amount sufficient to satisfy any federal, state or local withholding tax requirements before an



entry is made in the books of the Company (or its transfer agent) reflecting the issuance of the common shares or any certificate or certificates representing such shares is delivered to the recipient.

**11.2. Use of Common Shares to Satisfy Tax Obligation.** In order to assist an optionee or grantee in paying all federal, state and local taxes to be withheld or collected upon exercise of an option, the Committee in its sole discretion and subject to such rules as it may adopt, may permit the optionee or grantee to satisfy 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.

**12. Non-Assignability.** No award under the Plan shall be assignable or transferable by the participant except by will or by laws of descent and distribution. During the life of a participant, such award shall be exercisable only by the participant or by the participant's guardian or legal representative.

**13. Non-Uniform Determinations.** The Committee's determinations under the Plan (including, without limitation, determinations of the persons to receive awards, the form, amount and timing of such awards, the terms and provisions of awards and the stock option award documents evidencing the awards, and the establishment of values and performance targets) need not be uniform and may be made by it selectively among persons who receive, or are eligible to receive, awards under the Plan whether or not such persons are similarly situated.

**14. Dissolution, Liquidation, Merger.** In the event of (a) the proposed dissolution or liquidation of the Company, (b) a proposed sale of substantially all of the assets of the Company, or (c) a proposed merger, consolidation of the Company with or into any other entity, regardless of whether the Company is the surviving corporation, or a proposed statutory share exchange with any other entity (the actual effective date of the dissolution, liquidation, sale, merger, consolidation or exchange being herein called an "Event"), the Committee may, but shall not be obligated to, either (i) if the Event is a merger, consolidation or statutory share exchange, make appropriate provision for the protection of outstanding options granted under this Plan by the substitution, in lieu of such options, of options to purchase appropriate voting common stock (the "Survivor's Stock") of the corporation surviving any such merger or consolidation or, if appropriate, the parent corporation of the Company or such surviving corporation, or, alternatively, by the delivery of a number of shares of the Survivor's Stock which has a Fair Market Value as of the effective date of such merger, consolidation or statutory share exchange equal to the product of (x) the excess of (A) the Event Proceeds per Share (as hereinafter defined) covered by the option as of such effective date over (B) the exercise price per Share of the Shares subject to such option, times (y) the number of Shares covered by such option, or (ii) declare, at least twenty days prior to the Event, and provide written notice to each optionee of the declaration, that each outstanding option, whether or not then exercisable, shall be canceled at the time of, or immediately prior to the occurrence of, the Event (unless it shall have been exercised prior to the occurrence of the Event). In connection with any declaration pursuant to clause (ii) of the preceding sentence, the Committee may, but shall not be obligated to, cause payment to be made, within twenty days after the Event, in exchange for each cancelled option to each holder of an option that is cancelled, of cash equal to the amount (if any), for each Share covered by the canceled option, by which the Event Proceeds per Share (as hereinafter defined) exceeds the exercise price per Share covered by such option. At the time of any declaration pursuant to clause (ii) of the first sentence of this paragraph 14, each option that has not previously expired or been cancelled pursuant to any stock option award document issued shall immediately become exercisable in full and each holder of an option shall have the right, during the period preceding the time of cancellation of the option, to exercise his or her option as to all or any part of the Shares covered thereby. In the event of a declaration pursuant to clause (ii) of the first sentence of this paragraph 14, each outstanding option granted pursuant to this Plan that shall not have been exercised prior to the Event shall be canceled at the time of, or immediately prior to, the Event, as provided in the declaration, and this Plan shall terminate at the time of such cancellation, subject to the payment obligations of the Company provided in this Paragraph 14. Notwithstanding the foregoing, no person holding an option shall be entitled to the payment provided in this paragraph 14 if such option shall have expired or been cancelled pursuant to any stock option award document issued to this Plan. For purposes of this paragraph 14, "Event Proceeds per Share" shall mean the cash plus the fair market value, as determined in good faith by the Committee, of the non-cash consideration to be received per Share by the shareholders of the Company upon the occurrence of the Event.

**15. Adjustments in Shares.** In the event of any reorganization, merger, consolidation, recapitalization, liquidation, reclassification, stock dividend, stock split, combination of shares, rights offering, or extraordinary dividend or divestiture (including a spin-off), or any other change in the corporate structure or shares of the Company, the Committee (or if the Company does not survive any such transaction, a comparable committee of the Board of Directors of the surviving corporation) may, without the consent of any holder of an option, make such adjustment as it determines in its discretion to be appropriate as to the number and kind of securities subject to and reserved under this Plan and, in order to prevent dilution or enlargement of rights of participants in this Plan, the number and kind of securities issuable upon exercise of outstanding options and the exercise price thereof.

**16. Miscellaneous**

**16.1. Adoption.** This Plan was originally adopted in February 1999 as the Graco Inc. Employee Stock Incentive Plan.

**16.2 Amendment.** The Board may amend, suspend, or terminate the Plan at any time.

**16.3. Termination.** Unless the Plan shall have been discontinued at an earlier date, the Plan shall terminate on February 28, 2009. No option may be granted after such termination, but termination of the Plan shall not, without the consent of the optionee or grantee, alter or impair any rights or obligations under any award theretofore granted.

GRACO INC.

Nonemployee Director Stock Option Plan

---

THIS DOCUMENT CONSTITUTES PART OF A PROSPECTUS COVERING SECURITIES THAT HAVE BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933.

---

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

---

June 18, 2004

**GRACO INC. NONEMPLOYEE DIRECTOR STOCK OPTION PLAN**

**1. Purpose**

The purpose of the Graco Inc. Nonemployee Director Stock Option Plan (the "Plan") is to secure for Graco Inc. (the "Company") and its shareholders the benefits of the long-term incentives inherent in increased common stock ownership by the members of the Board of Directors (the "Board") of the Company who are not employees of the Company or its Affiliates, by strengthening the identification of Nonemployee Directors with the interests of all Graco shareholders.

## 2. Definitions

The terms defined in this Section 2 shall have the following meanings, unless the context otherwise requires.

- a. *Affiliate* shall mean any corporation, partnership, joint venture or other entity in which the Company holds an equity, profit or voting interest of more than fifty percent (50%).
  
- b. *Annual Meeting of Shareholders* shall mean the annual meeting of shareholders of the Company held each calendar year.
  
- c. *Code* shall mean the Internal Revenue Code of 1986, as amended to date and as it may be amended from time to time.
  
- d. *Company* shall mean Graco Inc., a Minnesota corporation.
  
- e. *ERISA* shall mean the Employee Retirement Income Security Act of 1974, as amended to date and as it may be amended from time to time.
  
- f. *Fair Market Value per Share* shall mean as of any day

- The fair market value of a share of the Company's common stock is the last sale price reported on the composite tape by the New York Stock Exchange on the business day immediately preceding the date as of
- (1) which fair market value is being determined or, if there were no sales of shares of the Company's common stock reported on the composite tape on such day, on the most recently preceding day on which there were sales, or

if the shares of the Company' s stock are not listed or admitted to trading on the New York Stock Exchange on  
(2) the day as of which the determination is made, the amount determined by the Board or its delegate to be the fair market value of a share on such day.

- g. *Nonemployee Director* shall mean a member of the Board of Directors of the Company who is not also an officer or other employee of the Company or an Affiliate.
- h. *Nonstatutory Stock Option ("NSO")* shall mean a stock option, which does not qualify for special tax treatment under Sections 421 or 422 of the Internal Revenue Code.
- i. *Option* shall mean either a First Option or an Annual Option granted pursuant to the provisions of Section 4 of this Plan.
- j. *Participant* shall mean any person who holds an Option granted under this Plan.
- k. *Plan* shall mean this Graco Inc. Nonemployee Director Stock Option Plan.

### **3. Administration**

- a. The Plan shall be administered by the Board. The Board may, by resolution, delegate part or all of its administrative powers with respect to the Plan.

- b. The Board shall have all of the powers vested in it by the terms of the Plan, such powers to include the authority, within the limits prescribed herein, to establish the form of the agreement embodying grants of Options made under the Plan.

- c. The Board shall, subject to the provisions of the Plan, have the power to construe the Plan, to determine all questions arising thereunder and to adopt and amend such rules and regulations for the administration of the Plan as it may deem desirable, such administrative decisions of the Board to be final and conclusive.

- The Board shall have no discretion to select the Nonemployee Directors to receive Option grants under the Plan,
- d. to determine the number of shares of the Company' s common stock subject to the Plan or to each grant, nor the exercise price of the Options granted pursuant to the Plan.

- The Board may authorize any one or more of their number or the Secretary or any other officer of the Company to
- e. execute and deliver documents on behalf of the Board. The Board hereby authorizes the Secretary to execute and deliver all documents to be delivered by the Board pursuant to the Plan.

- f. The expenses of the Plan shall be borne by the Company.

#### **4. Automatic Grants to Nonemployee Directors**

- As of the day upon which shareholders vote to elect directors at each annual meeting of the Company, each Nonemployee Director of the Board shall be granted an option to purchase two thousand five hundred (2,500) shares of the Company' s common stock under the Plan (the "Annual Option"); and a Nonemployee Director who has not
- a. previously been elected as a member of the Board of Directors of the Company shall be granted a First Option; i.e., an option to purchase three thousand (3,000) shares of the Company' s common stock under the Plan, on the first business day of the Nonemployee Director' s election to the Board, including election by the Board of Directors to fill a vacancy on the Board.

- b. The automatic grants to Nonemployee Directors shall not be subject to the discretion of any person.

- c. Each Option granted under the Plan shall be evidenced by a written Agreement. Each Agreement shall be subject to, and incorporate, by reference or otherwise, the applicable terms of this Plan.

- d. During the lifetime of a Participant, each Option shall be exercisable only by the Participant. No Option granted under the Plan shall be assignable or transferable by the Participant, except by will or by the laws of descent and distribution.

#### **5. Shares of Stock Subject to the Plan**

- Subject to adjustment as provided in Section 11 of the Plan, an aggregate of four hundred fifty thousand (450,000) shares of the Company's common stock, \$1.00 par value, shall be available for issuance to Nonemployee Directors under the Plan. No fractional shares shall be issued.
- a.

- First Option Grants and Annual Option Grants shall reduce the shares available for issuance under the Plan by the number of shares subject thereto. The shares deliverable upon exercise of any First Option Grant or Annual Option Grant may be made available from authorized but unissued shares or shares reacquired by the Company, including shares purchased in the open market or in private transactions. If any unexercised First Option Grant or Annual Option Grant shall terminate for any reason, the shares subject to, but not delivered under, such First Option Grant or Annual Option Grant shall be available for other First Option Grants or Annual Option Grants.
- b.

## 6. Nonstatutory Options.

- a. All Options granted to Nonemployee Directors pursuant to the Plan shall be NSOs.

## 7. Exercise Price.

- The price per share of the shares of the Company's common stock which may be purchased upon exercise of an Option ("Exercise Price") shall be one hundred percent (100%) of the Fair Market Value per Share on the date the Option is granted and shall be payable in full at the time the Option is exercised as follows:
- a.

- (1) in cash or by certified check,

- (2) by delivery of shares of common stock to the Company which shall have been owned for at least six (6) months and have a Fair Market Value per Share on the date of surrender equal to the exercise price, or

- (3) by delivery to the Company of a properly executed exercise notice together with irrevocable instructions to a broker to promptly deliver to the Company from sale or loan proceeds the amount required to pay the exercise price.

- b. Such price shall be subject to adjustment as provided in Section 11 hereof.

## 8. Duration and Vesting of Options.

- a. The term of each Option granted to a Nonemployee Director shall be for ten (10) years from the date of grant, unless terminated earlier pursuant to the provisions of Section 10 hereof.
  
- b. Each Option shall vest and become exercisable according to the following schedule:
  - (1) twenty-five percent (25%) of the total number of shares covered by the Option shall become exercisable beginning with the first anniversary date of the grant of the Option;
  
  - (2) thereafter twenty-five percent (25%) of the total number of shares covered by the Option shall become exercisable on each subsequent anniversary date of the grant of the Option until the fourth anniversary date of the grant of the Option upon which the total number of shares covered by Option shall become exercisable.

## 9. Change of Control

- a. Notwithstanding Section 8b(1) and (2) hereof, all outstanding Options not yet exercisable 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 their 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 9, 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 Nonemployee Director or any group that includes the Nonemployee Director, 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

- at least a majority of the members of the board of directors of the corporation resulting from such
- (c) 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 a Nonemployee Director if:

- (1) the acquisition of the 25% or greater interest referred to in subsection a(1) of this Section 9 is by a group, acting in concert, that includes the Nonemployee Director 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 Nonemployee Director.

## 10. Effect of Termination of Membership on the Board.

a. The right to exercise an Option granted to a Nonemployee Director shall be limited as follows, provided the actual date of exercise is in no event after the expiration of the term of the Option:

- (1) If a Nonemployee Director ceases being a director of the Company for any reason other than the reasons identified in subparagraph (2) of this Section 10, the Nonemployee Director shall have the right to exercise the Options as follows, subject to the condition that no Option shall be exercisable after the expiration of the term of the Option:

- (a) If the Nonemployee Director was a member of the Board of Directors of the Company for five (5) or more years, all outstanding Options become immediately exercisable upon the date the Nonemployee Director ceases being a director. The Nonemployee Director may exercise the Options for a period of thirty-six months (36) from the date the Nonemployee Director ceased being a director, provided that if the Nonemployee Director dies before the thirty-six (36) month period has expired, the Options may be exercised by the Nonemployee Director's legal representative or any person who acquires the right to

exercise an Option by reason of the Nonemployee Director' s death for a period of twelve (12) months from the date of the Nonemployee Director' s death.

- (b) If the Nonemployee Director was a member of the Board of Directors of the Company for less than five (5) years, the Nonemployee Director may exercise the Options, to the extent they were exercisable at the date the Nonemployee Director ceases being a member of the Board, for a period of thirty (30) days following the date the Nonemployee Director ceased being a director, provided that, if the Nonemployee Director dies before the thirty (30) day period has expired, the Options may be exercised by the Nonemployee Director' s legal representative, or any person who acquires the right to exercise an Option by reason of the Nonemployee Director' s death, for a period of twelve (12) months from the date of the Nonemployee Director' s death.

- (c) If the Nonemployee Director dies while a member of the Board, the Options, to the extent exercisable by the Nonemployee Director at the date of death, may be exercised by the Nonemployee Director' s legal representative, or any person who acquires the right to exercise an Option by reason of the Nonemployee Director' s death, for a period of twelve (12) months from the date of the Nonemployee Director' s death.

- (d) In the event any Option is exercised by the executors, administrators, legatees, or distributees of the estate of a deceased optionee, the Company shall be under no obligation to issue stock thereunder unless and until the Company is satisfied that the person or persons exercising the Option are the duly appointed legal representatives of the deceased optionee' s estate or the proper legatees or distributees thereof.

(2) If a Nonemployee Director ceases being a director of the Company due to an act of

- (a) fraud or intentional misrepresentation or
- (b) embezzlement, misappropriation or conversion of assets or opportunities of the Company or any Affiliate of the Company or
- (c) any other gross or willful misconduct

as determined by the Board, in its sole and conclusive discretion, all Options granted to such Nonemployee Director shall immediately be forfeited as of the date of the misconduct.

## **11. Adjustments and Changes in the Stock**

- a. If there is any change in the common stock of the Company by reason of any stock dividend, stock split, spin-off, split-up, merger, consolidation, recapitalization, reclassification, combination or exchange of shares, or any other similar corporate event, the aggregate number of shares available under the Plan, and the number and the price of shares of common stock subject to outstanding Options, shall be appropriately adjusted automatically.
- b. No right to purchase fractional shares shall result from any adjustment in Options pursuant to this Section 11. In case of any such adjustment, the shares subject to the Option shall be rounded down to the nearest whole share.
- c. Notice of any adjustment shall be given by the Company to each holder of any Option which shall have been so adjusted and such adjustment (whether or not such notice is given) shall be effective and binding for all purposes of the Plan.

## **12. Effective Date of the Plan**

- a. The Plan shall become effective on the date it is approved by the shareholders of the Company.
- b. Any amendment to the Plan shall become effective when adopted by the Board, unless specified otherwise, but no Option granted under any increase in shares authorized to be issued under this Plan shall be exercisable until the increase is approved in the manner prescribed in Section 13 of this Plan.

## **13. Amendment of the Plan**

- a. The Board of Directors may amend, suspend or terminate the Plan at any time, but without shareholder approval, no amendment shall materially increase the maximum number of shares which may be issued under the Plan (other than adjustments pursuant to Section 11 hereof), materially increase the benefits accruing to Participants under the Plan, materially modify the requirements as to eligibility for participation or extend the term of the Plan. Approval of the shareholders may be obtained, at a meeting of shareholders duly called and held, by the affirmative vote of a

majority of the holders of the Company' s voting stock who are present or represented by proxy and are entitled to vote on the Plan.

- It is intended that the Plan meet the requirements of Rule 16b-3 or any successor thereto promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended, including any applicable requirements regarding shareholder approval. Amendments to the Plan shall be subject to approval by the shareholders of the Company to the extent determined by the Board of Directors to be necessary to satisfy such requirements as in effect from time to time.
- b.

- Rights and obligations under any Option granted before any amendment of this Plan shall not be materially and adversely affected by amendment of the Plan, except with the consent of the person who holds the Option, which consent may be obtained in any manner that the Board or its delegate deems appropriate.
- c.

#### **14. Termination of the Plan**

- The Plan, unless sooner terminated, shall terminate at the end of ten (10) years from the date the Plan is approved by the shareholders of the Company. No Option may be granted under the Plan while the Plan is suspended or after it is terminated.
- a.

- Rights or obligations under any Option granted while the Plan is in effect, including the maximum duration and vesting provisions, shall not be altered or impaired by suspension or termination of the Plan, except with the consent of the person who holds the Option, which consent may be obtained in any manner that the Board or its delegate deems appropriate.
- b.

#### **15. Registration, Listing, Qualification, Approval of Stock and Options**

- If the Board shall determine, in its discretion, that it is necessary or desirable that the shares of common stock subject to any Option
- a.

(1) be registered, listed or qualified on any securities exchange or under any applicable law, or

(2) be approved by any governmental regulatory body, or

(3) approved by the shareholders of the Company,

as a condition of, or in connection with, the granting of such Option, or the issuance or purchase of shares upon exercise of the Option, the Option may not be exercised in whole or in part unless such registration, listing, qualification or approval has been obtained free of any condition not acceptable to the Board of Directors.

## **16. No Right to Option or as Shareholder**

No Nonemployee Director or other person shall have any claim or right to be granted an Option under the Plan, except as expressly provided herein. Neither the Plan nor any action taken hereunder shall be construed as giving any Nonemployee Director any right to be retained in the service of the Company.

Neither a Nonemployee Director, the Nonemployee Director's legal representative, nor any person who acquires the right to exercise an Option by reason of the Nonemployee Director's death shall be, or have any of the rights or privileges of, a shareholder of the Company in respect of any shares of common stock receivable upon the exercise of any Option granted under this Plan, in whole or in part, unless and until, either (i) an entry reflecting the issuance of the common shares to the recipient is made on the books of the Company (or its transfer agent), or (ii) a certificate or certificates representing the common shares is issued to the recipient.

## **17. Governing Law**

The validity, construction, interpretation, administration and effect of this Plan and any rules, regulations and actions relating to this Plan will be governed by and construed exclusively in accordance with the laws of the State of Minnesota.

**CERTIFICATION**

I, David A. Roberts, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

- a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

- b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

- c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and



d) Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting; and

5. The registrant' s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of the registrant' s board of directors:

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Date: April 29, 2005

/s/David A. Roberts  
David A. Roberts  
President and Chief Executive Officer

## CERTIFICATION

I, James A. Graner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

- a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

- b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

- c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting; and

5. The registrant' s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of the registrant' s board of directors:

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Date: April 29, 2005

/s/James A. Graner  
James A. Graner  
Vice President and Controller

## CERTIFICATION

I, Mark W. Sheahan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

- a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

- b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

- c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting; and

5. The registrant' s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of the registrant' s board of directors:

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Date: April 29, 2005

/s/Mark W. Sheahan  
Mark W. Sheahan  
Vice President and Treasurer

CERTIFICATION UNDER SECTION 1350

Pursuant to Section 1350 of Title 18 of the United States Code, each of the undersigned certifies that this periodic report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in this periodic report fairly presents, in all material respects, the financial condition and results of operations of Graco Inc.

Date: April 29, 2005

\_\_\_\_\_

/s/David A. Roberts

\_\_\_\_\_  
David A. Roberts

President and Chief Executive Officer

Date: April 29, 2005

\_\_\_\_\_

/s/James A. Graner

\_\_\_\_\_  
James A. Graner

Vice President and Controller

Chief Accounting Officer

Date: April 29, 2005

\_\_\_\_\_

/s/Mark W. Sheahan

\_\_\_\_\_  
Mark W. Sheahan

Vice President and Treasurer

Principal Financial Officer