

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 **March 30, 2012**

Commission File Number: 001-09249

**GRACO INC.**

(Exact name of registrant as specified in its charter)

Minnesota

(State of incorporation)

41-0285640

(I.R.S. Employer Identification Number)

88 - 11<sup>th</sup> 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).

Yes  No

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

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

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

Yes  No

60,446,000 shares of the Registrant's Common Stock, \$1.00 par value, were outstanding as of April 19, 2012.

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## SIGNATURES

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**PART I****Item 1.**

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

	Thirteen Weeks Ended	
	Mar 30, 2012	Apr 1, 2011
Net Sales	\$ 234,122	\$ 217,679
Cost of products sold	101,943	93,282
Gross Profit	132,179	124,397
Product development	11,638	9,931
Selling, marketing and distribution	38,026	37,483
General and administrative	24,546	19,914
Operating Earnings	57,969	57,069
Interest expense	3,689	616
Other expense, net	299	-
Earnings Before Income Taxes	53,981	56,453
Income taxes	18,600	19,200
Net Earnings	<u>\$ 35,381</u>	<u>\$ 37,253</u>
<b>Per Common Share</b>		
Basic net earnings	\$ 0.59	\$ 0.62
Diluted net earnings	\$ 0.58	\$ 0.61
Cash dividends declared	\$ 0.23	\$ 0.21

See notes to consolidated financial statements.

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(Unaudited) (In thousands)

	Thirteen Weeks Ended	
	Mar 30, 2012	Apr 1, 2011
Net Earnings	\$ 35,381	\$ 37,253
Other comprehensive income (loss)		
Pension and postretirement medical liability adjustment	2,339	1,363
Gain (loss) on interest rate hedge contracts	-	454
Income taxes	(843)	(666)
Other comprehensive income (loss)	1,496	1,151
Comprehensive Income	<u>\$ 36,877</u>	<u>\$ 38,404</u>

See notes to consolidated financial statements.



**GRACO INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

(Unaudited)  
(In thousands)

	Mar 30, 2012	Dec 30, 2011
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 326,771	\$ 303,150
Accounts receivable, less allowances of \$5,600 and \$5,500	172,158	150,912
Inventories	110,071	105,347
Deferred income taxes	18,917	17,674
Other current assets	4,139	5,887
Total current assets	632,056	582,970
Property, Plant and Equipment		
Cost	363,155	358,235
Accumulated depreciation	(224,458)	(219,987)
Property, plant and equipment, net	138,697	138,248
Goodwill	93,400	93,400
Other Intangible Assets, net	15,590	18,118
Deferred Income Taxes	31,762	29,752
Other Assets	14,189	11,821
Total Assets	\$ 925,694	\$ 874,309
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities		
Notes payable to banks	\$ 10,520	\$ 8,658
Trade accounts payable	30,921	27,402
Salaries and incentives	18,781	32,181
Dividends payable	13,495	13,445
Other current liabilities	59,843	49,596
Total current liabilities	133,560	131,282
Long-term Debt	300,000	300,000
Retirement Benefits and Deferred Compensation	121,112	120,287
Shareholders' Equity		
Common stock	60,408	59,747
Additional paid-in-capital	266,495	242,007
Retained earnings	119,104	97,467
Accumulated other comprehensive income (loss)	(74,985)	(76,481)
Total shareholders' equity	371,022	322,740
Total Liabilities and Shareholders' Equity	\$ 925,694	\$ 874,309

See notes to consolidated financial statements.

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

	Thirteen Weeks Ended	
	Mar 30, 2012	Apr 1, 2011
<b>Cash Flows From Operating Activities</b>		
Net Earnings	\$ 35,381	\$ 37,253
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	8,075	8,427
Deferred income taxes	(4,097)	(1,795)
Share-based compensation	2,920	2,658
Excess tax benefit related to share-based payment arrangements	(1,600)	(1,200)
Change in		
Accounts receivable	(20,755)	(27,372)
Inventories	(4,655)	(11,037)
Trade accounts payable	5,246	9,193
Salaries and incentives	(13,730)	(17,139)
Retirement benefits and deferred compensation	2,975	2,025
Other accrued liabilities	12,287	7,853
Other	1,407	5,314
<b>Net cash provided by operating activities</b>	<u>23,454</u>	<u>14,180</u>
<b>Cash Flows From Investing Activities</b>		
Property, plant and equipment additions	(6,513)	(4,517)
Proceeds from sale of property, plant and equipment	50	143
Capitalized software and other intangible asset additions	(1,407)	-
<b>Net cash used in investing activities</b>	<u>(7,870)</u>	<u>(4,374)</u>
<b>Cash Flows From Financing Activities</b>		
Borrowings on short-term lines of credit	6,491	7,861
Payments on short-term lines of credit	(4,756)	(5,220)
Borrowings on long-term notes and line of credit	-	252,175
Payments on long-term line of credit	-	(172,430)
Payments of debt issuance costs	(1,921)	-
Excess tax benefit related to share-based payment arrangements	1,600	1,200
Common stock issued	20,114	12,437
Common stock repurchased	(272)	-
Cash dividends paid	(13,451)	(12,612)
<b>Net cash provided by (used in) financing activities</b>	<u>7,805</u>	<u>83,411</u>
Effect of exchange rate changes on cash	232	(299)
Net increase (decrease) in cash and cash equivalents	23,621	92,918
Cash and cash equivalents		
Beginning of year	303,150	9,591
End of period	<u>\$ 326,771</u>	<u>\$ 102,509</u>

See notes to consolidated financial statements.

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

1. The consolidated balance sheet of Graco Inc. and Subsidiaries (the Company) as of March 30, 2012 and the related statements of earnings for the thirteen weeks ended March 30, 2012 and April 1, 2011, and cash flows for the thirteen weeks ended March 30, 2012 and April 1, 2011 have been prepared by the Company and have not been audited.

In the opinion of management, these consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of Graco Inc. and Subsidiaries as of March 30, 2012, 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 2011 Annual Report on Form 10-K.

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

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2. 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>Mar 30, 2012</u>	<u>Apr 1, 2011</u>
Net earnings available to common shareholders	\$ 35,381	\$ 37,253
Weighted average shares outstanding for basic earnings per share	60,052	60,270
Dilutive effect of stock options computed using the treasury stock method and the average market price	1,286	1,090
Weighted average shares outstanding for diluted earnings per share	61,338	61,360
Basic earnings per share	\$ 0.59	\$ 0.62
Diluted earnings per share	\$ 0.58	\$ 0.61

Stock options to purchase 876,000 and 828,000 shares were not included in the 2012 and 2011 computations of diluted earnings per share, respectively, because they would have been anti-dilutive.

3. Information on option shares outstanding and option activity for the thirteen weeks ended March 30, 2012 is shown below (in thousands, except per share amounts):

	<u>Option Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Options Exercisable</u>	<u>Weighted Average Exercise Price</u>
Outstanding, December 30, 2011	5,478	\$ 32.12	3,211	\$ 32.27
Granted	486	49.84		
Exercised	(426)	27.90		
Canceled	(26)	34.65		
Outstanding, March 30, 2012	<u>5,512</u>	\$ 34.00	3,499	\$ 32.21

The Company recognized year-to-date share-based compensation of \$2.9 million in 2012 and \$2.7 million in 2011. As of March 30, 2012, there was \$13.8 million of unrecognized compensation cost related to unvested options, expected to be recognized over a weighted average period of 2.2 years.

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

	Thirteen Weeks Ended	
	Mar 30, 2012	Apr 1, 2011
Expected life in years	6.5	6.5
Interest rate	1.3 %	2.8 %
Volatility	36.6 %	33.7 %
Dividend yield	1.8 %	2.0 %
Weighted average fair value per share	\$ 15.44	\$ 13.21

Under the Company's Employee Stock Purchase Plan, the Company issued 239,000 shares in 2012 and 313,000 shares in 2011. The fair value of the employees' purchase rights under this Plan was estimated on the date of grant. The benefit of the 15 percent discount from the lesser of the fair market value per common share on the first day and the last day of the plan year was added to the fair value of the employees' purchase rights determined using the Black-Scholes option-pricing model with the following assumptions and results:

	Thirteen Weeks Ended	
	Mar 30, 2012	Apr 1, 2011
Expected life in years	1.0	1.0
Interest rate	0.2 %	0.3 %
Volatility	40.6 %	27.8 %
Dividend yield	1.7 %	2.1 %
Weighted average fair value per share	\$ 15.58	\$ 10.05

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

	Thirteen Weeks Ended	
	Mar 30, 2012	Apr 1, 2011
<b>Pension Benefits</b>		
Service cost	\$ 1,290	\$ 1,233
Interest cost	3,231	3,370
Expected return on assets	(3,825)	(4,000)
Amortization and other	2,446	1,481
Net periodic benefit cost	<u>\$ 3,142</u>	<u>\$ 2,084</u>
<b>Postretirement Medical</b>		
Service cost	\$ 150	\$ 125
Interest cost	263	325
Amortization	(37)	-
Net periodic benefit cost	<u>\$ 376</u>	<u>\$ 450</u>

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

	Mar 30, 2012	Dec 30, 2011
Pension and postretirement medical liability adjustment	\$ (74,162)	\$ (75,658)
Cumulative translation adjustment	(823)	(823)
Total	<u>\$ (74,985)</u>	<u>\$ (76,481)</u>

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6. The Company has three reportable segments: Industrial, Contractor and Lubrication. Sales and operating earnings by segment for the thirteen weeks ended March 30, 2012 and April 1, 2011 were as follows (in thousands):

	Thirteen Weeks Ended	
	Mar 30, 2012	Apr 1, 2011
Net Sales		
Industrial	\$ 134,103	\$ 122,830
Contractor	71,986	70,205
Lubrication	28,033	24,644
Total	<u>\$ 234,122</u>	<u>\$ 217,679</u>
Operating Earnings		
Industrial	\$ 48,313	\$ 45,025
Contractor	12,539	11,115
Lubrication	6,089	5,227
Unallocated corporate (expense)	(8,972)	(4,298)
Total	<u>\$ 57,969</u>	<u>\$ 57,069</u>

Unallocated corporate in 2012 includes \$4 million of acquisition-related expenses.

Assets by segment were as follows (in thousands):

	Mar 30, 2012	Dec 30, 2011
Industrial	<u>\$ 308,666</u>	<u>\$ 302,805</u>
Contractor	156,411	146,556
Lubrication	89,717	91,137
Unallocated corporate	370,900	333,811
Total	<u>\$ 925,694</u>	<u>\$ 874,309</u>

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

	Mar 30, 2012	Dec 30, 2011
Finished products and components	<u>\$ 57,221</u>	<u>\$ 51,943</u>
Products and components in various stages of completion	38,817	39,268
Raw materials and purchased components	<u>54,734</u>	<u>54,561</u>
	150,772	145,772
Reduction to LIFO cost	<u>(40,701)</u>	<u>(40,425)</u>
Total	<u>\$ 110,071</u>	<u>\$ 105,347</u>

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

	Estimated Life (years)	Original Cost	Accumulated Amortization	Foreign Currency Translation	Book Value
<b>March 30, 2012</b>					
Customer relationships	2 - 8	\$ 40,925	\$ (32,323)	\$ (181)	\$ 8,421
Patents, proprietary technology and product documentation	3 - 10	14,668	(11,051)	(87)	3,530
Trademarks, trade names and other	2 - 3	3,860	(3,401)	-	459
		59,453	(46,775)	(268)	12,410
<b>Not Subject to Amortization:</b>					
Brand names		3,180	-	-	3,180
<b>Total</b>		<b>\$ 62,633</b>	<b>\$ (46,775)</b>	<b>\$ (268)</b>	<b>\$ 15,590</b>
<b>December 30, 2011</b>					
Customer relationships	2 - 8	\$ 40,925	\$ (30,788)	\$ (181)	\$ 9,956
Patents, proprietary technology and product documentation	3 - 10	14,668	(10,570)	(87)	4,011
Trademarks, trade names and other	2 - 3	6,140	(5,169)	-	971
		61,733	(46,527)	(268)	14,938
<b>Not Subject to Amortization:</b>					
Brand names		3,180	-	-	3,180
<b>Total</b>		<b>\$ 64,913</b>	<b>\$ (46,527)</b>	<b>\$ (268)</b>	<b>\$ 18,118</b>

Amortization of intangibles was \$2.5 million in the first quarter of 2012. Estimated annual amortization expense is as follows: \$9.0 million in 2012, \$4.3 million in 2013, \$0.9 million in 2014, \$0.5 million in 2015 and \$0.2 million in 2016.

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

	Mar 30, 2012	Dec 30, 2011
Accrued self-insurance retentions	\$ 6,633	\$ 6,563
Accrued warranty and service liabilities	6,758	6,709
Accrued trade promotions	2,735	5,852
Payable for employee stock purchases	1,374	6,607
Income taxes payable	18,087	2,689
Other	24,256	21,176
Total other current liabilities	<u>\$ 59,843</u>	<u>\$ 49,596</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 product warranty issues. Following is a summary of activity in accrued warranty and service liabilities (in thousands):

	Thirteen Weeks Ended Mar 30, 2012	Year Ended Dec 30 2011
Balance, beginning of year	\$ 6,709	\$ 6,862
Charged to expense	1,294	5,110
Margin on parts sales reversed	830	2,676
Reductions for claims settled	(2,075)	(7,939)
Balance, end of period	<u>\$ 6,758</u>	<u>\$ 6,709</u>

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

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

The Company periodically evaluates its monetary asset and liability positions denominated in foreign currencies. The Company enters into forward contracts or options, or borrows in various currencies, in order to hedge its net monetary positions. These instruments are recorded at current market values and the gains and losses are included in other expense (income), net. The notional amount of contracts outstanding

as of March 30, 2012, totaled \$21 million. The Company believes it uses strong financial counterparts in these transactions and that the resulting credit risk under these hedging strategies is not significant.

The Company uses significant other observable inputs to value the derivative instruments used to hedge interest rate volatility and net monetary positions, including reference to market prices and financial models that incorporate relevant market assumptions. The fair market value and balance sheet classification of such instruments follows (in thousands):

	Balance Sheet Classification	Mar 30, 2012	Dec 30, 2011
Gain (loss) on foreign currency forward contracts			
Gains		\$ 206	\$ 218
Losses		(71)	(120)
Net	Accounts receivable	<u>\$ 135</u>	<u>\$ 98</u>

11. In April 2011, the Company entered into a definitive agreement to purchase the finishing business operations of Illinois Tool Works Inc. (ITW) in a \$650 million cash transaction. In May 2011, the Company entered into a credit agreement, providing for a \$450 million unsecured revolving credit facility that would be available to the Company upon closing of the transaction. The transaction was completed on April 2, 2012, with funding provided by available cash balances and borrowings of \$350 million under the new credit agreement. On March 27, 2012, the Company's \$250 million credit agreement was terminated in connection with the execution of the new \$450 million credit agreement.

The new credit agreement is with a syndicate of lenders and expires in March 2017. It provides up to \$450 million of committed credit, available for general corporate purposes, working capital needs, share repurchases and acquisitions. The Company may borrow up to \$50 million under the swingline portion of the facility for daily working capital needs. Loans denominated in U.S. Dollars bear interest, at the Company's option, at either a base rate or a LIBOR-based rate. Loans denominated in currencies other than U.S. Dollars bear interest at a LIBOR-based rate. The base rate is an annual rate equal to a margin ranging from 0% to 1%, depending on the Company's cash flow leverage ratio (debt to earnings before interest, taxes, depreciation, amortization and extraordinary, non-operating or non-cash charges and expenses), plus the highest of (i) the bank's prime rate, (ii) the federal funds rate plus 0.5%, or (iii) one-month LIBOR plus 1.5%. In general, LIBOR-based loans bear interest at LIBOR plus 1% to 2%, depending on the Company's cash flow leverage ratio. The Company is also required to pay a fee on the undrawn amount of the loan commitment at an annual rate ranging from 0.15 percent to 0.40 percent, depending on the Company's cash flow leverage ratio.

In 2011, the Company entered into a note agreement and sold \$300 million of unsecured notes with maturities ranging from 2018 to 2026. The notes have a carrying amount of \$300 million and an estimated fair value of \$330 million as of March 30, 2012. Estimated fair value is based on the present value of future cash flows and rates that would be available for issuance of debt with similar terms and remaining maturities. The notes are classified as level 2 within the fair value hierarchy.

The Company's debt agreements require the Company to maintain certain financial ratios as to cash flow leverage and interest coverage. The Company is in compliance with all financial covenants of its debt agreements.

12. On April 2, 2012, the Company closed on its \$650 million acquisition of the ITW finishing businesses. The acquired businesses had sales of \$375 million in 2011 and will expand and complement the Company's Industrial segment. The acquisition added Gema<sup>®</sup>, a global leader in powder coating technology, which represented approximately one-third of the purchased business. The remaining two-thirds is a collection of industrial liquid finishing businesses, which the United States Federal Trade Commission ("FTC") has ordered to be held separate from Gema and other Graco businesses while the FTC investigates and considers a settlement proposal from Graco. In compliance with the FTC's order, the industrial liquid finishing businesses will be run independently by existing management under the supervision of a trustee who reports directly to the FTC.

During the hold separate period, the Company will not have a controlling interest in the liquid finishing businesses. Consequently, the Company's investment in those businesses will be recorded at cost and their financial results will not be consolidated with those of the Company. Income will be recognized based on dividends received from current earnings.

At the completion of its review, the FTC will issue a final decision and order that will identify the products, businesses and/or assets that Graco will be required to divest. The Company will have 180 days following the issuance of the final decision and order to complete such divestiture.

Item 2.

**GRACO INC. AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Overview**

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

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

**Results of Operations**

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

	Thirteen Weeks Ended		
	Mar 30, 2012	Apr 1, 2011	% Change
Net Sales	\$ 234.1	\$ 217.7	8 %
Net Earnings	\$ 35.4	\$ 37.3	(5)%
Diluted Net Earnings per Common Share	\$ 0.58	\$ 0.61	(5)%

All segments and geographic regions had revenue growth over last year. Net earnings were 5 percent lower than last year as higher expenses (product development, acquisition-related and interest) more than offset the favorable effects of higher sales and strong gross margins. Changes in currency translation rates did not have a significant effect on consolidated results for the quarter.

## Consolidated Results

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

	Thirteen Weeks Ended	
	Mar 30, 2012	Apr 1, 2011
Americas <sup>1</sup>	\$ 126.0	\$ 115.6
Europe <sup>2</sup>	54.7	53.3
Asia Pacific	53.4	48.8
Consolidated	<u>\$ 234.1</u>	<u>\$ 217.7</u>

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

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

First quarter sales increased 8 percent, including increases of 9 percent in the Americas, 3 percent in Europe (6 percent at consistent translation rates) and 10 percent in Asia Pacific (8 percent at consistent translation rates).

Gross profit margin, expressed as a percentage of sales, was 56 percent, slightly lower than the first quarter last year. The unfavorable effect of higher material costs was partially offset by realized price increases and improved efficiencies.

Total operating expenses increased \$7 million for the quarter, including \$4 million related to the acquisition of ITW's finishing businesses and a \$2 million increase in product development expense (headcount and project expenses).

The effective income tax rate of 34 1/2 percent for the quarter is higher than the rate for the first quarter last year due to the expiration of the federal R&D credit.

## Segment Results

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

### Industrial

	Thirteen Weeks Ended	
	Mar 30, 2012	Apr 1, 2011
Net sales (in millions)		
Americas	\$ 59.4	\$ 52.9
Europe	36.8	34.4
Asia Pacific	37.9	35.5
Total	<u>\$ 134.1</u>	<u>\$ 122.8</u>
Operating earnings as a percentage of net sales	<u>36 %</u>	<u>37 %</u>

Industrial segment sales increased 9 percent, with increases of 12 percent in the Americas, 7 percent in Europe (10 percent at consistent translation rates) and 7 percent in Asia Pacific (6 percent at consistent translation rates).

Operating margins remained strong while the segment's investments in product development and marketing continued.

### Contractor

	Thirteen Weeks Ended	
	Mar 30, 2012	Apr 1, 2011
Net sales (in millions)		
Americas	\$ 46.3	\$ 44.9
Europe	15.9	16.7
Asia Pacific	9.8	8.6
Total	<u>\$ 72.0</u>	<u>\$ 70.2</u>
Operating earnings as a percentage of net sales	<u>17 %</u>	<u>16 %</u>

Contractor segment sales increased 3 percent with gains of 3 percent in the Americas and 13 percent in Asia Pacific (11 percent at consistent translation rates). Sales were down 4 percent in Europe (down 1 percent at consistent translation rates) compared to the first quarter of 2011.

Operating margin improved as marketing spending was lower due to heavy product launch and promotion expenses in 2011 that were not repeated in 2012.

Lubrication

	Thirteen Weeks Ended	
	Mar 30, 2012	Apr 1, 2011
Net sales (in millions)		
Americas	\$ 20.3	\$ 17.8
Europe	1.9	2.2
Asia Pacific	5.8	4.6
Total	\$ 28.0	\$ 24.6
Operating earnings as a percentage of net sales	22 %	21 %

Lubrication segment sales increased 14 percent, with increases of 14 percent in the Americas and 25 percent in Asia Pacific. Sales decreased 14 percent in Europe, on a relatively small base.

Higher volume and expense leveraging contributed to improvement in operating earnings as a percentage of sales.

**Liquidity and Capital Resources**

Net cash provided by operating activities was \$23 million in 2012 and \$14 million in 2011. Increases in receivables and inventories moderated compared to the first quarter of last year.

Since the end of 2011, inventories increased by \$5 million to meet higher demand, and accounts receivable increased by \$21 million due to higher sales levels.

At March 30, 2012, the Company had various lines of credit totaling \$470 million, of which \$462 million was unused.

In April 2011, the Company entered into a definitive agreement to purchase the finishing business operations of Illinois Tool Works Inc. (ITW) in a \$650 million cash transaction. In May 2011, the Company entered into a credit agreement, providing for a \$450 million unsecured revolving credit facility that would be available to the Company upon closing of the transaction. The transaction was completed on April 2, 2012, with funding provided by available cash balances and borrowings of \$350 million under the new credit agreement. On March 27, 2012, the Company's \$250 million credit agreement was terminated in connection with the execution of the amendment to the new \$450 million credit agreement.

The new credit agreement is with a syndicate of lenders and expires in March 2017. It provides up to \$450 million of committed credit, available for general corporate purposes, working capital needs, share repurchases and acquisitions. The Company may borrow up to \$50 million under the swingline portion of the facility for daily working capital needs. Loans denominated in U.S. Dollars bear interest, at the Company's option, at either a base rate or a LIBOR-based rate. Loans denominated in currencies other than U.S. Dollars bear interest at a LIBOR-based rate. The base rate is an annual rate equal to a margin ranging from 0% to 1%, depending on the Company's cash flow leverage ratio (debt to earnings before interest, taxes, depreciation, amortization and extraordinary, non-operating or non-cash charges and expenses), plus the highest of (i) the bank's prime rate, (ii) the federal funds rate plus 0.5%, or

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(iii) one-month LIBOR plus 1.5%. In general, LIBOR-based loans bear interest at LIBOR plus 1% to 2%, depending on the Company's cash flow leverage ratio. The Company is also required to pay a fee on the undrawn amount of the loan commitment at an annual rate ranging from 0.15 percent to 0.40 percent, depending on the Company's cash flow leverage ratio. The agreement requires the Company to maintain certain financial ratios as to cash flow leverage and interest coverage.

Internally generated funds and unused financing sources are expected to provide the Company with the flexibility to meet its liquidity needs in 2012, including the needs of the finishing businesses acquired in April 2012.

### **Outlook**

Management remains optimistic that the Company will achieve growth in all geographies and business segments for the full-year 2012, but cautions that the Western European economies and select construction markets are challenging. The demand environment in the Americas continues to be favorable, if not resilient. While the Company has noted some weakening of industrial project activity in the Asia Pacific region recently, management believes that growth will continue throughout 2012. Management will be watching worldwide order trends closely throughout the year and expects that product launches scheduled for the second half of 2012 will help to countervail softness.

## **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, conference calls and the Company's Overview report to shareholders, 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 undertakes no obligation to update these statements in light of new information or future events.

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. In addition, risk factors related to the Company's acquisition of the ITW finishing businesses include: to what extent or when the required regulatory approvals will be obtained, whether and when the Company will be able to realize the expected financial results and accretive effect of the transaction, how customers, competitors, suppliers and employees will react to the transaction, economic changes in global markets, the extent of the acquired businesses required to be divested, whether the Company will be able to find a suitable purchaser(s) and structure the divestiture on acceptable terms, and whether the Company will be able to complete a divestiture in a time frame that is satisfactory to the Federal Trade Commission. Please refer to Item 1A of, and Exhibit 99 to, the Company's Annual Report on Form 10-K for fiscal year 2011 and Item 1A of this Quarterly Report on Form 10-Q for a more comprehensive discussion of these and other risk factors.

Investors should realize that factors other than those identified above and in Item 1A and Exhibit 99 might prove important to the Company's future results. It is not possible for management to identify each and every factor that may have an impact on the Company's operations in the future as new factors can develop from time to time.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There have been no material changes related to market risk from the disclosures made in the Company's 2011 Annual Report on Form 10-K.

**Item 4. Controls and Procedures**

**Evaluation of disclosure controls and procedures**

As of the end of the fiscal quarter covered by this report, the Company carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures. This evaluation was done under the supervision and with the participation of the Company's President and Chief Executive Officer, the Chief Financial Officer, the Vice President and Controller, and the Vice President, General Counsel and Secretary. Based upon that evaluation, they concluded that the Company's disclosure controls and procedures are effective.

**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 OTHER INFORMATION**

### **Item 1A. Risk Factors**

There have been no material changes to the Company's risk factors from those disclosed in the Company's 2011 Annual Report on Form 10-K, except for changes in the status of the previously proposed (now completed) acquisition, as described below:

**Acquisition - Our acquisition of the finishing business operations of Illinois Tool Works Inc. is subject to regulatory approvals and the expected benefits from the acquisition may not be fully realized.**

On April 2, 2012, the Company closed on its \$650 million acquisition of the Illinois Tool Works Inc. (ITW) finishing businesses. The acquisition added Gema<sup>®</sup>, a global leader in powder coating technology, which represented approximately one-third of the purchase. The remaining two-thirds of the acquisition is a collection of industrial liquid finishing businesses, which the United States Federal Trade Commission ("FTC") has ordered to be held separate from Gema and other Graco businesses while the FTC investigates and considers a settlement proposal from Graco. In compliance with the FTC's order, the industrial liquid finishing businesses will be run independently by existing management under the supervision of a trustee who reports directly to the FTC.

At the completion of its review, the FTC will issue a final decision and order that will identify the products, businesses and/or assets that Graco will be required to divest. The Company will have 180 days following the issuance of the final decision and order to complete such divestiture.

We cannot predict to what extent or when the required regulatory approvals will be obtained. Additional risk factors include: the extent of the acquired businesses required to be divested, whether the Company will be able to find a suitable purchaser(s) and structure the divestiture on acceptable terms, and whether the Company will be able to complete a divestiture in a time frame that is satisfactory to the FTC.

Significant changes to our financial condition as a result of global economic changes or difficulties in the integration or addition of the newly acquired businesses, including how customers, competitors, suppliers and employees react to the transaction, may affect our ability to obtain the expected benefits from the transaction or to satisfy the financial covenants included in the terms of the financing arrangements.

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

### Issuer Purchases of Equity Securities

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

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

Information on issuer purchases of equity securities follows:

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (at end of period)</u>
Dec 31, 2011 – Jan 27, 2012	-		-	3,990,978
Jan 28, 2012 – Feb 24, 2012	5,166	48.85	-	3,990,978
Feb 25, 2012 – Mar 30, 2012	368	52.18	-	3,990,978

## Item 5. Other Information

On March 27, 2012, the company's \$250 million credit agreement was terminated in connection with the execution of the amendment to the new \$450 million credit agreement.

**Item 6. Exhibits**

- 2.1 First Amendment to Asset Purchase Agreement dated as of April 2, 2012 by and among Graco Inc., Graco Holdings Inc., Graco Minnesota Inc., Finishing Brands Holdings Inc., Illinois Tool Works Inc. and ITW Finishing LLC. (Incorporated by reference to Exhibit 2.1 to the Company's Report on Form 8-K filed April 2, 2012.)
- 3.1 Restated Articles of Incorporation as amended June 14, 2007. (Incorporated by reference to Exhibit 3.1 to the Company's Report on Form 10-Q for the thirteen weeks ended June 29, 2007.)
- 3.2 Restated Bylaws as amended June 13, 2002. (Incorporated by reference to Exhibit 3 to the Company's Report on Form 10-Q for the thirteen weeks ended June 28, 2002.)
- 3.3 Form of Articles of Amendment of Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Shares. (Incorporated by reference to Exhibit 2 to the Company's Registration Statement on Form 8-A filed on February 16, 2010.)
- 4.1 Rights Agreement, dated as of February 12, 2010, between the Company and Wells Fargo Bank, N.A., as Rights Agent. (Incorporated by reference to Exhibit 1 to the Company's Registration Statement on Form 8-A dated February 16, 2010.)
- 10.1 Form of Amendment to Executive Officer and Non-Employee Director Stock Options to Permit Net Exercises, as adopted by the Board of Directors February 17, 2012.
- 10.2 Stock Option Agreement. Amended form of agreement used for award in 2012 of stock options to chief executive officer under the Graco Inc. 2010 Stock Incentive Plan.
- 10.3 Stock Option Agreement. Amended form of agreement used for award in 2012 of stock options to executive officers under the Graco Inc. 2010 Stock Incentive Plan.
- 10.4 Stock Option Agreement. Amended form of agreement used for award in 2012 of stock options to non-employee directors under the Graco Inc. 2010 Stock Incentive Plan.
- 10.5 Second Amendment to Revolving Credit Agreement and Waiver, dated as of February 15, 2012, by and among Graco Inc., the Banks signatory thereto and U.S. Bank National Association, as Agent for the Banks.
- 10.6 First Amendment to Credit Agreement dated March 27, 2012, by and among Graco Inc., the Banks signatory thereto and U.S. Bank National Association, as administrative agent. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K filed April 2, 2012.)
- 10.7 Amendment and Restatement No. 1 to Note Agreement dated March 27, 2012 between Graco Inc. and the Noteholders. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 8-K filed April 2, 2012.)

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10.8	Agreement between Graco Inc., Illinois Tool Works Inc., and ITW Finishing LLC, as the Respondents, and Counsel for the Federal Trade Commission. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K filed March 27, 2012.)
31.1	Certification of President and Chief Executive Officer pursuant to Rule 13a-14(a).
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a).
32	Certification of President and Chief Executive Officer and Chief Financial Officer pursuant to Section 1350 of Title 18, U.S.C.
99.1	Press Release, Reporting First Quarter Earnings, dated April 25, 2012.
101	Interactive Data File.

## 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 25, 2012 By: /s/ Patrick J. McHale  
Patrick J. McHale  
President and Chief Executive Officer  
*(Principal Executive Officer)*

Date: April 25, 2012 By: /s/ James A. Graner  
James A. Graner  
Chief Financial Officer  
*(Principal Financial Officer)*

Date: April 25, 2012 By: /s/ Caroline M. Chambers  
Caroline M. Chambers  
Vice President and Controller  
*(Principal Accounting Officer)*



# OFFICE MEMO

[FORM OF AMENDMENT TO EXECUTIVE OFFICER AND NON-EMPLOYEE  
DIRECTOR STOCK OPTIONS TO PERMIT NET EXERCISES]

**To:** [Section 16 Executive Officers / Non-Employee Directors]

**From:**

**Date:**

**Subject:** Notice of Amendment to Stock Option Agreements – Net Exercise

On February 17, 2012, the Management Organization and Compensation Committee approved, effective immediately, an amendment to all of your outstanding option awards to permit so-called net exercises.

A net exercise is one whereby you “pay” the exercise cost of the options you are exercising by directing Graco to withhold a number of shares, having an aggregate fair market value equal to the aggregate exercise price of the options being exercised [and the resulting taxes], from the shares that would otherwise be deliverable upon exercise of the option. This method results in your ownership of the remaining shares. This is an additional method of exercising options, and you may still use the other exercise methods described in your option award agreements at any time.

The net exercise method is only available to you so long as you are a [Section 16 officer / director]. If you cease to be a [Section 16 officer / director] for any reason, you will be limited to the methods of exercise originally provided for in your option agreement. Accordingly, the section of your outstanding stock option agreements describing methods for exercising your options is amended to permit you to exercise the option as follows:

“If you are serving as an executive officer or director of the Company, as applicable, on the date of exercise, by a reduction in the number of shares of Common Stock to be delivered upon exercise, which number of shares to be withheld shall have an aggregate fair market value on the date of exercise equal to the exercise price.”

I recommend that you file this notice of amendment with your outstanding award documents as a reminder of this amendment; your award documents will not be reissued.

**GRACO INC. 2010 STOCK INCENTIVE PLAN**

**CHIEF EXECUTIVE OFFICER  
STOCK OPTION AGREEMENT  
(Non-Qualified)**

**THIS AGREEMENT**, made this «DATE» day of «MONTH», «YEAR», by and between Graco Inc., a Minnesota corporation (the “Company”) and «NAME» (“«NAME»” or the “Employee”).

**WITNESSETH THAT:**

**WHEREAS**, the Company pursuant to the Graco Inc. 2010 Stock Incentive Plan (the “Plan”) wishes to grant this stock option to Employee;

**NOW THEREFORE**, in consideration of the premises and of the mutual covenants contained in this Agreement, the parties agree as follows:

1. Grant of Option

The Company grants to Employee, the right and option (the “Option”) to purchase all or any part of an aggregate of «SHARES» («SHARES») shares of Common Stock of the Company, par value USD 1.00 per share, at the price of USD «PRICE» per share on the terms and conditions set forth in this Agreement. The date of grant of the Option is «DATE» (the “Date of Grant”).

2. Duration and Exercisability

- A. No portion of this Option may be exercised by Employee until the first anniversary of the Date of Grant and then only in accordance with the Vesting Schedule set forth below. In no event shall this Option or any portion of this Option be exercisable following the tenth anniversary of the Date of Grant.

**Vesting Schedule**

<u>Vesting Date</u>	<u>Portion of Option Exercisable</u>
First Anniversary of Date of Grant	25%
Second Anniversary of Date of Grant	50%
Third Anniversary of Date of Grant	75%
Fourth Anniversary of Date of Grant	100%

If Employee does not purchase in any one year the full number of shares of Common Stock of the Company to which he/she is entitled under this Option, he/she may, subject to the terms and conditions of Section 3, purchase such shares of Common Stock in any subsequent year during the term of this Option. This Option shall expire as of the close of trading at the national securities exchange on which the Common Stock is traded ("Exchange") on the tenth anniversary of the Date of Grant or if the Exchange is closed on the anniversary date or the Common Stock of the Company is not trading on said anniversary date, such earlier business day on which the Common Stock is trading on the Exchange.

- B. During the lifetime of Employee, the Option shall be exercisable only by him/her and shall not be assignable or transferable by him/her otherwise than by will or the laws of descent and distribution.
- C. Under no circumstances may the Option or any portion of the Option granted by this Agreement be exercised after the term of the Option expires.

### 3. Effect of Termination of Employment

- A. If Employee's employment terminates for any reason other than Employee's gross and willful misconduct, death, retirement (as defined in Section 3D), or disability (as defined in Section 3D), Employee shall have the right to exercise that portion of the Option exercisable upon the date of termination of employment at any time within the period beginning on the day after termination of employment and ending at the close of trading on the Exchange ninety (90) days later.
- B. If Employee's employment terminates by reason of Employee's gross and willful misconduct during employment, including, but not limited to, wrongful appropriation of Company funds, serious violations of Company policy, breach of fiduciary duty or the conviction of a felony, the unexercised portion of the Option shall terminate as of the time of the misconduct. If the Company determines subsequent to the termination of Employee's employment for whatever reason, that Employee engaged in conduct during employment that would constitute gross and willful misconduct justifying termination, the Option shall terminate as of the time of such misconduct. Furthermore, if the Option is exercised in whole or in part and the Company thereafter determines that Employee engaged in gross and willful misconduct during employment which would have justified termination at any time prior to the date of such exercise, the Option shall be deemed to have terminated as of the time of the misconduct and the Company may elect to rescind the Option exercise. Gross and willful misconduct shall not include any action or inaction by the Employee contrary to the direction of the Board with respect to any

initiative, strategy or action of the Company, which action or inaction the Employee believes is in the best interest of the Company.

- C. If Employee shall die while employed by the Company or an affiliate and shall not have fully exercised the Option, all shares remaining under the Option shall become immediately exercisable. If Employee shall die within ninety (90) days after a termination of employment which meets the criteria of Section 3A above, only those shares vested as of the date of termination shall be exercisable. The executor or administrator of Employee's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent may exercise such exercisable shares at any time during a period beginning on the day after the date of Employee's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant.
- D. If Employee's termination of employment is due to retirement or disability, all shares remaining under the Option shall become immediately exercisable. Employee shall be deemed to have retired if the termination of employment occurs for reasons other than the Employee's gross and willful misconduct, death, or disability after Employee (i) has attained age 55 and 10 years of service with the Company or an affiliate, or (ii) has attained age 65. Employee shall be deemed to be disabled if the termination of employment occurs because Employee is unable to work due to an impairment which would qualify as a disability under the Company's long term disability program. Employee may exercise the shares remaining unexercised at any time during a period beginning on the day after the date of Employee's termination of employment and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant. If Employee should die during the period between the date of Employee's retirement or disability and the expiration of the Option, the executor(s) or administrator(s) of the Employee's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent may exercise the unexercised portion of the Option at any time during a period beginning the day after the date of Employee's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant. Notwithstanding anything to the contrary contained in Section 3, if the Employee's employment is terminated by retirement (as defined in this Section 3D) and Employee has not given written notice to the Chair of the Management Organization and Compensation Committee of the Board of Directors (the "Committee"), of Employee's intention to retire not less than six (6) months prior to the date of his retirement, then in such event, for purposes of this Agreement only, said termination of employment shall be deemed to be not a retirement but a termination subject to the provisions of Section 3A, *provided, however*, that in the event that the Committee determines that said termination of employment without six (6) months prior written notice

is in the best interests of the Company, such termination shall be deemed to be a retirement and shall be subject to this Section 3D.

- E. If the 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 hereunder unless and until the Company is satisfied that the person(s) exercising the Option is the duly appointed legal representative of the deceased optionee's estate or the proper legatee or distributee thereof.
- F. For purposes of this Section 3, if the last day of the relevant period is a day upon which the Exchange is not open for trading or the Common Stock is not trading on that day, the relevant period will expire at the close of trading on such earlier business day on which the Exchange is open and the Common Stock is trading.

#### 4. Manner of Exercise

- A. Employee or other proper party may exercise the Option only by delivering within the term of the Option written notice to the Company at its principal office in Minneapolis, Minnesota, stating the number of shares as to which the Option is being exercised and, except as provided in Sections 4B(2) and 4C, accompanied by payment-in-full of the Option price for all shares designated in the notice.
- B. The Employee may, at Employee's election, pay the Option price as follows:
  - (1) by cash or check (bank check, certified check, or personal check),
  - (2) by delivering to the Company for cancellation, shares of Common Stock of the Company which have a fair market value equal to the Option price, or
  - (3) if the Employee is still serving as an executive officer of the Company on the date of exercise, by a reduction in the number of shares of Common Stock to be delivered upon exercise, which number of shares to be withheld shall have an aggregate fair market value on the date of exercise equal to the exercise price.

For purposes of Sections 4B(2) and 4B(3), the fair market value per share of the Company's Common Stock shall be the closing price of the Common Stock on the day immediately preceding the date of exercise on the Exchange. If there is not a quotation available for such day, then the closing price on the next preceding day for which such a quotation exists

shall be determinative of fair market value. If the shares are not then traded on an exchange, the fair market value shall be the average of the closing bid and asked prices of the Common Stock as reported by the National Association of Securities Dealers Automated Quotation System. If the Common Stock is not then traded on NASDAQ or on an exchange, then the fair market value shall be determined in such manner as the Company shall deem reasonable.

- C. The Employee may, with the consent of the Company, pay the Option price by delivering to the Company 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.

5. Payment of Withholding Taxes

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

6. Change of Control

- A. Notwithstanding Section 2A hereof, the entire Option shall become immediately and fully exercisable upon a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:

- (1) an acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "1934 Act")), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) which, together with other acquisitions by such Person, results in the aggregate beneficial ownership by such Person of 30% 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 by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
  - (ii) an acquisition by the Employee or any group that includes the Employee, or
  - (iii) an acquisition by any entity pursuant to a transaction that complies with clauses (a), (b) and (c) of Section 6A(3) below; 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 by or on behalf of a Person other than the Board; or
- (3) Consummation of a reorganization, merger or consolidation of the Company with or into another entity or a 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"); 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 and Outstanding Company Voting Securities

immediately prior to such Business Combination beneficially own, directly or indirectly, a majority 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 (or comparable equity interests), as the case may be, of the surviving or acquiring entity resulting from such Business Combination (including, without limitation, an entity that as a result of such transaction beneficially owns 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly) in substantially the same proportions (as compared to the other holders of the Company's common stock and voting securities prior to the Business Combination) as their respective ownership, immediately prior to such Business Combination, of the Outstanding Company Common Stock and Outstanding Company Voting Securities,

- (b) no Person (excluding (i) any employee benefit plan (or related trust) sponsored or maintained by the Company or such entity resulting from such Business Combination or any entity controlled by the Company or the entity resulting from such Business Combination, (ii) any entity beneficially owning 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly and (iii) the Employee and any group that includes the Employee) beneficially owns, directly or indirectly, 30% or more of the then outstanding shares of common stock (or comparable equity interests) of the entity resulting from such Business Combination or the combined voting power of the then outstanding voting securities (or comparable equity interests) of such entity, and
- (c) immediately after the Business Combination, a majority of the members of the board of directors (or comparable governors) of the entity resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

- (4) approval by the shareholders of the Company of a complete liquidation or dissolution of the Company.

7. Adjustments: Fundamental Change

- A. If there shall be any change in the number or character of the Common Stock of the Company through merger, consolidation, reorganization, recapitalization, dividend in the form of stock (of whatever amount), stock split or other change in the corporate structure of the Company, and all or any portion of the Option shall then be unexercised and not yet expired, appropriate adjustments in the outstanding Option shall be made by the Company, in order to prevent dilution or enlargement of Employee's Option rights. Such adjustments shall include, where appropriate, changes in the number of shares of Common Stock and the price per share subject to the outstanding Option.
- B. In the event of a proposed (i) dissolution or liquidation of the Company, (ii) a sale of substantially all of the assets of the Company, (iii) a merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, or (iv) a statutory share exchange involving the capital stock of the Company (each, a "Fundamental Change"), the Committee may, but shall not be obligated to:
- (1) with respect to a Fundamental Change that involves a merger, consolidation or statutory share exchange, make appropriate provision for the protection of the Option by the substitution of options and appropriate voting common stock of the corporation surviving any such merger or consolidation or, if appropriate, the "parent corporation" (as defined in Section 424(e) of the Internal Revenue Code of 1986, as amended from time to time, and any regulations promulgated thereunder, or any successor provision) of the Company or such surviving corporation, in lieu of the Option and shares of Common Stock of the Company, or
  - (2) with respect to any Fundamental Change, including, without limitation, a merger, consolidation or statutory share exchange, declare, prior to the occurrence of the Fundamental Change, and provide written notice to the holder of the Option of the declaration, that the Option, whether or not then exercisable, shall be canceled at the time of, or immediately prior to the occurrence of, the Fundamental Change in exchange for payment to the holder of the Option, within 20 days after the Fundamental Change, of cash (or, if the Committee so elects in lieu of solely cash, of such form(s) of consideration, including cash and/or property, singly or in such combination as the Committee shall determine, that the holder of

the Option would have received as a result of the Fundamental Change if the holder of the Option had exercised the Option immediately prior to the Fundamental Change) equal to, for each share of Common Stock covered by the canceled Option, the amount, if any, by which the Fair Market Value (as defined in this Section 7B) per share of Common Stock exceeds the exercise price per share of Common Stock covered by the Option. At the time of the declaration provided for in the immediately preceding sentence, the Option shall immediately become exercisable in full and the holder of the Option shall have the right, during the period preceding the time of cancellation of the Option, to exercise the Option as to all or any part of the shares of Common Stock covered thereby in whole or in part, as the case may be. In the event of a declaration pursuant to this Section 7B, the Option, to the extent that it shall not have been exercised prior to the Fundamental Change, shall be canceled at the time of, or immediately prior to, the Fundamental Change, as provided in the declaration. Notwithstanding the foregoing, the holder of the Option shall not be entitled to the payment provided for in this Section 7B if such Option shall have expired or been forfeited. For purposes of this Section 7B only, "Fair Market Value" per share of Common Stock means the fair market value, as determined in good faith by the Committee, of the consideration to be received per share of Common Stock by the shareholders of the Company upon the occurrence of the Fundamental Change, notwithstanding anything to the contrary provided in this Agreement.

8. Miscellaneous

- A. This Option is issued pursuant to the Plan and is subject to its terms. The terms of the Plan are available for inspection during business hours at the principal offices of the Company.
- B. This Agreement shall not confer on Employee any right with respect to continuance of employment by the Company or any of its subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time.
- C. Neither Employee, the Employee's legal representative, nor the executor(s) or administrator(s) of the Employee's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent 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 this Option, in whole or in part, unless and until such shares shall have been issued upon exercise of this Option.

- D. The Company shall at all times during the term of the Option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.
- E. 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 this Agreement, the Plan and any rules and regulations relating to the Plan or this Option.
- F. Employee hereby consents to the transfer to his employer or the Company of information relating to his/her participation in the Plan, including the personal data set forth in this Agreement, between them or to other related parties in the United States or elsewhere, or to any financial institution or other third party engaged by the Company, but solely for the purpose of administering the Plan and this Option. Employee also consents to the storage and processing of such data by such persons for this purpose.

IN WITNESS WHEREOF, the Company, by the Management Organization and Compensation Committee of the Board of Directors, and the Employee have caused this Agreement to be executed and delivered, all as of the day and year first above written.

GRACO INC.  
Management Org and Comp Committee

By \_\_\_\_\_  
«NAME»  
Its Chairman

EMPLOYEE

By \_\_\_\_\_  
«NAME»

**GRACO INC. 2010 STOCK INCENTIVE PLAN**  
**EXECUTIVE OFFICER STOCK OPTION AGREEMENT**  
**(Non-Qualified)**

**THIS AGREEMENT**, made this «DATE» day of «MONTH», «YEAR», by and between Graco Inc., a Minnesota corporation (the “Company”) and «NAME» (the “Employee”).

**WITNESSETH THAT:**

**WHEREAS**, the Company pursuant to the Graco Inc. 2010 Stock Incentive Plan (the “Plan”) wishes to grant this stock option to Employee;

**NOW THEREFORE**, in consideration of the premises and of the mutual covenants contained in this Agreement, the parties agree as follows:

1. Grant of Option

The Company grants to Employee, the right and option (the “Option”) to purchase all or any part of an aggregate of «SHARES» shares of Common Stock of the Company, par value USD 1.00 per share, at the price of USD «PRICE» per share on the terms and conditions set forth in this Agreement. The date of grant of the Option is «DATE» (the “Date of Grant”).

2. Duration and Exercisability

- A. No portion of this Option may be exercised by Employee until the first anniversary of the Date of Grant and then only in accordance with the Vesting Schedule set forth below. In no event shall this Option or any portion of this Option be exercisable following the tenth anniversary of the Date of Grant.

**Vesting Schedule**

<u>Vesting Date</u>	<u>Portion of Option Exercisable</u>
First Anniversary of Date of Grant	25%
Second Anniversary of Date of Grant	50%
Third Anniversary of Date of Grant	75%
Fourth Anniversary of Date of Grant	100%

If Employee does not purchase in any one year the full number of shares of Common Stock of the Company to which he/she is entitled under this

Option, he/she may, subject to the terms and conditions of Section 3, purchase such shares of Common Stock in any subsequent year during the term of this Option. This Option shall expire as of the close of trading at the national securities exchange on which the Common Stock is traded ("Exchange") on the tenth anniversary of the Date of Grant or if the Exchange is closed on the anniversary date or the Common Stock of the Company is not trading on said anniversary date, such earlier business day on which the Common Stock is trading on the Exchange.

- B. During the lifetime of Employee, the Option shall be exercisable only by him/her and shall not be assignable or transferable by him/her otherwise than by will or the laws of descent and distribution.
- C. Under no circumstances may the Option or any portion of the Option granted by this Agreement be exercised after the term of the Option expires.

3. Effect of Termination of Employment

- A. If Employee's employment terminates for any reason other than Employee's gross and willful misconduct, death, retirement (as defined in Section 3D), or disability (as defined in Section 3D), Employee shall have the right to exercise that portion of the Option exercisable upon the date of termination of employment at any time within the period beginning on the day after termination of employment and ending at the close of trading on the Exchange ninety (90) days later.
- B. If Employee's employment terminates by reason of Employee's gross and willful misconduct during employment, including, but not limited to, wrongful appropriation of Company funds, serious violations of Company policy, breach of fiduciary duty or the conviction of a felony, the unexercised portion of the Option shall terminate as of the time of the misconduct. If the Company determines subsequent to the termination of Employee's employment for whatever reason, that Employee engaged in conduct during employment that would constitute gross and willful misconduct justifying termination, the Option shall terminate as of the time of such misconduct. Furthermore, if the Option is exercised in whole or in part and the Company thereafter determines that Employee engaged in gross and willful misconduct during employment which would have justified termination at any time prior to the date of such exercise, the Option shall be deemed to have terminated as of the time of the misconduct and the Company may elect to rescind the Option exercise.
- C. If Employee shall die while employed by the Company or an affiliate and shall not have fully exercised the Option, all shares remaining under the Option shall become immediately exercisable. If Employee shall die within

ninety (90) days after a termination of employment which meets the criteria of Section 3A above, only those shares vested as of the date of termination shall be exercisable. The executor or administrator of Employee's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent may exercise such exercisable shares at any time during a period beginning on the day after the date of Employee's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant.

- D. If Employee's termination of employment is due to retirement or disability, all shares remaining under the Option shall become immediately exercisable. Employee shall be deemed to have retired if the termination of employment occurs for reasons other than the Employee's gross and willful misconduct, death, or disability after Employee (i) has attained age 55 and 10 years of service with the Company or an affiliate, or (ii) has attained age 65. Employee shall be deemed to be disabled if the termination of employment occurs because Employee is unable to work due to an impairment which would qualify as a disability under the Company's long term disability program. Employee may exercise the shares remaining unexercised at any time during a period beginning on the day after the date of Employee's termination of employment and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant. If Employee should die during the period between the date of Employee's retirement or disability and the expiration of the Option, the executor(s) or administrator(s) of the Employee's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent may exercise the unexercised portion of the Option at any time during a period beginning the day after the date of Employee's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant.
- E. Notwithstanding anything to the contrary contained in this Section 3, if the Employee's employment is terminated by retirement (as defined in Section 3D) and Employee has not given the Company written notice to his/her immediate supervisor and the Chief Executive Officer, of Employee's intention to retire not less than six (6) months prior to the date of his/her retirement, then in such event, for purposes of this Agreement only, said termination of employment shall be deemed to be not a retirement but a termination subject to the provisions of Section 3A, *provided, however*, that in the event that the Chief Executive Officer determines that said termination of employment without six (6) months prior written notice is in the best interests of the Company, such termination shall be deemed to be a retirement and shall be subject to Section 3D.
- F. If the 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 hereunder unless and until the Company is satisfied that the person(s) exercising the Option is the duly appointed legal representative of the deceased optionee's estate or the proper legatee or distributee thereof.

- G. For purposes of this Section 3, if the last day of the relevant period is a day upon which the Exchange is not open for trading or the Common Stock is not trading on that day, the relevant period will expire at the close of trading on such earlier business day on which the Exchange is open and the Common Stock is trading.

4. Manner of Exercise

- A. Employee or other proper party may exercise the Option only by delivering within the term of the Option written notice to the Company at its principal office in Minneapolis, Minnesota, stating the number of shares as to which the Option is being exercised and, except as provided in Sections 4B(2) and 4C, accompanied by payment-in-full of the Option price for all shares designated in the notice.
- B. The Employee may, at Employee's election, pay the Option price as follows:
- (1) by cash or check (bank check, certified check, or personal check),
  - (2) by delivering to the Company for cancellation, shares of Common Stock of the Company which have a fair market value equal to the Option price, or
  - (3) if the Employee is still serving as an executive officer of the Company on the date of exercise, by a reduction in the number of shares of Common Stock to be delivered upon exercise, which number of shares to be withheld shall have an aggregate fair market value on the date of exercise equal to the exercise price.

For purposes of Sections 4B(2) and 4B(3), the fair market value per share of the Company's Common Stock shall be the closing price of the Common Stock on the day immediately preceding the date of exercise on the Exchange. If there is not a quotation available for such day, then the closing price on the next preceding day for which such a quotation exists shall be determinative of fair market value. If the shares are not then traded on an exchange, the fair market value shall be the average of the closing bid and asked prices of the Common Stock as reported by the National Association of Securities Dealers Automated Quotation System. If the Common Stock is not then traded on NASDAQ or on an exchange,

then the fair market value shall be determined in such manner as the Company shall deem reasonable.

- C. The Employee may pay the Option price by delivering to the Company 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.

5. Payment of Withholding Taxes

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

6. Change of Control

- A. Notwithstanding Section 2A hereof, the entire Option shall become immediately and fully exercisable upon a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:

- (1) an acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "1934 Act")), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) which, together with other acquisitions by such Person, results in the aggregate beneficial ownership by such Person of 30% 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 by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
  - (ii) an acquisition by the Employee or any group that includes the Employee, or
  - (iii) an acquisition by any entity pursuant to a transaction that complies with clauses (a), (b) and (c) of Section 6A(3) below; 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 by or on behalf of a Person other than the Board; or
- (3) Consummation of a reorganization, merger or consolidation of the Company with or into another entity or a 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"); 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 and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, a majority 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 (or comparable equity interests), as the case may be, of the surviving or acquiring entity resulting from such Business Combination (including, without limitation, an entity that as a result of such transaction beneficially owns 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly) in substantially the same proportions (as compared to the other holders of the Company's common stock and voting securities prior to the Business Combination) as their respective ownership, immediately prior to such Business Combination, of the Outstanding Company Common Stock and Outstanding Company Voting Securities,

- (b) no Person (excluding (i) any employee benefit plan (or related trust) sponsored or maintained by the Company or such entity resulting from such Business Combination or any entity controlled by the Company or the entity resulting from such Business Combination, (ii) any entity beneficially owning 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly and (iii) the Employee and any group that includes the Employee) beneficially owns, directly or indirectly, 30% or more of the then outstanding shares of common stock (or comparable equity interests) of the entity resulting from such Business Combination or the combined voting power of the then outstanding voting securities (or comparable equity interests) of such entity, and
  - (c) immediately after the Business Combination, a majority of the members of the board of directors (or comparable governors) of the entity resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or
- (4) approval by the shareholders of the Company of a complete liquidation or dissolution of the Company.

7. Adjustments: Fundamental Change

- A. If there shall be any change in the number or character of the Common Stock of the Company through merger, consolidation, reorganization, recapitalization, dividend in the form of stock (of whatever amount), stock split or other change in the corporate structure of the Company, and all or any portion of the Option shall then be unexercised and not yet expired, appropriate adjustments in the outstanding Option shall be made by the Company, in order to prevent dilution or enlargement of Employee's Option rights. Such adjustments shall include, where appropriate, changes in the number of shares of Common Stock and the price per share subject to the outstanding Option.
- B. In the event of a proposed (i) dissolution or liquidation of the Company, (ii) a sale of substantially all of the assets of the Company, (iii) a merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, or (iv) a statutory share exchange involving the capital stock of the Company (each, a "Fundamental Change"), the Management Organization and Compensation Committee of the Board of Directors (the "Committee") may, but shall not be obligated to:
- (1) with respect to a Fundamental Change that involves a merger, consolidation or statutory share exchange, make appropriate provision for the protection of the Option by the substitution of options and appropriate voting common stock of the corporation surviving any such merger or consolidation or, if appropriate, the "parent corporation" (as defined in Section 424(e) of the Internal Revenue Code of 1986, as amended from time to time, and any regulations promulgated thereunder, or any successor provision) of the Company or such surviving corporation, in lieu of the Option and shares of Common Stock of the Company, or
  - (2) with respect to any Fundamental Change, including, without limitation, a merger, consolidation or statutory share exchange, declare, prior to the occurrence of the Fundamental Change, and provide written notice to the holder of the Option of the declaration, that the Option, whether or not then exercisable, shall be canceled at the time of, or immediately prior to the occurrence of, the Fundamental Change in exchange for payment to the holder of the Option, within 20 days after the Fundamental Change, of cash (or, if the Committee so elects in lieu of solely cash, of such form(s) of consideration, including cash and/or property, singly or in such combination as the Committee shall determine, that the holder of the Option would have received as a result of the Fundamental Change if the holder of the Option had exercised the Option immediately prior to the Fundamental Change) equal to, for each share of Common Stock covered by the canceled Option, the

amount, if any, by which the Fair Market Value (as defined in this Section 7B) per share of Common Stock exceeds the exercise price per share of Common Stock covered by the Option. At the time of the declaration provided for in the immediately preceding sentence, the Option shall immediately become exercisable in full and the holder of the Option shall have the right, during the period preceding the time of cancellation of the Option, to exercise the Option as to all or any part of the shares of Common Stock covered thereby in whole or in part, as the case may be. In the event of a declaration pursuant to this Section 7B, the Option, to the extent that it shall not have been exercised prior to the Fundamental Change, shall be canceled at the time of, or immediately prior to, the Fundamental Change, as provided in the declaration. Notwithstanding the foregoing, the holder of the Option shall not be entitled to the payment provided for in this Section 7B if such Option shall have expired or been forfeited. For purposes of this Section 7B only, "Fair Market Value" per share of Common Stock means the fair market value, as determined in good faith by the Committee, of the consideration to be received per share of Common Stock by the shareholders of the Company upon the occurrence of the Fundamental Change, notwithstanding anything to the contrary provided in this Agreement.

8. Miscellaneous

- A. This Option is issued pursuant to the Plan and is subject to its terms. The terms of the Plan are available for inspection during business hours at the principal offices of the Company.
- B. This Agreement shall not create an employment relationship between Employee and the Company and shall not confer on Employee any right with respect to continuance of employment by the Company or any of its affiliates or subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time.
- C. Neither Employee, the Employee's legal representative, nor the executor(s) or administrator(s) of the Employee's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent 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 this Option, in whole or in part, unless and until such shares shall have been issued upon exercise of this Option.
- D. This option has been granted to Employee as a purely discretionary benefit and shall not form part of Employee's salary or entitle Employee to

receive similar option grants in the future. Benefits received under the Plan shall not be used in calculating severance payments, if any.

- E. The Company shall at all times during the term of the Option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.
- F. The internal law, and not the law of conflicts, of the State of Minnesota, USA, shall govern all questions concerning the validity, construction and effect of this Agreement, the Plan and any rules and regulations relating to the Plan or this Option
- G. Employee hereby consents to the transfer by his/her employer or the Company of information relating to his/her participation in the Plan, including the personal data set forth in this Agreement, between them or to other related parties in the United States or elsewhere, or to any financial institution or other third party engaged by the Company, but solely for the purpose of administering the Plan and this Option. Employee also consents to the storage and processing of such data by such persons for this purpose.

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

GRACO INC.

By \_\_\_\_\_  
«NAME»  
President and Chief Executive Officer

EMPLOYEE

\_\_\_\_\_  
«NAME»

**NONEMPLOYEE DIRECTOR  
GRACO INC. 2010 STOCK INCENTIVE PLAN  
STOCK OPTION AGREEMENT  
(NSO)**

**THIS AGREEMENT**, made this «DATE» day of «MONTH», «YEAR» by and between Graco Inc., a Minnesota corporation (the “Company”) and «NAME» (the “Nonemployee Director”).

**WITNESSETH THAT:**

**WHEREAS**, the Company pursuant to the Graco Inc. 2010 Stock Incentive Plan (the “2010 Plan”) wishes to grant this stock option to Nonemployee Director.

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

1. Grant of Option

The Company grants to Nonemployee Director the right and option (the “Option”) to purchase all or any part of an aggregate of «SHARES» shares of Common Stock of the Company, par value \$1.00 per share, at the price of «PRICE» per share on the terms and conditions set forth herein. This is a nonstatutory stock Option which does not qualify for special tax treatment under Sections 421 or 422 of the Internal Revenue Code. The date of grant is «DATE» (the “Date of Grant”)

2. Duration and Exercisability

- A. No portion of this Option may be exercised by Nonemployee Director until the first anniversary of the Date of Grant, and then only in accordance with the Vesting Schedule set forth below. In no event shall this Option or any portion of this Option be exercisable following the tenth anniversary of the Date of Grant.

**Vesting Schedule**

<u>Date</u>	<u>Portion of Option Exercisable</u>
First Anniversary of Date of Grant	25%
Second Anniversary of Date of Grant	50%
Third Anniversary of Date of Grant	75%
Fourth Anniversary of Date of Grant	100%

If Nonemployee Director does not purchase in any one year the full number of shares of Common Stock of the Company to which he/she is entitled under this Option, he/she may, subject to the terms and conditions of Section 3 hereof, purchase such shares of Common Stock in any subsequent year during the term of this Option. The Option shall expire as of the close of trading at the national securities exchange on which the Common Stock is traded ("Exchange") on the tenth anniversary of the Date of Grant, or if the Exchange is closed on the anniversary date, or the Common Stock of the Company is not trading on said anniversary date, such earlier business day on which the Common Stock is trading on the Exchange.

- B. During the lifetime of Nonemployee Director, the Option shall be exercisable only by him/her and shall not be assignable or transferable by him/her otherwise than by will or the laws of descent and distribution.
- C. Under no circumstances may the Option granted by this Agreement be exercised after the term of the Option expires.

3. Effect of Termination of Membership on the Board

- A. In the event Nonemployee Director ceases being a director of the Company for any reason other than the reasons identified in Section 3B below, Nonemployee Director shall have the right to exercise the Option as follows:
  - (1) If Nonemployee Director was a member of the Board of Directors of the Company for five (5) or more years, the portion of the Option not yet exercisable shall become immediately exercisable upon the date Nonemployee Director ceases being a director. Nonemployee Director may exercise all or any portion of the Option not yet exercised for a period beginning on the day after the date of Nonemployee Director's ceasing to be a director and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant. If Nonemployee Director dies during the period between the date of Nonemployee Director ceasing to be a director and the expiration of the Option, the executor(s) or administrator(s) of Nonemployee Director's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent may exercise the unexercised portion of the Option at any time during a period beginning the day after the date of Nonemployee Director's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant. In no event shall the Option be exercisable following the tenth anniversary of the Date of Grant.

- (2) If Nonemployee Director was a member of the Board of Directors of the Company for less than five (5) years, Nonemployee Director may exercise that portion of the Option exercisable upon the date Nonemployee Director ceases being a director at any time within the period beginning on the day after Nonemployee Director ceases being a director and ending at the close of trading on the Exchange ninety (90) days later. If Nonemployee Director dies within the ninety (90) day period and shall not have fully exercised the Option, the executor(s) or administrator(s) of Nonemployee Director's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent, may exercise the remaining portion of the Option at any time during a period beginning on the day after the date of Nonemployee Director's death and ending at the close of trading on the Exchange on the anniversary of death one (1) year later.
  - (3) If Nonemployee Director dies while a member of the Board of Directors of the Company, the Option, to the extent exercisable by Nonemployee Director at the date of death, may be exercised by the executor(s) or administrator(s) of Nonemployee Director's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent, at any time during a period beginning on the day after the date of Nonemployee Director's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant.
  - (4) In the event the Option is exercised by the executors, administrators, legatees, or distributees of the estate of a deceased Nonemployee Director, the Company shall be under no obligation to issue stock thereunder unless and until the Company is satisfied that the person(s) exercising the Option is the duly appointed legal representative of Nonemployee Director's estate or the proper legatee or distributee thereof.
- B. If Nonemployee Director ceases being a director of the Company by reason of Nonemployee Director's gross and willful misconduct, including but not limited to, (i) fraud or intentional misrepresentation; (ii) embezzlement, misappropriation or conversion of assets or opportunities of the Company or any affiliate of the Company; (iii) breach of fiduciary duty, or (iv) any other gross or willful misconduct, as determined by the Board, in its sole and conclusive discretion, the unexercised portion of the Option granted to such Nonemployee Director shall immediately be forfeited as of the time of the misconduct. If the Board determines subsequent to the time Nonemployee Director ceases being a director of the Company for whatever reason, that Nonemployee Director engaged in conduct while a member of the Board of Directors of the Company that

would constitute gross and willful misconduct, the Option shall terminate as of the time of such misconduct. Furthermore, if the Option is exercised in whole or in part and the Board thereafter determines that Nonemployee Director engaged in gross and willful misconduct while a member of the Board of Directors of the Company at any time prior to the date of such exercise, the Option shall be deemed to have terminated as of the time of the misconduct and the Company may elect to rescind the Option exercise.

- C. For purposes of this Section 3, if the last day of the relevant period is a day upon which the Exchange is not open for trading or the Common Stock is not trading on that day, the relevant period will expire at the close of trading on such earlier business day on which the Exchange is open and the Common Stock is trading.

4. Manner of Exercise

- A. Nonemployee Director or other proper party may exercise the Option only by delivering within the term of the Option written notice to the Company at its principal office in Minneapolis, Minnesota, stating the number of shares as to which the Option is being exercised and, except as provided in Sections 4B(2) and 4C, accompanied by payment in full of one hundred percent (100%) of the Option price.
- B. The Nonemployee Director may, at his/her election, pay the Option price as follows:
- (1) by cash or check (bank check, certified check, or personal check),
  - (2) by delivery of shares of Common Stock to the Company, which shall have a fair market value per share on the date of surrender equal to the exercise price, or
  - (3) if the Nonemployee Director is still serving as a director of the Company on the date of exercise, by a reduction in the number of shares of Common Stock to be delivered upon exercise, which number of shares to be withheld shall have an aggregate fair market value on the date of exercise equal to the exercise price.

For purposes of Sections 4B(2) and 4B(3), the fair market value per share of the Company's Common Stock shall be the closing price of the Common Stock on the Exchange on the day immediately preceding the date of exercise. If there is not a quotation available for such day, then the closing price on the next preceding day for which such a quotation exists shall be determinative of fair market value. If the shares are not then traded on an exchange, the fair market value shall be the average of

the closing bid and asked prices of the Common Stock as reported by the National Association of Securities Dealers Automated Quotation System. If the Common Stock is not then traded on NASDAQ or on an exchange, then the fair market value shall be determined in such manner as the Company shall deem reasonable.

- C. The Nonemployee Director may, with the consent of the Company, pay the Option price 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.

5. Change of Control

- A. Notwithstanding Section 2A hereof, the entire Option shall become immediately and fully exercisable upon a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:

- (1) an acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "1934 Act")), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) which, together with other acquisitions by such Person, results in the aggregate beneficial ownership by such Person of 30% 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 by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
- (ii) an acquisition by the Employee or any group that includes the Employee, or

- (iii) an acquisition by any entity pursuant to a transaction that complies with clauses (a), (b) and (c) of Section 5A(3) below; 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 by or on behalf of a Person other than the Board; or
- (3) Consummation of a reorganization, merger or consolidation of the Company with or into another entity or a 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"); 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 and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, a majority 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 (or comparable equity interests), as the case may be, of the surviving or acquiring entity resulting from such Business Combination (including, without limitation, an entity that as a result of such transaction beneficially owns 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly) in substantially the same proportions (as compared to the other holders of the Company's common stock and voting securities prior to the Business

Combination) as their respective ownership, immediately prior to such Business Combination, of the Outstanding Company Common Stock and Outstanding Company Voting Securities,

- (b) no Person (excluding (i) any employee benefit plan (or related trust) sponsored or maintained by the Company or such entity resulting from such Business Combination or any entity controlled by the Company or the entity resulting from such Business Combination, (ii) any entity beneficially owning 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly and (iii) the Employee and any group that includes the Employee) beneficially owns, directly or indirectly, 30% or more of the then outstanding shares of common stock (or comparable equity interests) of the entity resulting from such Business Combination or the combined voting power of the then outstanding voting securities (or comparable equity interests) of such entity, and
  - (c) immediately after the Business Combination, a majority of the members of the board of directors (or comparable governors) of the entity resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or
- (4) approval by the shareholders of the Company of a complete liquidation or dissolution of the Company.

6. Adjustments; Fundamental Change

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

- B. In the event of a proposed (i) dissolution or liquidation of the Company, (ii) a sale of substantially all of the assets of the Company, (iii) a merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, or (iv) a statutory share exchange involving the capital stock of the Company (each, a “Fundamental Change”), the Management Organization and Compensation Committee of the Board (the “Committee”) may, but shall not be obligated to:
- (1) with respect to a Fundamental Change that involves a merger, consolidation or statutory share exchange, make appropriate provision for the protection of the Option by the substitution of options and appropriate voting common stock of the corporation surviving any such merger or consolidation or, if appropriate, the “parent corporation” (as defined in Section 424(e) of the Internal Revenue Code of 1986, as amended from time to time, and any regulations promulgated thereunder, or any successor provision) of the Company or such surviving corporation, in lieu of the Option and shares of Common Stock of the Company, or
  - (2) with respect to any Fundamental Change, including, without limitation, a merger, consolidation or statutory share exchange, declare, prior to the occurrence of the Fundamental Change, and provide written notice to the holder of the Option of the declaration, that the Option, whether or not then exercisable, shall be canceled at the time of, or immediately prior to the occurrence of, the Fundamental Change in exchange for payment to the holder of the Option, within 20 days after the Fundamental Change, of cash (or, if the Committee so elects in lieu of solely cash, of such form(s) of consideration, including cash and/or property, singly or in such combination as the Committee shall determine, that the holder of the Option would have received as a result of the Fundamental Change if the holder of the Option had exercised the Option immediately prior to the Fundamental Change) equal to, for each share of Common Stock covered by the canceled Option, the amount, if any, by which the Fair Market Value (as defined in this Section 6B) per share of Common Stock exceeds the exercise price per share of Common Stock covered by the Option. At the time of the declaration provided for in the immediately preceding sentence, the Option shall immediately become exercisable in full and the holder of the Option shall have the right, during the period preceding the time of cancellation of the Option, to exercise the Option as to all or any part of the shares of Common Stock covered thereby in whole or in part, as the case may be. In the event of a declaration pursuant to this Section 6B, the Option, to the extent that it shall not have been exercised prior to the Fundamental

Change, shall be canceled at the time of, or immediately prior to, the Fundamental Change, as provided in the declaration. Notwithstanding the foregoing, the holder of the Option shall not be entitled to the payment provided for in this Section 6B if such Option shall have expired or been forfeited. For purposes of this Section 6B only, "Fair Market Value" per share of Common Stock means the fair market value, as determined in good faith by the Committee, of the consideration to be received per share of Common Stock by the shareholders of the Company upon the occurrence of the Fundamental Change, notwithstanding anything to the contrary provided in this Agreement.

7. Miscellaneous

- A. This Option is granted pursuant to the 2010 Plan and is subject to its terms. The terms of the 2010 Plan are available for inspection during business hours at the principal offices of the Company.
- B. Neither the 2010 Plan nor any action taken hereunder shall be construed as giving Nonemployee Director any right to be retained in the service of the Company.
- C. Neither Nonemployee Director, Nonemployee Director's legal representative, nor the executor(s) or administrator(s) of Nonemployee Director's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent 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 this Option, in whole or in part, unless and until such shares shall have been issued upon exercise of this Option.
- D. The Company shall at all times during the term of the Option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.
- E. The internal law, and not the law of conflicts, of the State of Minnesota, U.S.A., shall govern all questions concerning the validity, construction and effect of this Agreement, the 2010 Plan and any rules and regulations relating to the 2010 Plan or this Option.
- F. Nonemployee Director hereby consents to the transfer to his employer or the Company of information relating to his/her participation in the 2010 Plan, including the personal data set forth in this Agreement, between them or to other related parties in the United States or elsewhere, or to any financial institution or other third party engaged by the Company, but solely for the purpose of administering the 2010 Plan and this Option.

Nonemployee Director also consents to the storage and processing of such data by such persons for this purpose.

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

GRACO INC.

By \_\_\_\_\_  
Its Vice President, General Counsel  
and Secretary

NONEMPLOYEE DIRECTOR

\_\_\_\_\_  
«NAME»

SECOND AMENDMENT TO REVOLVING  
CREDIT AGREEMENT AND WAIVER

THIS SECOND AMENDMENT AND WAIVER (this "Amendment"), is entered into as of February 15, 2012, by and among GRACO INC. (the "Borrower"), the Banks (as defined in the Credit Agreement) signatory hereto and U.S. BANK NATIONAL ASSOCIATION, as Agent for the Banks (in such capacity, the "Agent"). Capitalized terms used herein but not defined herein shall have the meaning given such terms in the Credit Agreement (as defined below).

W I T N E S S E T H

WHEREAS, the Borrower, the Banks and the Agent are party to that certain Revolving Credit Agreement, dated as of July 12, 2007 (as amended, restated, supplemented, or otherwise modified prior to the date hereof, the "Credit Agreement");

WHEREAS, the Borrower has requested that certain modifications be made to the Credit Agreement; and

WHEREAS, the Banks have agreed to amend the Credit Agreement on the terms and conditions set forth herein.

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree to amend the Credit Agreement as follows:

SECTION 1. Amendments to Credit Agreement.

(a) The definition of "Reportable Event" appearing in Section 1.1 of the Credit Agreement is amended and restated in its entirety to read as follows:

"Reportable Event" means a reportable event as defined in Section 4043 of ERISA and the regulations issued under such Section, with respect to a Plan, excluding, however, such events as to which the PBGC by regulations issued and in effect as of the date of this Agreement has waived the requirement of Section 4043(a) of ERISA that it be notified within 30 days of the occurrence of such event, provided that a material failure to meet the minimum funding standard of Section 412 of the Code and Section 302 of ERISA shall be a reportable event regardless of the

issuance of any such waivers in accordance with Section 412(c) of the Code.”

(b) The definition of “Funding Threshold” appearing in Section 1.1 of the Credit Agreement is hereby deleted in its entirety.

(c) Section 7.9 of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

“ERISA. Each Plan complies in all material respects with all applicable requirements of ERISA and the Code and with all applicable rulings and regulations issued under the provisions of ERISA and the Code setting forth those requirements, except for any noncompliance that could not reasonably be expected to result in an Adverse Event. No Reportable Event that is an Adverse Event has occurred and is continuing with respect to a Plan. All of the minimum funding standards applicable to such Plans have been satisfied and there exists no event or condition which would permit the institution of proceedings to terminate any Plan under Section 4042 of ERISA (except for immaterial failures).”

(d) Clause (e) of Section 8.1 of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

“(e) Immediately upon a Responsible Employee becoming aware of the occurrence, with respect to any Plan, of any Reportable Event that is an Adverse Event, a notice specifying the nature thereof and what action the Company proposes to take with respect thereto, and, when received, copies of any notice from PBGC of intention to terminate or have a trustee appointed for any Plan.”

(e) Section 8.9 of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

“ERISA. Maintain each Plan in compliance in all material respects with all applicable requirements of ERISA and of the Code and with all applicable rulings and regulations issued under the provisions of ERISA and of the Code, except for any noncompliance that could not reasonably be expected to result in an Adverse Event.”

(f) Section 9.3 of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

“Plans. Permit any condition to exist in connection with any Plan which might constitute grounds for the PBGC to institute proceedings to have such Plan terminated or a trustee appointed to administer such Plan, permit any Plan to terminate under any circumstances which would cause the lien provided for in Section 4068 of ERISA to attach to any property, revenue or asset of the Company or any Subsidiary or permit any Plan to be in “at-risk status” (within the meaning of Section 430(i)(4) of the Code) under circumstances where the present value of liabilities of the Plan exceed the value of the assets of the Plan by more than \$50,000,000 (with liabilities and assets valued in the manner used to determine the funding target attainment percentage under Section 430 of the Code (disregarding the special rules contained in Section 430(i)(1)(b))).”

(g) Clause (i) of Section 10.1 of the Credit Agreement is hereby amended and restated in its entirety to read as follows:

“(i) The institution by the Company or any ERISA Affiliate of steps to terminate any Plan if in order to effectuate such termination, the Company or any ERISA Affiliate would be required to make a contribution to such Plan, or would incur a liability or obligation to such Plan, in excess of \$50,000,000, if the payment of such liability would constitute an Adverse Event, or the institution by the PBGC of steps to terminate any Plan;”

SECTION 2. Waiver. The Borrower has informed the Agent and the Banks that as of December 30, 2011, the Borrower was not in compliance with Section 9.3 of the Credit Agreement. The Agent and the Banks are aware that, notwithstanding such non-compliance, the Borrower has borrowed Loans under the Credit Agreement, and borrowing while not in compliance with Section 9.3 constitutes non-compliance with Section 6.2 of the Credit Agreement (such non-compliance with Section 9.3 and Section 6.2, the “Existing Defaults”). The Borrower has requested that the Banks waive the Existing Defaults. As of the Effective Date, the Banks waive the Existing Defaults, and waive any Default or Event of Default arising from the Existing Defaults. Except as expressly provided herein, all provisions of the Credit Agreement remain in full force and effect and this waiver shall not apply to any other or subsequent failure to comply with such sections or any other provision of the Credit Agreement.

SECTION 3. Conditions of Effectiveness. This Amendment shall become effective as of the date hereof (the “Effective Date”) when, and only when, the Agent

shall have received an executed counterpart of this Amendment from the Borrower, the Required Banks and the Agent.

SECTION 4. Representations and Warranties. Each of the parties hereto represents and warrants that this Amendment and the Credit Agreement, as amended by this Amendment, constitute legal, valid and binding obligations of such party enforceable against such party in accordance with their terms, except as enforceability may be limited by bankruptcy, insolvency or similar laws affecting the enforcement of creditors' rights generally and general equitable principles.

SECTION 5. Reference to and the Effect on the Agreement.

(a) On and after the effective date of this Amendment, each reference in the Credit Agreement to "this Agreement", "hereunder", "hereof", "herein" or words of like import referring to the Credit Agreement and each reference to the Credit Agreement in any certificate delivered in connection therewith, shall mean and be a reference to the Credit Agreement as amended hereby.

(b) Each of the parties hereto hereby agrees that, except as specifically amended above, the Credit Agreement is hereby ratified and confirmed and shall continue to be in full force and effect and enforceable, except as such enforcement may be limited by applicable bankruptcy, insolvency, reorganization or other similar laws relating to or limiting creditors' rights generally and general equitable principles.

SECTION 6. Headings. Section headings in this Amendment are included herein for convenience only and shall not constitute a part of this Amendment for any other purpose.

SECTION 7. Execution in Counterparts. This Amendment may be executed in any number of counterparts and by different parties hereto in separate counterparts, each of which when so executed and delivered shall be deemed to be an original and all of which taken together shall constitute but one and the same agreement. Delivery of an executed counterpart to this Amendment by facsimile, electronic mail, portable document format (PDF) or similar means shall be effective as delivery of a manually executed counterpart of this Amendment.

SECTION 8. Governing Law. The validity, construction and enforceability of this Amendment shall be governed by the internal laws of the State of Minnesota, without giving effect to conflict of laws principles thereof, but giving effect to federal laws of the United States applicable to national banks.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed by their respective authorized signatories as of the day and year first above written.

GRACO INC.  
as Borrower

By: /s/ Christian E. Rothe  
Name: Christian E. Rothe  
Title: Vice President and Treasurer

U.S. BANK NATIONAL ASSOCIATION  
as Agent and a Bank

By: /s/ Ludmila Yakovlev  
Name: Ludmila Yakovlev  
Title: Assistant Vice President

JPMORGAN CHASE BANK, N.A.  
as a Bank

By: /s/ Suzanne Ergastolo  
Name: Suzanne Ergastolo  
Title: Vice President

WELLS FARGO BANK, NATIONAL ASSOCIATION,  
as a Bank

By: /s/ Peter Kiedrowski

Name: Peter Kiedrowski

Title: Director

BANK OF AMERICA, N.A.,  
as a Bank

By: /s/ Steven K. Kessler

Name: Steven K. Kessler

Title: Senior Vice President

**CERTIFICATION**

I, Patrick J. McHale, 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 officer 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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 officer 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 25, 2012

/s/ Patrick J. McHale

Patrick J. McHale  
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 officer 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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 officer 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 25, 2012

/s/ James A. Graner  
James A. Graner  
Chief Financial Officer

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 25, 2012

/s/ Patrick J. McHale  
Patrick J. McHale  
President and Chief Executive Officer

Date: April 25, 2012

/s/ James A. Graner  
James A. Graner  
Chief Financial Officer



# News Release

**FOR IMMEDIATE RELEASE:**

Wednesday, April 25, 2012

**FOR FURTHER INFORMATION:**

James A. Graner (612) 623-6635

## Graco Reports Record First Quarter Sales and Operating Earnings

**MINNEAPOLIS, MN (April 25, 2012)** - Graco Inc. (**NYSE: GGG**) today announced results for the first quarter ended March 30, 2012.

### Summary

\$ in millions except per share amounts

	Thirteen Weeks Ended		
	Mar 30, 2012	Apr 1, 2011	% Change
Net Sales	\$ 234.1	\$ 217.7	8 %
Net Earnings	35.4	37.3	(5)%
Diluted Net Earnings per Common Share	\$ 0.58	\$ 0.61	(5)%

- Sales increased in all divisions and regions.
- Gross margin rate remained strong at 56 percent.
- Operating expenses included \$4 million related to the acquisition of ITW's finishing businesses.
- Product development expenses were \$2 million higher than last year, reflecting our continuing investment in new products and technology.
- Interest expense was \$3 million higher than last year due to higher debt levels.
- Changes in currency translation rates did not have a significant effect on consolidated results. Favorable translation effects in Asia Pacific offset unfavorable effects in Europe.

"The first quarter was strong for Graco, reflecting good execution throughout the Company and continued demand by customers worldwide," said Patrick J. McHale, Graco's President and Chief Executive Officer. "As expected, growth rates moderated somewhat in the quarter from the prior record-level sales achieved in the first quarter of 2011. Growth in the Americas at 9 percent was better than expected, driven by double-digit increases in the Lubrication and Industrial segments. North American paint channel sales were also healthy in the first quarter, growing double-digits compared to the prior year. Sales in the Asia Pacific region grew at 10 percent (8 percent at consistent translation rates), with double-digit increases in the Lubrication and Contractor segments. In the European region, sales grew at 3 percent (6 percent at consistent translation rates), reflecting strong Industrial segment growth that was offset by macroeconomic conditions, which weighed on our Contractor segment.

"We invested heavily in our core strategies during the first quarter. Product development has been expanded through additional engineering teams in our Industrial segment, focused on growing our end markets served worldwide, and increased project spending in all segments. In addition, we invested \$8 million in capital expenditures during the quarter to drive plant-level and administrative efficiencies. Headcount also continues to expand worldwide, as we add resources to drive growth in the emerging markets of Asia, Europe, the Middle East and Latin America. These investments are expected to yield strong returns in the future."

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**Page 2 GRACO****Consolidated Results**

First quarter sales increased 8 percent, including increases of 9 percent in the Americas, 3 percent in Europe (6 percent at consistent translation rates) and 10 percent in Asia Pacific (8 percent at consistent translation rates).

Gross profit margin, expressed as a percentage of sales, was 56 percent, slightly lower than the first quarter last year. The unfavorable effect of higher material costs was partially offset by realized price increases and improved efficiencies.

Total operating expenses increased \$7 million for the quarter, including \$4 million related to the acquisition of ITW's finishing businesses and a \$2 million increase in product development expense.

The effective income tax rate of 34 1/2 percent for the quarter is higher than the rate for the first quarter last year due to the expiration of the federal R&D credit.

**Segment Results**

Certain measurements of segment operations are summarized below:

	<b>Thirteen Weeks</b>		
	<u>Industrial</u>	<u>Contractor</u>	<u>Lubrication</u>
Net sales (in millions)	\$ 134.1	\$ 72.0	\$ 28.0
Percentage change from last year			
Sales	9 %	3 %	14 %
Operating earnings	7 %	13 %	16 %
Operating earnings as a percentage of sales			
2012	36 %	17 %	22 %
2011	37 %	16 %	21 %

Industrial segment sales increased 9 percent, with increases of 12 percent in the Americas, 7 percent in Europe (10 percent at consistent currency translation rates) and 7 percent in Asia Pacific (6 percent at consistent translation rates). Contractor segment sales increased 3 percent with gains of 3 percent in the Americas and 13 percent in Asia Pacific (11 percent at consistent translation rates). Contractor sales were down 4 percent in Europe (down 1 percent at consistent translation rates) compared to the first quarter of 2011. Lubrication segment sales increased 14 percent, with increases of 14 percent in the Americas and 25 percent in Asia Pacific. Lubrication sales decreased 14 percent in Europe, on a relatively small base.

Operating earnings as a percentage of sales were steady in all segments compared to the first quarter of last year.

**Finishing Brands Acquisition**

On April 2, 2012, Graco closed on its \$650 million acquisition of the Illinois Tool Works Inc. (NYSE: ITW) finishing businesses. The acquisition added Gema®, a global leader in powder coating technology, which represented approximately one-third of the purchase. The remaining two-thirds of the acquisition is a collection of industrial liquid finishing businesses, which the United States Federal Trade Commission ("FTC") has ordered to be held separate from Gema and other Graco businesses while the FTC investigates and considers a settlement proposal from Graco. In compliance with the FTC's order, the

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industrial liquid finishing businesses will be run independently by existing management under the supervision of a trustee who reports directly to the FTC.

At the completion of its review, the FTC will issue a final decision and order that will identify the products, businesses and/or assets that Graco will be required to divest. The Company will have 180 days following the issuance of the final decision and order to complete such divestiture.

**Outlook**

"We remain optimistic that the Company will achieve growth in all geographies and business segments for the full-year 2012, but caution that the Western European economies and select construction markets are challenging," said McHale. "The demand environment in the Americas continues to be favorable, if not resilient. While we have noted some weakening of industrial project activity in our Asia Pacific region recently, we believe that growth will continue throughout 2012. We will be watching worldwide order trends closely throughout the year and expect that product launches scheduled for the second half of 2012 will help to countervail softness."

**Cautionary Statement Regarding Forward-Looking Statements**

A forward-looking statement is any statement made in this earnings release and other reports that the Company files periodically with the Securities and Exchange Commission, as well as in press releases, analyst briefings, conference calls and the Company's Overview report to shareholders, 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 undertakes no obligation to update these statements in light of new information or future events.

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. In addition, risk factors related to the Company's acquisition of the ITW finishing businesses include: whether and when the required regulatory approvals will be obtained, whether and when the Company will be able to realize the expected financial results and accretive effect of the transaction, how customers, competitors, suppliers and employees will react to the transaction, economic changes in global markets, the extent of the acquired businesses required to be divested, whether the Company will be able to find a suitable purchaser(s) and structure the divestiture on acceptable terms, and whether the Company will be able to complete a divestiture in a time frame that is satisfactory to the Federal Trade Commission. Please refer to Item 1A of, and Exhibit 99 to, the Company's Annual Report on Form 10-K for fiscal year 2011 (and most recent Form 10-Q) for a more comprehensive discussion of these and other risk factors. These reports are available on the Company's website at [www.graco.com](http://www.graco.com) and the Securities and Exchange Commission's website at [www.sec.gov](http://www.sec.gov).

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**Conference Call**

Graco management will hold a conference call, including slides via webcast, with analysts and institutional investors on Thursday, April 26, 2012, at 11:00 a.m. ET, to discuss Graco's first quarter results.

A real-time webcast of the conference call will be broadcast live over the Internet. Individuals wanting to listen and view slides can access the call at the Company's website at [www.graco.com](http://www.graco.com). Listeners should go to the website at least 15 minutes prior to the live conference call to install any necessary audio software.

For those unable to listen to the live event, a replay will be available soon after the conference call at Graco's website, or by telephone beginning at approximately 2:00 p.m. ET on April 26, 2012, by dialing 800-406-7325, Conference ID #4530277, if calling within the U.S. or Canada. The dial-in number for international participants is 303-590-3030, with the same Conference ID #. The replay by telephone will be available through April 30, 2012.

Graco Inc. supplies technology and expertise for the management of fluids in both industrial and commercial applications. It designs, manufactures and markets systems and equipment to move, measure, control, dispense and spray fluid materials. A recognized leader in its specialties, Minneapolis-based Graco serves customers around the world in the manufacturing, processing, construction and maintenance industries. For additional information about Graco Inc., please visit us at [www.graco.com](http://www.graco.com).

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**GRACO INC. AND SUBSIDIARIES**  
**Consolidated Statement of Earnings (Unaudited)**

(in thousands, except per share amounts)	Thirteen Weeks Ended	
	Mar 30, 2012	Apr 1, 2011
<b>Net Sales</b>	<b>\$ 234,122</b>	<b>\$ 217,679</b>
Cost of products sold	101,943	93,282
<b>Gross Profit</b>	<b>132,179</b>	<b>124,397</b>
Product development	11,638	9,931
Selling, marketing and distribution	38,026	37,483
General and administrative	24,546	19,914
<b>Operating Earnings</b>	<b>57,969</b>	<b>57,069</b>
Interest expense	3,689	616
Other expense, net	299	—
<b>Earnings Before Income Taxes</b>	<b>53,981</b>	<b>56,453</b>
Income taxes	18,600	19,200
<b>Income taxes</b>	<b>\$ 35,381</b>	<b>\$ 37,253</b>
<b>Net Earnings per Common Share</b>		
Basic	\$ 0.59	\$ 0.62
Diluted	\$ 0.58	\$ 0.61
<b>Weighted Average Number of Shares</b>		
Basic	60,052	60,270
Diluted	61,338	61,360

**Segment Information (Unaudited)**

	Thirteen Weeks Ended	
	Mar 30, 2012	Apr 1, 2011
<b>Net Sales</b>		
Industrial	\$ 134,103	\$ 122,830
Contractor	71,986	70,205
Lubrication	28,033	24,644
<b>Total</b>	<b>\$ 234,122</b>	<b>\$ 217,679</b>
<b>Operating Earnings</b>		
Industrial	\$ 48,313	\$ 45,025
Contractor	12,539	11,115
Lubrication	6,089	5,227
Unallocated corporate (expense)	(8,972)	(4,298)
<b>Total</b>	<b>\$ 57,969</b>	<b>\$ 57,069</b>

All figures are subject to audit and adjustment at the end of the fiscal year.

The consolidated Balance Sheets, Consolidated Statements of Cash Flows and Management's Discussion and Analysis are available in our Quarterly Report on Form 10-Q on our website at [www.graco.com](http://www.graco.com).

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