

UNITED STATES
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-K

☒ Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 29, 2000 or

☐ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____.

Commission File No. 001-9249

Graco Inc.
(Exact name of Registrant as specified in its charter)

Minnesota 41-0285640
(State or other jurisdiction (I.R.S. Employer Identification No.)
of incorporation or organization)

88 - 11th Avenue Northeast
Minneapolis, MN 55413
(Address of principal executive offices) (Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:
Common Stock, par value \$1.00 per share
Preferred Share Purchase Rights
Shares registered on the New York Stock Exchange.

Securities registered pursuant to Section 12(g) of the Act:
None

As of March 5, 2001, 30,747,876 shares of Common Stock were outstanding.

Indicate by a 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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No .

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K ☐

The aggregate market value of approximately 27,025,728 shares held by non-affiliates of the registrant was approximately \$727 million on March 5, 2001.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive Proxy Statement for its Annual Meeting of Shareholders to be held on May 1, 2001, are incorporated by reference into Part III, as specifically set forth in said Part III.

GRACO INC.

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ON FORM 10-K

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NOTE: Certain exhibits listed in the Index to Exhibits beginning on page 33, and filed with the Securities and Exchange Commission, have been omitted. Copies of such exhibits may be obtained upon written request directed to:

Treasurer
Graco Inc.
P.O. Box 1441
Minneapolis, Minnesota
55440-1441

Part I

Item 1. Business

General Information

Graco Inc. ("Graco" or "the Company") supplies technology and expertise for the management of fluids in both industrial and commercial settings. The Company helps customers solve difficult manufacturing problems, increase productivity, improve quality, conserve energy, save expensive material, control environmental emissions and reduce labor costs. Graco is the successor to Gray Company, Inc., which was incorporated in 1926 as a manufacturer of automobile lubrication equipment and became a public company in 1969.

Based in Minneapolis, Minnesota, Graco serves customers around the world in the manufacturing, process, construction and maintenance industries. It designs, manufactures and markets systems, products and technology to move, measure, control, dispense and spray a wide variety of fluids and viscous materials.

Among Graco's strategic objectives is that of being the highest quality, lowest cost, most responsive supplier in the world for its principal products. In working to achieve this goal, Graco has organized its manufacturing operations around product-focused factories which contain product-based cells. Other strategic objectives include generating 30 percent of each year's sales from products introduced in the last three years, generating at least 5 percent of each year's sales from sales in markets entered in the last three years, expanding its distribution network outside North America and active pursuit of focused acquisitions.

Operating Segment Information

Graco's businesses are classified by management into three operating segments: (1) Industrial/Automotive Equipment, (2) Contractor Equipment, and (3) Lubrication Equipment. Financial information concerning these operating segments is set forth in Part II, Item 7, at page 10, and in Note B to the Consolidated Financial Statements.

Industrial/Automotive Equipment

Graco's Industrial/Automotive Equipment segment designs and markets fluid application products, primarily for paints, coatings, sealants and adhesives. The markets served include automotive assembly and components plants, wood products, rail, marine, aerospace, farm and construction equipment, truck, bus and recreational vehicles, and approximately thirty other industries.

Worldwide, the equipment designed and manufactured by this segment is sold through general and specialized distributors and integrators as well as directly to automotive assembly plants. Distributors promote and sell the equipment, provide product application expertise, and offer integration capabilities, on-site service and technical support.

Products marketed by the Industrial/Automotive Equipment segment are manufactured in Minneapolis and Rogers, Minnesota, Sioux Falls, South Dakota and Bielefeld, Germany. Assembly of certain products for the European market is performed in Maasmechelen, Belgium.

Recent Developments. Graco is focusing its product design and marketing efforts on four key areas of application: sealants and adhesives, process, finishing and protective coatings. A major driver of product development in the Industrial/Automotive segment is the need to reduce the emission of volatile organic compounds ("VOCs") from coatings during the application process in order to meet environmental regulations. In addition, Graco is developing new products for the global marketplace and expanding its specialized distribution throughout the world in order to achieve maximum coverage.

Graco serves the automotive market by selling pre-engineered packages, modules and equipment primarily through independent distributors, integrators, and robot manufacturers and directly to automotive assembly plants. An experienced specialized sales force meets the unique needs of these customers as well as those of original equipment manufacturers and material suppliers.

In 2000, Graco introduced ValueMix(TM), the first electronic entry-level plural component sprayer. Environmental regulations have driven small and medium-sized industrial users of paint to more environmentally friendly methods of application. The ValueMix technology offers these companies an easy-to-use, cost effective alternative to manual or mechanical premixing of plural component materials.

The Therm-O-Flow Plus(TM), a high performance pump for the high volume dispensing of heated adhesives and sealants, was introduced in a multi-voltage configuration which allows its use throughout the world. The uniquely designed platen on this unit transfers heat to the material more quickly than competitive designs.

The PrecisionMix II 3K entered the market in 2000. This high-end three component

proportioner automatically integrates the catalyst, resin and solvent from the supply pumps and delivers the mixture to the spray gun, thus permitting the elimination of solvent premixing and reducing the cost of labor and material.

Graco continued to expand its offering of electronic monitoring devices, to assist customers in meeting their environmental responsibilities and business needs. The PrecisionView(TM)AMR, an easy-to-use software package, allows customers to automatically track and report their material usage, emissions and on-line processes. It can be used with the PrecisionMix II and II 3K and the Informer(TM).

In December 2000, Graco received TE 9000 certification. Automotive manufacturers established the TE 9000 supplement to ISO 9000 in the mid-1990's, to ensure that the machine tools they buy will perform as required. In order to obtain TE 9000 certification, suppliers must demonstrate that they are pursuing a plan that will meet customer requirements for product quality, reliability, maintainability and durability. Certification will allow Graco to maintain its preferred business association with these customers.

Products. Products offered by the Industrial/Automotive segment include air, electric and hydraulically powered pumps that pressurize and transfer paints, stains, chemicals, sealants, adhesives, food, and other viscous materials through various application devices, including air, airless, air-airless, electrostatic, and high-volume-low-pressure ("HVLP") spray guns. Fluid pressures ranging from 20 to more than 6,000 pounds per square inch and flow rates from under 1 gallon to 275 gallons per minute are available. Sealant and adhesive, paint circulating and plural component packages and modules and a complete line of parts and accessories are also offered.

Contractor Equipment

Graco's Contractor Equipment segment designs and markets sprayers for the application of paint and other architectural coatings, and for the high-pressure cleaning of equipment and structures. The segment offers its equipment to distributors selling to contractors in the painting, roofing, texture, corrosion control and line stripping markets. The segment offers equipment which gives contractors the opportunity to produce a higher quality finish at higher production rates with sprayers that are durable and easy to use.

The equipment is sold primarily through retail stores which sell paint and other coatings, and secondarily through general equipment distributors. In 2000, Graco began marketing a limited line of sprayers through the home center channel. Manufacturers' representatives are used to sell the Company's equipment to the rental market.

Products for the contractor equipment markets are manufactured in Rogers, Minnesota, and Sioux Falls, South Dakota. Assembly of certain products for the European market is performed in Maasmechelen, Belgium.

Recent Developments. In 2000, the Magnum(TM) sprayers, a new line of airless sprayers and accessories for the entry-level painting contractor and remodeler, were introduced into the home center market, a new channel for Graco.

The Pro ST(TM) family of electronic airless sprayers with the SmartControl(TM) microprocessor, Endurance E(TM) pump and a helical drive was introduced in 2000. The SmartControl microprocessor automatically adjusts to the size of the spray tip, offers spray pressure consistency and a higher atomizing pressure over competitive designs. The Endurance E pump allows the pump to be repacked in one-half the time of other models.

The 190 ES(TM) electric airless sprayer introduced in 2000 represents a new price point for an entry level professional sprayer.

Graco added to its broad line of spray guns a new extended reach pole gun with the revolutionary CleanShot(TM) shut-off valve, which allows material flow to be shut off at the spray tip and eliminates spitting.

Products. The segment's primary product lines are airless paint sprayers and associated accessories such as spray guns, filters, valves and tips. Also offered are pressure washers and specialized spraying equipment for the application of roofing materials, texture coatings and traffic paint. Fluid pressures ranging from 5 to more than 4,000 pounds per square inch and flow rates up to 4 gallons per minute are available. Pumps are electric, hydraulic and air-powered models in addition to gasoline-powered models, increasing the flexibility of contractors in areas where electricity is not readily available. High-volume-low-pressure ("HVLP") equipment has become increasingly popular as regulation of volatile emissions has increased. Replacement and maintenance parts, such as packings, seals and hoses, which must be replaced periodically in order to maintain efficiency and prevent loss of material, are also offered for sale.

Lubrication Equipment

The Lubrication Equipment segment designs and markets products for the lubrication and maintenance of vehicles and other equipment. The markets for the segment's products include fast oil change facilities, service garages, fleet service centers, automobile dealerships, the mining industry, and industrial lubrication. The purchase of vehicle lubrication equipment is often funded by major oil companies for their customers as a marketing tool.

Products are distributed primarily through independent distributors worldwide, which are serviced by direct sales personnel and a network of independent sales representatives.

Products for the Lubrication Equipment markets are manufactured in Minneapolis, Minnesota.

Recent Developments. A family of electronic metering devices designed to meter and dispense bulk fluids in the servicing of vehicles and equipment was brought to market in 2000. The EM6(TM) leads the competition in gallons per minute flow and higher fluid pressures. All valves in the family handle multiple fluids.

In 2000, the Pro-Shot(TM) Grease Dispense Valve was introduced. This robust heavy-duty valve has a ball check mechanism with four times longer life, a pressure assist trigger pull to reduce operator fatigue and a trigger lock to prevent accidental triggering.

The 350 and 500 Series Hose Reels, two new lines of heavy-duty hose reels designed for use with air and water, were launched during the year. Intended to broaden Graco's reel offerings to bus and truck fleets, manufacturing plants and lubrication trucks, the 500 Series allows 15 different mounting positions.

The Dyna-Star (R) Hydraulic Pump Module provides a hydraulically-powered pump as an alternative to air-powered equipment for the lubrication of mobile mining equipment. A Visual Level Indicator with a magnetic proximity switch to sense high and low fluid levels is offered as an option.

Products. The Lubrication Equipment segment offers a full line of lubrication pumps (air and hydraulic-powered), meters, fluid and air pressure gauges, fluid management systems, hose reels and dispense valves. The segment sells a fluid management system for the vehicle services market, which tracks and records inventories of lubricants and the quantities dispensed. It continues to develop its capability to service the mining industry with automatic lubrication systems. A complete line of parts and accessories is also offered.

Marketing and Distribution

Graco sells its full line of products in each of the following major geographic markets: the Americas (North, Central and South America), Europe (including the Middle East and Africa), and Asia Pacific. The Industrial/Automotive Equipment segment, Contractor Equipment segment, and the Lubrication Equipment segment provide worldwide marketing, product design and application assistance to each of these geographic markets.

Graco sells its equipment worldwide principally through independent distributors. In Japan, Korea, and Europe, Graco equipment is sold to distributors through sales subsidiaries. Manufacturers' representatives are used in the Lubrication Equipment and the Contractor Equipment segments.

It is the Company's goal to generate at least 5 percent of each year's revenues from sales in markets entered in the last three years. The home center channel into which the Contractor Equipment Division introduced the Magnum line of airless sprayers in 2000 is an example of the Company's efforts to reach this goal.

In 2000, Graco's net sales in the Americas were \$359,881,000 or approximately 73 percent of the Company's consolidated net sales; in Europe net sales were \$84,733,000 or approximately 17 percent; and in the Asia Pacific Region, net sales were \$49,759,000 or approximately 10 percent.

Research, Product Development and Technical Services

Graco's research, development and engineering activities are organized by operating segment. The engineering group in each segment focuses on new product design, product improvements, applied engineering and strategic technologies for its specific customer base. It is one of Graco's goals to generate 30 percent of each year's sales from products introduced in the prior three years. All major research and development activities are conducted in facilities located in Minneapolis, and Rogers, Minnesota. Total research and development expenditures were \$19,998,000, \$19,688,000 and \$18,213,000 for 2000, 1999 and 1998.

Intellectual Property

Graco owns a number of patents and has patent applications pending both in the United States and in foreign countries, licenses its patents to others, and is licensed under patents owned by others. In the opinion of the Company, its business is not materially dependent upon any one or more of these patents or licenses. The Company also owns a number of trademarks in the United States and foreign countries, including the registered trademarks for "GRACO," several forms of a capital "G" and various product trademarks which are material to the business of the Company inasmuch as they identify Graco and its products to its customers.

Competition

Graco faces substantial competition in all of its markets. The nature and extent of this competition varies in different markets due to the depth and breadth of the Company's product lines. Product quality, reliability, design, customer

support and service, specialized engineering and pricing are the major competitive factors. Although no competitor duplicates all of Graco's products, some competitors are larger than the Company, both in terms of sales of directly competing products and in terms of total sales and financial resources. The Company faces competitors with different cost structures and expectations of profitability. Graco believes it is one of the world's leading producers of high-quality specialized fluid management equipment. It is impossible, because of the absence of reliable industry-wide third-party data, to determine its relative market position.

Environmental Protection

The Company's compliance with Federal, State and local environmental laws and regulations did not have a material effect upon the capital expenditures, earnings or competitive position of the Company during the fiscal year ending December 29, 2000.

Employees

As of December 29, 2000, the Company employed approximately 1920 persons on a full-time basis. Of this total, approximately 300 were employees based outside the United States, and 821 were hourly factory workers in the United States. None of the Company's U.S. employees is covered by a collective bargaining agreement. Various national industry-wide labor agreements apply to certain employees in Europe. Compliance with such agreements has no material effect on the Company or its operations.

Item 2. Properties

As of December 29, 2000, the Company's principal operations that occupy more than 10,000 square feet were conducted in the following facilities:

Type of Facility	Location	Gross Square Footage
-----	-----	-----
Owned		

Distribution/Manufacturing/Office	Rogers, Minnesota	333,000
Manufacturing/Office	Minneapolis, Minnesota	242,300
Manufacturing/Office	Minneapolis, Minnesota	202,300
Research & Development/Corporate Headquarters	Minneapolis, Minnesota	138,700
Assembly/European Headquarters/Warehouse	Maasmechelen, Belgium	75,200
Manufacturing/Office	Sioux Falls, South Dakota	55,100
Leased		

Manufacturing/Office	Bielefeld, Germany	69,400
Office/Warehouse	Yokohama, Japan (2 facilities)	32,800
Office/Warehouse	Gwangju-Gun, Korea	10,500
Office	Plymouth, Michigan	21,000

A 163,000 square foot addition to one of its buildings in Minneapolis is expected to be completed during 2001. This addition will permit the Company to provide space in its Rogers, Minnesota facility for the expansion of its Contractor Equipment manufacturing capability and create a separate warehouse in Minneapolis for Industrial/Automotive and Lubrication Equipment products closer to their respective manufacturing facilities.

The Company leases space for liaison offices in China.

A 73,800 square foot office building in Golden Valley, Minnesota was sold in December 2000.

With the expansion of one of its buildings in Minneapolis, Graco's facilities are in satisfactory condition, suitable for their respective uses and are sufficient and adequate to meet current needs. Manufacturing capacity met business demand in 2000. Production requirements in the immediate future are expected to be met through existing production capabilities, expanded production facilities currently under construction, efficiency and productivity improvements, and the use of available subcontract services.

Item 3. Legal Proceedings

The Company is engaged in routine litigation incident to its business, which management believes will not have a material adverse effect upon its operations or consolidated financial position.

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

No issues were submitted to a vote of security holders during the fourth quarter of 2000.

Executive Officers of the Company

The following are all the executive officers of the Company as of March 5, 2001.

George Aristides, 65, was elected Chief Executive Officer effective January 3, 2000. From March 1, 1999 to December 29, 1999, he was Vice Chairman. From January 1, 1996 to February 28, 1999 he was Chief Executive Officer. From 1993 to 1997 he was President. From 1993 to 1996 he was President and Chief Operating Officer. He joined the Company in 1973 as Corporate Controller and became Vice President and Controller in 1980. He has served as a director of the Company since 1993.

Stephen L. Bauman, 48, was elected Vice President, Human Resources, effective October 25, 2000. Prior to joining Graco, he held various positions with Alliant Techsystems, Inc. most recently as Vice President of Human Resources, Alliant Integrated Defense Company, a subsidiary.

James A. Graner, 56, was elected Vice President and Controller in February 1994. He became Treasurer in May 1993. Prior to becoming Assistant Treasurer in 1988, he held various managerial positions in the treasury, accounting and information systems departments. He joined Graco in 1974.

Dale D. Johnson, 46, was elected President and Chief Operating Officer effective January 14, 2000. From December 1996 to January 2000 he was Vice President, Contractor Equipment Division. Prior to becoming the Director of Marketing, Contractor Equipment Division in June 1996, he held various marketing and sales positions in the Contractor Equipment Division and the Industrial Equipment Division. He joined the Company in 1976.

D. Christian Koch, 36, was appointed Vice President, Lubrication Equipment Division effective February 15, 2000. From August 1999 to February 2000, he was the Director, Industrial Global Sales and Marketing. From December 1998 to August 1999 he was Director, Lubrication Marketing. Prior to joining the Company in December 1998, he was employed by H.B. Fuller Company, where he held various positions, including President and Division Manager of TEC Incorporated and Vice President and Business Unit Manager of Foster Products Corporation. (Mr. Koch is not related to David A. Koch, Chairman of the Board.)

David M. Lowe, 45, became Vice President and General Manager, European Operations effective September 1, 1999. Mr. Lowe was Vice President, Lubrication Equipment Division from December 1996 to September 1999. From February 1995 to December 1996 he was Treasurer. Prior to joining the Company in 1995, he was employed by Ecolab Inc., where he held various positions in the Treasury Department, including Manager, Corporate Finance; Director, Corporate Finance; and Director, Corporate Development.

Robert M. Mattison, 53, was first elected Vice President, General Counsel and Secretary, in January 1992, a position which he holds today.

Patrick J. McHale, 39, was appointed Vice President, Contractor Equipment Division effective February 15, 2000. Mr. McHale was Vice President, Lubrication Equipment Division from September 1999 to February 2000. He was Contractor Equipment Manufacturing - Distribution Operations Manager from February 1998 to September 1999. From March 1997 to February 1998 he was Director of Michigan Operations. From February 1996 to March 1997 he was Contractor Equipment Manufacturing Operations Manager and from January 1994 to February 1996 he was the Sioux Falls Plant Manager. Mr. McHale joined the Company in December 1989.

Charles L. Rescorla, 49, is Vice President, Manufacturing and Distribution Operations, a position to which he was first elected on May 5, 1998. Mr. Rescorla was previously appointed to that position on January 1, 1995. Prior to becoming the Director of Manufacturing in March 1994, he was the Director of Engineering, Industrial/Automotive Division, a position which he assumed in 1988 when he joined the Company.

Mark W. Sheahan, 36, was elected Vice President and Treasurer on December 11, 1998. Effective December 17, 1996, he was elected Treasurer. Prior to joining the Company as Treasury Operations Manager in 1995, he was a Senior Manager with KPMG Peat Marwick LLP.

Fred A. Sutter, 40, was appointed Vice President, Asia Pacific and Latin America effective March 1, 1999. From March 1995 to February 28, 1999 he was Director of Industrial Marketing. Prior to joining the Company in 1995, he held various positions with Fisher-Rosemount, most recently as Director of Marketing.

The Board of Directors elected Messrs. Aristides, Johnson, Graner, Lowe, Mattison, Rescorla and Sheahan on May 2, 2000, all to hold office until the next annual meeting of directors or until their successors are elected and qualify.

PART II

Item 5. Market for the Company's Common Stock and Related Shareholder Matters

Graco Common Stock. Graco common stock is traded on the New York Stock Exchange under the ticker symbol "GGG." As of March 5, 2001, the share price was \$26.90 and there were 30,747,876 shares outstanding and 2,500 common shareholders of record, which includes nominees or broker dealers holding stock on behalf of an estimated 4,600 beneficial owners.

Quarterly Financial Information

(In thousands, except per share amounts)

2000	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net sales	\$122,227	\$132,768	\$123,100	\$116,278
Gross profit	62,129	66,102	62,949	59,672
Net earnings	14,975	18,331	18,073	18,729
Per common share:				
Basic net earnings	0.49	0.60	0.60	0.62
Diluted net earnings	0.48	0.59	0.59	0.61
Dividends declared	0.09	0.09	0.09	0.10
Stock price (per share)				
High	\$ 22.75	\$ 23.33	\$ 23.92	\$ 27.67
Low	19.33	20.00	20.42	20.13
Close	19.33	21.67	21.67	27.59
Volume (# of shares)	4,532	4,880	2,223	2,904

1999				
Net sales	\$105,141	\$116,803	\$112,076	\$116,454
Gross profit	52,857	59,619	57,510	61,149
Net earnings	11,201	17,961	15,043	15,136
Per common share:				
Basic net earnings	0.37	0.59	0.49	0.49
Diluted net earnings	0.36	0.57	0.48	0.48
Dividends declared	0.07	0.07	0.07	0.09
Stock price (per share)				
High	\$ 20.17	\$ 21.75	\$ 23.25	\$ 23.92
Low	13.33	14.33	19.00	21.29
Close	14.29	19.54	22.04	23.92
Volume (# of shares)	4,289	4,496	3,503	3,792

[FN]

1 Pursuant to EITF 00-10, freight expense for products shipped to customers, previously netted against sales, has been reclassified to cost of products sold.

2 All share and per share data has been restated for the three-for-two stock split declared on December 8, 2000 and distributed February 6, 2001.

3 As of the last trading day of the calendar quarter.

Item 6. Selected Financial Data

Graco Inc. & Subsidiaries (In thousands, except per share amounts)	2000	1999	1998	1997	1996
Net sales	\$494,373	\$450,474	\$440,585	\$423,897	\$399,356
Net earnings	70,108	59,341	47,263	44,716	36,169
Per common share:					
Basic net earnings	\$ 2.31	\$ 1.95	\$ 1.37	\$ 1.17	\$ 0.93
Diluted net earnings	2.27	1.90	1.34	1.14	0.92
Total assets	\$237,976	\$236,033	\$233,702	\$264,532	\$247,814
Long-term debt (including current portion)	19,360	66,910	115,739	7,959	9,920
Cash dividends declared per common share	\$ 0.38	\$ 0.31	\$ 0.29	\$ 0.25	\$ 0.22

1 Pursuant to EITF 00-10, freight expense for products shipped to customers, previously netted against sales, has been reclassified to cost of products sold.

2 All share and per share data has been restated for the three-for-two stock split declared on December 8, 2000 and distributed February 6, 2001.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

MANAGEMENT'S REVIEW AND DISCUSSION

Graco's net earnings of \$70.1 million in 2000 are 18 percent higher than the \$59.3 million earned in 1999 and are 48 percent higher than the \$47.3 million

recorded in 1998. The increase in 2000 was a result of higher sales, improved manufacturing efficiencies (largely due to increased volume), improved business processes and price increases. The increase in 1999 is primarily due to enhanced profit margins resulting from many factors, including improved business processes, exiting the custom systems business, closing facilities, improved manufacturing efficiencies and price increases.

The table below reflects the percentage relationship between income and expense items included in the Consolidated Statements of Earnings for the three fiscal years and the percentage changes in those items for such years.

	Revenue & Expense Item As a Percentage of Net Sales			Revenue & Expense Item % Increase (Decrease)	
	2000	1999	1998	00/99	99/98
	-----	-----	-----	-----	-----
Net Sales	100.0	100.0	100.0	10	2
	-----	-----	-----	-----	-----
Cost of products sold	49.3	48.7	50.2	11	(1)
Product development	4.0	4.4	4.1	2	8
Selling, marketing and distribution	17.5	17.7	18.9	8	(4)
General and administrative	6.7	8.5	9.4	(14)	(7)
	-----	-----	-----	-----	-----
Operating profit	22.5	20.7	17.4	19	21
	-----	-----	-----	-----	-----
Interest expense	0.8	1.6	1.2	(41)	32
Other expense (income), net	0.3	(0.6)	--	*	*
	-----	-----	-----	-----	-----
Earnings before income taxes	21.4	19.7	16.2	19	24
Income taxes	7.2	6.5	5.5	21	22
	-----	-----	-----	-----	-----
Net Earnings	14.2	13.2	10.7	18	26
	=====	=====	=====	=====	=====

* Not a meaningful figure.

NET SALES

Worldwide net sales in 2000 reached a record \$494.4 million, a 10 percent increase over 1999 net sales of \$450.5 million. Foreign currency translations had a negative impact on reported sales in 2000 when compared to 1999, reducing sales by 2 percent. By segment, 2000 net sales versus 1999 increased in the Contractor Equipment and Lubrication Equipment by 24 percent and 2 percent, respectively. Sales in the Industrial/Automotive segment were flat. The large increase in Contractor Equipment sales in 2000 was due primarily to the introduction of a new line of sprayers for entry into the home center channel. After growing in the first half of 2000, Industrial/Automotive equipment sales declined in the second half of 2000 due primarily to a slowing North American economy. Lubrication Equipment sales in 2000 were flat in a market that is mature and well served.

Geographically, sales outside of the Americas represented 27 percent of total sales in 2000, compared to 30 percent in 1999. Net sales gains in Asia Pacific were offset by lower sales in Europe. In the Americas, 2000 sales increased 15 percent for the year, primarily due to strong sales in the Company's Contractor Equipment business segment. In Europe, sales measured in local currencies increased 6 percent but reported net sales were 6 percent lower than 1999 after unfavorable currency translations. In the Asia Pacific Region, sales measured in local currencies increased 3 percent but reported net sales were 7 percent higher than 1999 after favorable currency translations.

Worldwide net sales in 1999 were \$450.5 million, a 2 percent increase over 1998. Foreign currency translations had no net impact on reported sales in 1999 when compared to 1998. The 1999 increase was due to higher sales in all regions except Europe. Net sales in the Americas, which accounted for 70 percent of net sales, advanced 3 percent, primarily due to strong sales in the Contractor Equipment segment. Lower sales in Europe offset net sales gains in the Asia Pacific Region.

Consolidated backlog on December 29, 2000 was \$12 million, which the Company expects to fill within the current fiscal year. Backlog was \$21 million at the end of 1999 and \$13 million at the end of 1998. The decrease in 2000 backlog reflected a return to normal levels from the large backlog that resulted from orders in late 1999 for the home center channel products that were shipped in the first quarter of 2000.

	% Increase (Decrease)				
(In thousands)	2000	1999	1998	00/99	99/98
	-----	-----	-----	-----	-----
Segment Sales:					
Industrial/Automotive Equipment	\$227,963	\$227,772	\$235,328	--	(3)
Contractor Equipment	221,538	178,616	160,718	24	11
Lubrication Equipment	44,872	44,086	44,539	2	(1)
	-----	-----	-----	-----	-----

Consolidated	\$494,373	\$450,474	\$440,585	10	2
	=====	=====	=====	=====	=====
Geographic Sales:					
Americas	\$359,881	\$313,915	\$305,860	15	3
Europe	84,733	90,112	95,938	(6)	(6)
Asia Pacific	49,759	46,447	38,787	7	20
	-----	-----	-----	-----	-----
Consolidated	\$494,373	\$450,474	\$440,585	10	2
	=====	=====	=====	=====	=====

GROSS MARGINS

Gross margins, expressed as a percentage of sales, were 50.7 percent in 2000, compared with 51.3 percent in 1999. The effects of higher production levels, enhanced pricing, and improved manufacturing efficiencies were offset by the mix of products sold and the negative foreign exchange rate impact. 1999 gross margins of 51.3 percent were up from 1998 gross margins of 49.8 percent. The mix of products sold, pricing, improved manufacturing efficiencies, exiting the custom-engineered systems business, and slightly higher sales all contributed to the enhanced gross margin.

OPERATING EXPENSES

Overall, operating expenses, expressed as a percentage of net sales, decreased 2.4 percentage points in 2000 versus 1999. Product development expenses were \$20.0 million in 2000, \$19.7 million in 1999 and \$18.2 million in 1998. Graco continues to make significant investments in product development to grow its sales revenue.

Selling, marketing, distribution and general and administrative expenses were higher in 2000 due to higher sales, but decreased as a percentage of sales to 24.2 percent in 2000 from 26.2 percent in 1999. In 2000, selling, marketing, and distribution expenses were higher than in 1999 due to higher sales and expenses related to the launch of home center products. General and administrative expenses were lower than 1999 due to corporate expense reduction initiatives and lower information systems expenditures. In 1999, selling, marketing, distribution and administrative expenses, expressed as a percentage of sales, decreased to 26.2 percent from 28.2 percent in 1998. In 1999, overall selling, marketing, distribution and administrative expenses were lower than in 1998 due to the benefits of prior year corporate expense reduction initiatives, lower information systems expenditures, and reduced non-recurring charges.

The Company recorded pension income of \$3.8 million in 2000, \$2.1 million in 1999 and \$2.1 million in 1998, which resulted from recognition of investment gains attributable to pension plan assets. Pension expense/income is included in cost of products sold and operating expenses based on salaries and wages.

SEGMENT OPERATING PROFITS

Increases in 2000 operating profits are the result of several factors, including higher sales, expense reduction initiatives and improved manufacturing efficiencies. Operating profits for Industrial/Automotive Equipment increased by 20.1 percent versus 1999 and by 4.3 percentage points as a percentage of net sales primarily as a result of improved gross margin rates along with lower product development, marketing and sales-related expenses. Contractor Equipment operating profits increased by 14.9 percent versus 1999 but decreased 1.8 percentage points as a percentage of net sales due to the mixture of products sold. Lubrication Equipment operating profits increased by 2.8 percent versus 1999 and increased by .2 percentage points as a percentage of net sales.

FOREIGN CURRENCY EFFECTS

Approximately 27 percent of the Company's sales in 2000 and 5 percent of its product costs are in currencies other than the U.S. dollar. The strong U.S. dollar, versus European currencies, decreased the Company's profits. In 2000, the adverse impact of the strengthening dollar in Europe was partially offset by the dollar weakening against the Japanese yen and Korean won. The Company estimates that fluctuations in exchange rates adversely impacted operating earnings by \$5 million in 2000 and had no significant impact in 1999.

OTHER EXPENSE (INCOME)

In 2000, interest expense, net of interest income, decreased to \$4.1 million due to the significant reduction in borrowings. In 1999, interest expense of \$7.0 million was higher than the \$5.3 million of interest expense in 1998 due to the full year impact of borrowings for the July 2, 1998 stock repurchase of 5.8 million shares.

Other expense, net of other income, was \$1.2 million in 2000 compared to other income in 1999 of \$2.6 million and other expense in 1998 of \$0.2 million. Other expense (income) includes, among other things, foreign currency translation losses of \$1.6 million in 2000. The Company sold its Golden Valley headquarters building in 2000 and facilities in Los Angeles and Plymouth, Michigan in 1999 with gains of \$2.2 million and \$3.2 million respectively.

INCOME TAXES

The Company's net effective tax rate of 34 percent in 2000 is one percentage

point lower than the 2000 U.S. federal tax rate of 35 percent. The increase from the 33 percent effective rate in 1999 is due primarily to earnings from sales outside of the U.S. being taxed at higher effective rates. The 1999 effective tax rate of 33 percent was lower than the 1998 effective tax rate of 34 percent principally due to earnings from sales outside the U.S. being taxed at lower effective rates. Reconciliations of the U.S. federal tax rate to the effective rates for 2000, 1999 and 1998 are included in Note E to the Consolidated Financial Statements.

ACCOUNTING CHANGES

To conform with the requirements of the Emerging Issues Task Force Issue Number 00-10, "Accounting for Shipping and Handling Fees and Costs," the Company reclassified freight expenses for products shipped to customers into cost of products sold. Such expenses were formerly classified as a reduction of net sales. This change has no impact on previously reported gross profit amounts or net earnings.

On December 30, 2000, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities." Based on current practice, the Company expects that adoption will have no effect on consolidated results of operations or financial position.

The Company has reviewed its revenue recognition policy and practice and has determined that they meet the requirements of SEC Staff Accounting Bulletin No. 101.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

As discussed under Foreign Currency Effects, Graco sells and purchases products and services in currencies other than the U.S. dollar. Consequently, the Company is subject to profitability risk arising from exchange rate movements.

Graco uses foreign exchange contracts to reduce risks associated with foreign currency net monetary asset and liability positions. These contracts typically have maturities of 90 days or less, and gains or losses from changes in market value of these contracts offset foreign exchange gains and losses on the underlying balance sheet items. At December 29, 2000, the foreign currencies to which the Company had the most significant balance sheet exchange rate exposure were the European euro, Canadian dollar, Japanese yen, British pound, and Korean won. The Company does not hold or issue derivative financial instruments for trading purposes.

To evaluate its currency exchange rate risks on its foreign exchange contracts, the Company uses sensitivity analysis, which measures the impact on earnings of hypothetical changes in the value of foreign currencies to which it has exposure. At December 29, 2000, due to the short-term nature of the Company's hedging instruments, reasonably likely fluctuations in foreign currency exchange rates in the near term would not materially affect Graco's consolidated operating results, financial position or cash flows.

When appropriate, the Company utilizes interest rate swaps to manage its exposure to fluctuations in earnings due to changes in interest rates on its variable rate debt. At December 29, 2000, a 50 basis point increase or decrease in market interest rates, principally LIBOR, would not materially increase or decrease interest expense or cash flows.

For further discussion of the Company's foreign currency and interest rate hedging strategy and position, see Note A to the Consolidated Financial Statements.

OUTLOOK

Management's view of 2001 is that while pursuing the Company's growth strategies of developing new products, expanding distribution, entering new markets, and strategic acquisitions, it believes that 2001 will be a difficult economic environment for Graco and its industry. In the current environment, where sales growth will be a challenge, Graco is committed to improved profitability. Graco's strong and capable distribution channel, productive manufacturing operation, commitment to developing new products, and global marketing capabilities position it well to take advantage of a global economic recovery.

SAFE HARBOR CAUTIONARY STATEMENT

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

SHAREHOLDER ACTIONS

Periodically, the Company initiates measures aimed at enhancing shareholder value, broadening common stock ownership, improving the liquidity of its common shares and effectively managing its cash balances. A summary of recent actions

follows:

- o a seven percent increase in the regular dividend in 2001;
- o three-for-two stock splits in 2001, 1998 and 1996;
- o a 27 percent increase in the regular dividend paid in 2000;
- o repurchase of 5.8 million shares in 1998 from Graco's largest shareholder, the Trust under the Will of Clarissa L. Gray; and
- o an 18 percent increase in the regular dividend in 1997

LIQUIDITY AND SOURCES OF CAPITAL

The following table highlights several key measures of asset performance.

(In thousands)	2000	1999
Cash and cash equivalents	\$11,071	\$6,588
Working capital	\$61,901	\$59,726
Current ratio	1.8	1.8
Average days receivables outstanding	63	65
Inventory turnover	7.4	5.6

In 2000, working capital increased \$2.2 million to \$61.9 million. As a result of strong cash flow from operations, the Company reduced its total debt by \$46.5 million in 2000. Total debt at the end of 2000 was \$35.1 million as compared to \$81.6 million at the end of 1999. Receivables increased \$6.1 million in 2000 compared with year-end 1999 due to higher sales volume. Inventories decreased \$4.6 million in 2000, compared to year-end 1999, primarily as a result of a build-up in inventory in late 1999 in conjunction with the launch of the home center products.

Cash provided by operations was \$79.6 million in 2000, versus \$75.8 million in 1999 and \$77.1 million in 1998. Significant uses of cash in 2000 included retirement of debt, capital expenditures, dividends and share repurchases. Significant uses of cash in 1999 included the retirement of debt, the acquisition of certain assets of Bollhoff Verfahrenstechnik, capital expenditures, dividends and share repurchases. In 1998, additional cash needs were funded by bank borrowings and significant uses of cash included the purchase of 5.8 million shares of Graco Inc. common stock for \$191 million, capital expenditures and dividends.

At December 29, 2000, Graco had various lines of credit totaling \$95.3 million, of which \$66.0 million was unused. The Company believes that the combination of present capital resources, internally generated funds and unused financing sources are more than adequate to meet cash requirements for 2001. In 2001, the Company is building a new factory and distribution center in Minneapolis, Minnesota. The incremental capital required for this project is estimated to be approximately \$15 million.

Item 8. Financial Statements and Supplementary Data

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RESPONSIBILITY FOR FINANCIAL REPORTING

Management is responsible for the accuracy, consistency, and integrity of the information presented in this Annual Report on Form 10-K. The consolidated financial statements and financial statement schedule have been prepared in accordance with generally accepted accounting principles and, where necessary, include estimates based upon management's informed judgment.

In meeting this responsibility, management believes that its comprehensive systems of internal control provide reasonable assurance that the Company's assets are safeguarded and transactions are executed and recorded by qualified personnel in accordance with approved procedures. Internal auditors periodically review these accounting and control systems. Deloitte & Touche LLP, independent certified public accountants, are retained to audit the consolidated financial statements, and express an opinion thereon. Their opinion is included below.

The Board of Directors pursues its oversight role through its Audit Committee. The Audit Committee, composed of directors who are not employees, meets twice a year with management, internal auditors, and Deloitte & Touche LLP to review the systems of internal control, accounting practices, financial reporting and the results of auditing activities.

INDEPENDENT AUDITORS' REPORT

Shareholders and Board of Directors
Graco Inc.
Minneapolis, Minnesota

We have audited the accompanying consolidated balance sheets of Graco Inc. and Subsidiaries (the Company) as of December 29, 2000 and December 31, 1999 and the related statements of earnings, shareholders' equity, comprehensive income, and cash flows for each of the three years in the period ended December 29, 2000. Our audits also included the financial statement schedule listed in the Index at Item 14. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Graco Inc. and Subsidiaries as of December 29, 2000 and December 31, 1999 and the results of their operations and cash flows for each of the three years in the period ended December 29, 2000, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/Deloitte & Touche LLP
Deloitte & Touche LLP
Minneapolis, Minnesota
January 22, 2001

CONSOLIDATED STATEMENTS OF EARNINGS

Graco Inc. and Subsidiaries

(In thousands, except per share amounts)	Years Ended		
	December 29, 2000	December 31, 1999	December 25, 1998
Net Sales	\$494,373	\$450,474	\$440,585
Cost of products sold	243,521	219,339	221,184
Gross Profit	250,852	231,135	219,401
Product development	19,998	19,688	18,213
Selling, marketing and distribution	86,598	79,922	83,169
General and administrative	33,014	38,334	41,146
Operating Earnings	111,242	93,191	76,873
Interest expense	4,127	7,016	5,319
Other expense (income), net	1,207	(2,666)	191
Earnings before Income Taxes	105,908	88,841	71,363
Income taxes	35,800	29,500	24,100
Net Earnings	\$ 70,108	\$ 59,341	\$ 47,263
Basic Net Earnings per Common Share	\$ 2.31	\$ 1.95	\$ 1.37
Diluted Net Earnings per Common Share	\$ 2.27	\$ 1.90	\$ 1.34

All per share data has been restated for the three-for-two stock split declared on December 8, 2000, to be distributed February 6, 2001.

See Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

Graco Inc. and Subsidiaries

(In thousands, except per share amounts)

December 29, 2000

December 31, 1999

Assets		
Current Assets:		
Cash and cash equivalents	\$ 11,071	\$ 6,588
Accounts receivable, less allowances of \$4,700 and \$4,500	85,836	79,696
Inventories	33,079	37,702
Deferred income taxes	11,574	12,357
Other current assets	2,182	1,646
	-----	-----
Total current assets	143,742	137,989
Property, Plant and Equipment, net	83,989	86,493
Other Assets	10,245	11,551
	-----	-----
Total Assets	\$237,976	\$236,033
	=====	=====
Liabilities and Shareholders' Equity		
Current Liabilities:		
Notes payable to banks	\$ 15,713	\$ 14,640
Current portion of long-term debt	1,310	1,215
Trade accounts payable	12,899	13,500
Salaries, wages and commissions	14,532	12,832
Accrued insurance liabilities	10,622	10,332
Income taxes payable	4,642	2,323
Other current liabilities	22,123	23,421
	-----	-----
Total current liabilities	81,841	78,263
Long-Term Debt, less current portion	18,050	65,695
Retirement Benefits and Deferred Compensation	27,230	29,135
Commitments and Contingencies (Note K)		
Shareholders' Equity		
Common stock, \$1 par value; 45,000,000 shares authorized; shares outstanding, 20,273,561 and 20,415,827 in 2000 and 1999	20,274	20,416
Additional paid-in capital	39,954	31,755
Retained earnings	50,233	9,279
Accumulated comprehensive income	394	1,490
	-----	-----
Total shareholders' equity	110,855	62,940
	-----	-----
Total Liabilities and Shareholders' Equity	\$237,976	\$236,033
	=====	=====

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Graco Inc. and Subsidiaries

(In thousands)	Years Ended		
	December 29, 2000	December 31, 1999	December 25, 1998
Cash Flows from Operating Activities			
Net earnings	\$ 70,108	\$ 59,341	\$ 47,263
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	15,452	14,701	13,736
Deferred income taxes	1,644	1,152	(593)
(Gain) loss on sale of fixed assets	(1,561)	(2,936)	(139)
Change in:			
Accounts receivable	(8,287)	2,097	6,293
Inventories	4,161	3,309	10,547
Trade accounts payable	(516)	1,551	(761)
Salaries, wages and commissions	1,921	(946)	(934)
Retirement benefits and deferred compensation	(3,999)	(2,112)	(3,255)
Other accrued liabilities	1,416	(1,257)	2,695
Other	(730)	921	2,257
Net cash provided by operating activities	79,609	75,821	77,109
Cash Flows from Investing Activities			
Property, plant and equipment additions	(14,523)	(9,140)	(11,962)
Proceeds from sale of property, plant and equipment	4,845	9,695	2,201
Acquisition of business	--	(18,388)	--
Net cash used in investing activities	(9,678)	(17,833)	(9,761)
Cash Flows from (for) Financing Activities			
Borrowing on notes payable and lines of credit	188,552	118,900	65,869
Payments on notes payable and lines of credit	(187,144)	(119,201)	(54,376)
Borrowings on long-term debt	43,665	25,001	180,985
Payments on long-term debt	(91,215)	(73,711)	(73,273)
Common stock issued	9,630	6,760	4,876
Retirement of common stock	(19,182)	(5,077)	(190,899)
Cash dividends paid	(11,361)	(8,927)	(10,701)
Net cash used in financing activities	(67,055)	(56,255)	(77,519)
Effect of exchange rate changes on cash	1,607	1,300	203
Net increase (decrease) in cash and cash equivalents	4,483	3,033	(9,968)
Cash and cash equivalents			
Beginning of year	6,588	3,555	13,523
End of year	\$ 11,071	\$ 6,588	\$ 3,555

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Graco Inc. and Subsidiaries

(In thousands)	December 29, 2000	December 31, 1999	December 25, 1998
Common Stock, \$1 par value			
Balance, beginning of year	\$ 20,416	\$ 20,097	\$ 25,553
Shares issued	475	466	344
Shares repurchased	(617)	(147)	(5,800)
Balance, end of year	20,274	20,416	20,097
Additional Paid-In Capital			
Balance, beginning of year	31,755	23,892	26,085
Shares issued	9,155	8,184	4,535
Shares repurchased	(956)	(321)	(6,728)
Balance, end of year	39,954	31,755	23,892
Retained Earnings (deficit)			
Balance, beginning of year	9,279	(35,878)	105,030
Net income	70,108	59,341	47,263
Dividends declared	(11,545)	(9,575)	(10,102)
Change in accounting period	--	--	300
Shares repurchased	(17,609)	(4,609)	(178,369)
Balance, end of year	50,233	9,279	(35,878)
Foreign Currency Translation Adjustments			
Balance, beginning of year	1,490	1,817	1,817
Current period change	(1,096)	(327)	--
Balance, end of year	394	1,490	1,817
Unearned Compensation			
Balance, beginning of year	--	(615)	(976)
Current period change	--	615	361
Balance, end of year	--	--	(615)
Total Shareholders' Equity	\$110,855	\$ 62,940	\$ 9,313
See Notes to Consolidated Financial Statements.			

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Graco Inc. and Subsidiaries

(In thousands)	December 29, 2000	December 31, 1999	December 25, 1998
Net Earnings	\$ 70,108	\$ 59,341	\$ 47,263
Other comprehensive income, net of tax:			
Foreign currency translation adjustments	(1,096)	(327)	--
Additional minimum pension liability adjustment	16	(90)	--
Comprehensive Income	\$69,028	\$58,924	\$47,263
See Notes to Consolidated Financial Statements.			

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

GRACO Inc. & Subsidiaries

Years Ended December 29, 2000, December 31, 1999 and December 25, 1998

A. Summary of Significant Accounting Policies

Fiscal Year. The Company's fiscal year is 52 or 53 weeks, ending on the last Friday in December. The year ended December 31, 1999 was a 53-week year. Years ended December 29, 2000 and December 25, 1998 were 52-week years.

Basis of Statement Presentation. The Consolidated Financial Statements include the accounts of the parent company and its subsidiaries after elimination of all significant intercompany balances and transactions. As of December 29, 2000, all subsidiaries are 100 percent owned. Subsidiaries in Japan and Korea have been included on the basis of fiscal years ended November 30 to effect more timely consolidated financial reporting.

Foreign Currency Translation. The U.S. dollar is the functional currency for all foreign subsidiaries except Graco Verfahrenstechnik (GV) in Germany, whose functional currency is the Euro. Accordingly, adjustments resulting from the translation of GV's financial statements into U.S. dollars are charged or credited to a separate component of shareholders' equity. Gains and losses from the translation of foreign currency balances and transactions of other foreign subsidiaries are included in other expense (income).

Accounting Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Equivalents. All highly liquid investments with a maturity of three months or less at the date of purchase are considered to be cash equivalents.

Inventory Valuation. Inventories are stated at the lower of cost or market. The last-in, first-out (LIFO) cost method is used for valuing all U.S. inventories. Inventories of foreign subsidiaries are valued using the first-in, first-out (FIFO) cost method.

Property, Plant and Equipment. For financial reporting purposes, plant and equipment are depreciated over their estimated useful lives, primarily by using the straight-line method as follows:

Buildings and improvements	10 to 30 years
Leasehold improvements	5 to 10 years
Manufacturing equipment and tooling	5 to 10 years
Office, warehouse and automotive equipment	3 to 10 years

Impairment of Long-Lived Assets. Long-lived assets are reviewed for impairment whenever events or changes in business circumstances indicate the carrying value of the assets may not be recoverable. There have been no write downs of any long-lived assets in the periods presented.

Self-Insurance. The Company is self-insured for certain losses relating to product liability, workers' compensation and employee medical benefits claims. The Company has purchased stop-loss coverage in order to limit its exposure to significant claims. Accrued insurance liabilities are based on claims filed and estimates of claims incurred but not reported.

Revenue Recognition. The Company recognizes revenue when title passes, which is usually upon shipment. The Company records provisions for anticipated returns and warranty claims at the time revenue is recognized. Provisions for sales returns are recorded as a reduction of net sales, and provisions for warranty claims are recorded in selling, marketing and distribution expenses.

Freight Expense. Freight expenses for products shipped to customers are included in cost of products sold, in accordance with EITF No. 00-10, "Accounting for Shipping and Handling Fees and Costs." Such expenses were formerly reported as a reduction of net sales. Freight-out expenses for 1999 and 1998 have been reclassified to cost of products sold, which had no effect on previously reported gross profit amounts or net earnings.

Earnings Per Common Share. Basic earnings per share is computed by dividing earnings available to common shareholders by the weighted average number of shares outstanding during the year. Diluted earnings per share is computed after giving effect to the exercise of all dilutive outstanding option grants.

Comprehensive Earnings. Comprehensive earnings is a measure of all changes in shareholders' equity except those resulting from investments by and distributions to owners, and includes such items as net earnings, certain foreign currency translation items, minimum pension liability adjustments and changes in the value of available-for-sale securities.

Stock-Based Compensation. As allowed under SFAS No. 123 "Accounting for Stock-Based Compensation," the Company has elected to apply Accounting

Principles Board Opinion No. 25 and related interpretations in accounting for its stock option and purchase plans and adopt the "disclosure only" provisions of SFAS No. 123.

Derivative Instruments and Hedging Activities. As part of its risk management program, the Company uses currency hedges and interest rate swaps to hedge known market exposures. Terms of derivative instruments are structured to match the terms of the risk being hedged and are generally held to maturity. The Company does not hold or issue derivative financial instruments for trading purposes.

The Company periodically evaluates its monetary asset and liability positions denominated in foreign currencies. The Company enters into forward contracts, borrowings in various currencies or options, in order to hedge its net monetary positions. These hedges and net monetary positions are recorded at current market values and the gains and losses are included in other expense (income). 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 notional amounts (which may not be indicative of credit or market risk) of such contracts were \$12 million and \$23 million at December 29, 2000 and December 31, 1999.

The Company utilizes interest rate swaps to convert a portion of its underlying debt from a variable rate to a fixed rate. Gains and losses on these agreements are included in interest expense under the settlement method of accounting. The notional amounts of such contracts were \$1.5 million and \$52 million at December 29, 2000 and December 31, 1999.

On December 30, 2000, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that all derivatives, including those embedded in other contracts, be recognized as either assets or liabilities and that those financial instruments be measured at fair value. The accounting for changes in the fair value of derivatives depends on their intended use and designation.

The Company has reviewed the requirements of SFAS No. 133 and has determined that the forward currency contracts and the interest rate swap discussed above are freestanding derivatives. The forward currency contracts are used to hedge the net monetary position of subsidiaries whose translation adjustments are recorded in earnings and therefore no designated hedging strategy is required to achieve the Company's economic strategy. The fair value of the interest rate swap is insignificant.

All 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 adoption of SFAS No. 133 on December 30, 2000, resulted in no transition adjustment.

B. Segment Information

The Company has three reportable segments: Industrial/Automotive, Contractor and Lubrication. The Industrial/Automotive segment markets equipment and pre-engineered packages for moving and applying paints, coatings, sealants, adhesives and other fluids. Markets served include automotive and truck assembly and components plants, wood products, rail, marine, aerospace, farm, construction, bus, recreational vehicles, and various other industries. The Contractor segment markets sprayers for architectural coatings for painting, roofing, texture, corrosion control and line striping and also high-pressure washers. The Lubrication segment markets products to move and dispense lubricants for fast oil change facilities, service garages, fleet service centers, automobile dealerships, the mining industry and industrial lubrication. All segments market parts and accessories for their products.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The cost of manufacturing for each segment is based on product cost, and expenses are based on actual costs incurred along with cost allocations of shared and centralized functions. Certain products are sold across segments, in which case the segment marketing the product is credited with the sale. Assets of the Company are not tracked along reportable segment lines.

Reportable segments are defined by product and type of customer. Segments are responsible for the sales, marketing and development of their products and market channel. This allows for focused marketing and efficient product development. The segments share common purchasing, manufacturing, distribution and administration functions.

(In thousands) Reportable Segments	Industrial/ Automotive	Contractor	Lubrication	Unallocated Corporate Expenses	Total
2000					
Net sales to unaffiliated customers	\$227,963	\$221,538	\$44,872		\$494,373

Segment operating earnings	57,798	47,935	10,600	(5,091)	111,242
1999					
Net sales to unaffiliated customers	227,772	178,616	44,086		450,474
Segment operating earnings	48,143	41,736	10,307	(6,995)	93,191
1998					
Net sales to unaffiliated customers	235,328	160,718	44,539		440,585
Segment operating earnings	42,973	35,836	8,829	(10,765)	76,873
	-----	-----	-----	-----	-----

Geographic Information	2000	1999	1998
- - - - -	- - - - -	- - - - -	- - - - -
Sales			
United States	\$329,068	\$286,483	\$270,337
Other countries	165,305	163,991	170,248
	-----	-----	-----
Total	\$494,373	\$450,474	\$440,585
	-----	-----	-----
Long-lived assets			
United States	\$80,811	\$80,259	\$91,068
Belgium	10,437	11,298	5,554
Other countries	3,555	5,972	4,569
	-----	-----	-----
Total	\$94,803	\$97,529	\$101,191
	=====	=====	=====

Sales to Major Customers

No customer represented 10 percent or more of consolidated sales in 2000 or 1998. In 1999, sales to a paint manufacturer and retailer in the Contractor segment totaled 11 percent of consolidated sales.

C. Inventories

Major components of inventories were as follows:

(In thousands)	2000	1999
-----	-----	-----
Finished products and components	\$26,812	\$25,748
Products and components in various stages of completion	20,153	23,560
Raw materials and purchased components	19,259	21,961
	-----	-----
	66,224	71,269
Reduction to LIFO cost	(33,145)	(33,567)
	-----	-----
Total	\$33,079	\$37,702
	=====	=====

Inventories valued under the LIFO method were \$20,585,000 and \$22,990,000 for 2000 and 1999. All other inventory was valued on the FIFO method.

In 2000 and 1999, certain inventory quantities were reduced, resulting in liquidation of LIFO inventory quantities carried at lower costs from prior years. The effect on net earnings was not significant.

D. Property, Plant and Equipment

Property, plant and equipment were as follows:

(In thousands)	2000	1999
-----	-----	-----
Land	\$ 4,062	\$ 3,923
Buildings and improvements	50,512	54,607
Manufacturing equipment	105,509	101,044
Office, warehouse and automotive equipment	22,652	22,196
Construction in progress	4,137	386
	-----	-----
Total property, plant and equipment	186,872	182,156
Accumulated depreciation	(102,883)	(95,663)
	-----	-----
Net property, plant and equipment	\$ 83,989	\$ 86,493
	=====	=====

E. Income Taxes

Earnings before income tax expense consist of:

(In thousands)	2000	1999	1998
-----	-----	-----	-----
Domestic	\$ 95,440	\$87,292	\$61,709
Foreign	10,468	1,549	9,654
	-----	-----	-----
Total	\$105,908	\$88,841	\$71,363
	=====	=====	=====

Income tax expense consists of:

(In thousands)	2000	1999	1998
-----	-----	-----	-----
Current:			
Domestic:			
Federal	\$28,532	\$23,081	\$17,374
State and local	2,164	2,323	1,600
Foreign	3,018	2,867	5,628
	-----	-----	-----
	\$33,714	\$28,271	\$24,602
	-----	-----	-----
Deferred:			
Domestic	2,414	1,778	(423)
Foreign	(328)	(549)	(79)
	-----	-----	-----
	2,086	1,229	(502)
	-----	-----	-----
Total	\$35,800	\$29,500	\$24,100
	=====	=====	=====

Income taxes paid were \$30,919,000, \$31,272,000 and \$22,922,000 in 2000, 1999 and 1998.

A reconciliation between the U.S. federal statutory tax rate and the effective tax rate is as follows:

	2000	1999	1998
-----	----	----	----
Statutory tax rate	35%	35%	35%
Earnings from non-U.S. sales at lower tax rates	(1)	(2)	(1)
State taxes, net of federal effect	1	2	2
U.S. general business tax credits	(1)	(2)	(1)
Other	--	--	(1)
	----	----	----
Effective tax rate	34%	33%	34%
	=====	=====	=====

Deferred income taxes are provided for all temporary differences between the financial reporting and the tax basis of assets and liabilities. The deferred tax assets (liabilities) resulting from these differences are as follows:

(In thousands)	2000	1999
Inventory valuations	\$ 2,847	\$ 3,365
Insurance accruals	3,247	3,202
Vacation accruals	1,435	1,207
Bad debt reserves	1,321	1,247
Net operating loss carryforward	334	653
Other	2,390	2,683
Current	11,574	12,357
Unremitted earnings of consolidated foreign subsidiaries	(1,950)	(2,544)
Excess of tax over book depreciation	(7,494)	(6,597)
Postretirement benefits	5,721	5,363
Pension and deferred compensation	1,880	3,239
Other	1,275	1,054
Non-current	(568)	515
Net deferred tax assets	\$11,006	\$12,872

Total deferred tax assets were \$20,923,000 and \$22,319,000 and total deferred tax liabilities were \$9,917,000 and \$9,447,000 on December 29, 2000 and December 31, 1999.

F. Debt

(In thousands)	2000	1999
Reducing revolving credit facility, 7.14% at December 29, 2000	\$17,500	\$63,834
Other	1,860	3,076
Total long-term debt	19,360	66,910
Less current portion	1,310	1,215
Long-term portion	\$18,050	\$65,695

Aggregate annual scheduled maturities of long-term debt for the next five years are as follows: 2001-\$1,310,000; 2002-\$550,000; 2003-\$17,500,000; zero in 2004 and 2005. Interest paid on debt during 2000, 1999 and 1998 amounted to \$4,171,000, \$6,843,000 and \$4,742,000. The fair value of the Company's long-term debt at December 29, 2000 and December 31, 1999 is not materially different than its recorded value.

In July 1998, the Company entered into a five-year \$190 million reducing revolving credit facility (the "Revolver") with a syndicate of ten banks including the lead bank, U.S. Bank National Association. The Revolver was subsequently reduced to \$132 million by December 31, 1999 and was further reduced to \$72 million by December 29, 2000. The \$17,500,000 outstanding balance bears interest at the London Interbank Offered Rate plus a spread of 0.45 percent. This spread changes as the ratio of total debt to earnings before interest, taxes and depreciation and amortization declines. The Revolver specifies quarterly reductions of the maximum amount of the credit line, and requires the Company to maintain certain financial ratios as to net worth, cash flow leverage and fixed charge coverage. The Revolver effectively restricts dividend payments that would cause a violation of the tangible net worth ratio covenant. The amount of the restriction on future dividend payments was \$51 million at December 29, 2000.

The Company had an interest rate swap agreement in place whereby it fixed the underlying interest rate on \$50 million of the Revolver at 5.76 percent. This contract matured on July 3, 2000. The cash flows related to the swap agreement were recorded as an adjustment to interest expense.

On December 29, 2000, the Company had lines of credit with U.S. and foreign banks of \$95 million, including the \$72 million Revolver. The unused portion of these credit lines was \$66 million at December 29, 2000. Borrowing rates under these credit lines vary with the prime rate, rates on domestic certificates of deposit and the London interbank market. The weighted short-term borrowing rates were 6.2 percent, 5.4 percent and 6.3 percent for the years ended December 29, 2000, December 31, 1999, and December 25, 1998. The Company pays commitment fees of up to 0.175 percent per annum on the daily average unused amounts on certain

of these lines. No compensating balances are required.

The Company is in compliance with the financial covenants of its debt agreements.

G. Shareholders' Equity

In July 1998 the Company repurchased 5.8 million shares of common stock for \$190,887,000 from its largest shareholder, the Trust under the Will of Clarissa L. Gray. The stock repurchase was funded with cash of \$32,887,000 and \$158,000,000 from the Revolver.

The Board of Directors declared a three-for-two stock split on December 8, 2000, to be distributed February 6, 2001, for shares outstanding on January 15, 2001. All stock option, share and per share data has been restated to reflect the split.

At December 29, 2000, the Company had 22,549 authorized, but not issued, cumulative preferred shares. The Company also has authorized, but not issued, a separate class of 3 million shares of preferred stock, \$1 par value.

The Company maintains a plan in which one preferred share purchase right ("Right") exists for each common share of the Company. Each Right will entitle its holder to purchase one four-hundredth of a share of a new series of junior participating preferred stock at an exercise price of \$180, subject to adjustment. The Rights are exercisable only if a person or group acquires beneficial ownership of 15 percent or more of the Company's outstanding common stock. The Rights expire in March 2010 and may be redeemed earlier by the Board of Directors for \$.001 per Right.

H. Stock Option and Purchase Plans

Stock Option Plans. In 1999, the Board of Directors approved an Employee Stock Incentive Plan, under which the Company grants stock options to employees who are not officers of the Company. The option price is the market price on the date the grant is approved and the options vest three years from the date of the grant and expire after ten years. 1,500,000 shares have been reserved for issuance under the Plan, with 1,497,600 remaining reserved at December 29, 2000.

The Company has a Long-Term Stock Incentive Plan, under which a total of 7,818,750 common shares have been reserved for issuance, with 3,547,620 shares remaining reserved at December 29, 2000. Grants under this Plan are in the form of restricted share awards and stock options. The option price is the market price on the date the grant is approved. Options become exercisable at such time and in such installments as set by the Company, and expire ten years from the date of grant. Restricted share awards of 963,914 common shares have been made to certain key employees under the Plan. No restricted share awards are outstanding at December 29, 2000 and there is no related compensation cost in 2000. Compensation cost charged to operations for the restricted share awards was \$615,000 and \$361,000 in 1999 and 1998.

The Company has a Non-employee Director Stock Option Plan, under which the Company makes initial and annual grants to the non-employee directors of the Company. Non-employee directors receive an initial option grant of 3,000 shares upon first appointment or election and an annual option grant of 2,500 shares. There are 450,000 common shares authorized for issuance under the Plan; 444,936 remained reserved at the end of 2000. The exercise price of each option is the fair market value at the date of grant. The options have a ten-year duration and may be exercised in equal installments over four years, beginning one year from the date of grant.

Options on common shares granted and outstanding, as well as the weighted average exercise price, are shown below:

	Options	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
- - - - -	- - - - -	- - - - -	- - - - -	- - - - -
Outstanding, December 26, 1997	1,655,577	\$ 7.77	690,219	\$ 5.82
Granted	479,625	19.86		
Exercised	(213,083)	5.73		
Canceled	(149,437)	11.89		
	- - - - -	- - - - -	- - - - -	- - - - -
Outstanding, December 25, 1998	1,772,682	\$10.86	766,329	\$ 6.59
Granted	706,748	14.57		
Exercised	(424,580)	4.82		
Canceled	(55,705)	15.69		
	- - - - -	- - - - -	- - - - -	- - - - -
Outstanding, December 31, 1999	1,999,145	\$12.69	1,117,539	\$10.00
Granted	438,000	20.59		
Exercised	(387,597)	10.69		
Canceled	(87,258)	15.39		
	- - - - -	- - - - -	- - - - -	- - - - -
Outstanding, December 29, 2000	1,962,290	\$14.74	943,151	\$11.46
	=====	=====	=====	=====

The following table summarizes information for options outstanding and exercisable at December 29, 2000:

Range of Prices	Options Outstanding	Options Outstanding Weighted Avg. Remaining Life	Options Outstanding Weighted Avg. Exercise Price	Options Exercisable	Options Exercisable Weighted Avg. Exercise Price
\$ 4-10	515,519	2	\$ 6.74	512,091	\$ 6.72
11-18	626,699	4	13.99	195,921	13.38
19-24	820,072	5	20.34	235,139	20.17
\$ 4-24	1,962,290	4	\$14.74	943,151	\$11.46

Stock Purchase Plans. Under the Company's Employee Stock Purchase Plan, 8,775,000 common shares have been reserved for sale to employees, 1,169,840 of which remained unissued at the end of 2000. The purchase price of the shares under the Plan is the lesser of 85 percent of the fair market value on the first day or the last day of the Plan year.

Non-employee Director Stock Plan. The Plan enables individual non-employee directors of the Company to elect to receive or defer all or part of a director's annual retainer, and/or payment for attendance at Board or Committee meetings, in the form of shares of the Company's common stock instead of cash. The Company issued 6,927, 6,161 and 5,035 shares under this Plan during 2000, 1999 and 1998. The expense related to this Plan is not significant.

Stock-Based Compensation. No compensation cost has been recognized for the Employee Stock Purchase Plan and stock options granted under the Employee Stock Incentive Plan, the Long-Term Stock Incentive Plan and the Non-employee Director Stock Option Plan. Had compensation cost for the stock option plans been determined based upon fair value at the grant date for awards under these plans, the Company's net earnings and earnings per share would have been reduced as follows:

	2000	1999	1998
Net earnings			
As reported	\$70,108	\$59,341	\$47,263
Pro forma	65,506	55,998	45,144
Net earnings per common share			
Basic as reported	\$ 2.31	\$ 1.95	\$ 1.37
Diluted as reported	2.27	1.90	1.34
Pro forma basic	2.16	1.84	1.31
Pro forma diluted	2.09	1.79	1.28

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:

	2000	1999	1998
Expected life in years	6.1	5.3	8.0
Interest rate	6.4%	5.1%	5.5%
Volatility	44.5%	43.5%	40.2%
Dividend yield	1.8%	1.9%	1.5%

Based upon these assumptions, the weighted average fair value at grant date of options granted in 2000, 1999 and 1998 was \$8.16, \$5.19 and \$8.25.

The fair value of the employees' purchase rights under the Employee Stock Purchase Plan was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	2000	1999	1998
Expected life in years	1.0	1.0	1.0
Interest rate	6.4%	5.2%	5.5%
Volatility	45.2%	43.8%	40.2%
Dividend yield	1.9%	2.0%	1.5%

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 Black-Scholes. The weighted average fair value per common share was \$5.95, \$4.08 and \$5.23 in 2000, 1999 and 1998.

I. Earnings per Share

Earnings per share for all years presented has been calculated to reflect the three-for-two stock split to be distributed February 6, 2001. The following table sets forth the computation of basic and diluted earnings per share:

(In thousands, except per share amounts)	2000	1999	1998
Numerator:			
Net earnings available to common shareholders	\$70,108	\$59,341	\$47,263
Denominators:			
Denominator for basic earnings per share - weighted average shares	30,407	30,372	34,412
Dilutive effect of stock options computed based on the treasury stock method using the average market price	498	927	909
Denominator for diluted earnings per share	30,905	31,299	35,321
Basic earnings per share	\$ 2.31	\$ 1.95	\$ 1.37
Diluted earnings per share	\$ 2.27	\$ 1.90	\$ 1.34

J. Retirement Benefits

The Company has a defined contribution plan, under Section 401(k) of the Internal Revenue Code, which provides additional retirement benefits to all U.S. employees who elect to participate. The Company matches employee contributions at a 100 percent rate, up to 3 percent of the employee's compensation. Employer contributions were \$2,162,000, \$2,008,000 and \$1,989,000 in 2000, 1999 and 1998.

The Company's postretirement medical plan provides certain medical benefits for retired employees. U.S. employees are eligible for these benefits upon retirement and fulfillment of other eligibility requirements as specified by the Plan.

The Company has non-contributory defined benefit pension plans covering substantially all U.S. employees and directors and some of the employees of the Company's non-U.S. subsidiaries. For the U.S. plans, the benefits are based on years of service and the highest five consecutive years' earnings in the ten years preceding retirement. The Company funds these plans annually in amounts consistent with minimum funding requirements and maximum tax deduction limits and invests primarily in common stocks and bonds, including the Company's common stock. The market value of the Plans' investment in the common stock of the Company was \$16,090,000 and \$19,472,000 at December 29, 2000 and December 31, 1999. The following tables provide a reconciliation of the changes in the Plans' benefit obligations and fair value of assets over the periods ending December 29, 2000 and December 31, 1999, and a statement of the funded status as of the same dates.

(In thousands)	Pension Benefits		Other Benefits	
	2000	1999	2000	1999
Reconciliation of benefit obligation				
Obligation, beginning of year	\$102,040	\$ 95,141	\$ 15,430	\$ 15,623
Service cost	3,733	3,517	459	482
Interest cost	6,961	6,267	1,063	995
Acquisition	--	2,671	--	--
Curtailment	--	(541)	--	--
Actuarial (gain) loss	211	(2,162)	537	(573)
Benefit payments	(3,363)	(2,853)	(1,191)	(1,097)
Obligation, end of year	\$109,582	\$102,040	\$ 16,298	\$ 15,430
Reconciliation of fair value of plan assets				
Fair value, beginning of year	\$135,997	\$103,106	\$ --	\$ --
Actual return on assets	3,770	35,454	--	--
Employer contribution	412	264	1,191	1,097
Benefit payments	(3,363)	(2,827)	(1,191)	(1,097)
Fair value, end of year	\$136,816	\$135,997	\$ --	\$ --
Funded status				
Funded status over (under), end of year	\$ 27,234	\$ 33,957	\$(16,298)	\$(15,430)
Unrecognized transition (asset) obligation	(64)	(68)	--	--
Unrecognized prior service cost	1,734	1,954	--	--
Unrecognized (gain) loss	(35,946)	(46,058)	645	107
Net	\$ (7,042)	\$(10,215)	\$(15,653)	\$(15,323)
	=====	=====	=====	=====

The following table provides the amounts included in the Statement of Financial Position as of December 29, 2000 and December 31, 1999.

(In thousands)	Pension Benefits		Other Benefits	
	2000	1999	2000	1999
Accrued benefit liability	\$(10,018)	\$(10,659)	\$(15,653)	\$(15,323)
Other assets	2,976	427	--	--
Net	\$ (7,042)	\$(10,232)	\$(15,653)	\$(15,323)
	=====	=====	=====	=====

The components of net periodic benefit cost for the plans for 2000, 1999 and 1998 were as follows:

(In thousands)	Pension Benefits			Other Benefits		
	2000	1999	1998	2000	1999	1998
Service cost - benefits earned during the period	\$ 3,733	\$ 3,517	\$ 2,959	\$ 459	\$ 482	\$ 442
Interest cost on projected benefit obligation	6,961	6,267	5,595	1,063	995	954
Expected return on assets	(12,086)	(11,189)	(9,711)	--	--	--
Amortization of transition (asset) obligation	(3)	(4)	(3)	--	--	--
Amortization of prior service cost	220	231	230	--	--	--
Amortization of net (gain) loss	(2,707)	(629)	(1,067)	--	--	--
Cost of pension plans which are not significant and have not adopted SFAS No. 87	130	266	371	N/A	N/A	N/A
Net periodic benefit (credit) cost	(3,752)	(1,541)	(1,626)	1,522	1,477	1,396
Curtailment gain	--	(541)	(239)	--	--	--
Settlement gain	--	--	(271)	--	--	--
Net periodic benefit (credit) cost after curtailments and settlements	\$ (3,752)	\$ (2,082)	\$ (2,136)	\$1,522	\$1,477	\$1,396
	=====	=====	=====	=====	=====	=====

The Company's retirement medical plan limits the annual cost increase that will

be paid by the Company. In measuring the Accumulated Postretirement Benefit Obligation (APBO), a 6 percent maximum annual trend rate for healthcare costs was assumed for the year ending December 29, 2000. This rate is assumed to remain constant through the year 2001, decline to 5.5 percent in 2002 and 4.5 percent in 2003, and remain at that level thereafter. The other assumptions used in the measurement of the Company's benefit obligation are shown below:

	Pension Benefits			Other Benefits		
Weighted average assumptions	2000	1999	1998	2000	1999	1998
Discount rate	7.0%	6.5%	6.5%	7.0%	6.5%	7.0%
Expected return on assets	9.0%	11.0%	11.0%	N/A	N/A	N/A
Rate of compensation increase	3.6%	3.6%	3.3%	N/A	N/A	N/A
	====	====	====	====	====	====

At December 29, 2000, a 1 percent change in assumed healthcare cost trend rates would have the following effects:

(In thousands)	1% Increase	1% Decrease
Effect on total of service and interest cost components of net periodic postretirement healthcare benefit cost	\$ 247	\$ (200)
Effect on the healthcare component of the accumulated postretirement benefit obligation	\$2,276	\$(1,882)

K. Commitments and Contingencies

Lease Commitments. Aggregate annual rental commitments at December 29, 2000, under operating leases with non-cancelable terms of more than one year, were \$6,230,000, payable as follows:

(In thousands)	Buildings	Vehicles & Equipment	Total
2001	\$1,533	\$1,128	\$2,661
2002	969	692	1,661
2003	930	454	1,384
2004	280	183	463
2005	46	15	61
Thereafter	--	--	--
Total	\$3,758	\$2,472	\$6,230
	=====	=====	=====

Total rental expense was \$2,499,000 for 2000, \$3,492,000 for 1999 and \$3,307,000 for 1998.

Contingencies. The Company is party to various legal proceedings arising in the normal course of business activities, none of which, in management's opinion, is expected to have a material adverse impact on the Company's consolidated results of operations or its financial position.

L. Acquisition

In 1999, the Company formed Graco Verfahrenstechnik which on June 1, 1999 purchased certain assets and assumed certain liabilities of Bollhoff Verfahrenstechnik (BV), located in Bielefeld, Germany. BV designed, manufactured and sold fluid application equipment for industrial and automotive markets, primarily in Germany, and had 1998 sales of approximately \$20 million.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information under the heading "Executive Officers of the Company" in Part I of this 2000 Annual Report on Form 10-K and the information under the headings "Election of Directors, Nominees and Other Directors" on pages 2 through 4 and under the heading "Section 16(a) Beneficial Ownership Reporting Compliance" on page 15, of the Company's Proxy Statement for its 2001 Annual Meeting of Shareholders, to be held on May 1, 2001 (the "Proxy Statement"), is incorporated herein by reference.

Item 11. Executive Compensation

The information contained under the heading "Executive Compensation" on pages 6 through 13 of the Proxy Statement is incorporated herein by reference, other than the subsection thereunder entitled "Report of the Management Organization and Compensation Committee" and "Comparative Stock Performance Graph."

Item 12. Security Ownership of Certain Beneficial Owners and Management

The information contained under the heading "Beneficial Ownership of Shares" on pages 14 through 15 of the Proxy Statement is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

The information under the heading "Certain Business Relationships" on page 14 of the Company's Proxy Statement for its 2001 Annual Meeting of Shareholders, to be held on May 1, 2001 (the "Proxy Statement"), is incorporated herein by reference.

PART IV

Item 14. Exhibits, Financial Statement Schedule, and Reports on Form 8-K

(a) The following documents are filed as part of this report:

(1) Financial Statements
See Part II

(2) Financial Statement Schedule Page

o Schedule II - Valuation and Qualifying Accounts.....31

All other schedules are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements or Notes thereto.

(3) Management Contract, Compensatory Plan or Arrangement.
(See Exhibit Index).....33

Those entries marked by an asterisk are Management Contracts, Compensatory Plans or Arrangements.

(b) Reports on Form 8-K
There were no reports on Form 8-K for the thirteen weeks ended December 29, 2000.

(c) Exhibit Index33

Schedule II - Valuation and Qualifying Accounts
Graco Inc. and Subsidiaries

Description	Balance at beginning of year	Additions charged to costs and expenses	Deductions From Reserves	Change Add (Deduct)	Balance at end of end of year
Year ended December 29, 2000:					
Allowance for doubtful accounts	\$2,500	\$ 100	\$ 300		\$2,300
Allowance for returns and credits	2,000	7,300	6,900		2,400
	-----	-----	-----	-----	-----
	\$4,500	\$7,400	\$7,200		\$4,700
	-----	-----	-----	-----	-----
Year ended December 31, 1999:					
Allowance for doubtful accounts	\$2,600	\$ 300	\$ 600	\$200	\$2,500
Allowance for returns and credits	1,800	6,000	5,800		2,000
	-----	-----	-----	-----	-----
	\$4,400	\$6,300	\$6,400	\$200	\$4,500
	=====	=====	=====	=====	=====
Year ended December 25, 1998:					
Allowance for doubtful accounts	\$2,200	\$ 900	\$ 500		\$2,600
Allowance for returns and credits	1,900	3,400	3,500		1,800
	-----	-----	-----	-----	-----
	\$4,100	\$4,300	\$4,000		\$4,400
	=====	=====	=====	=====	=====

- 1 Accounts determined to be uncollectible and charged against reserve, net of collections on accounts previously charged against reserves.
- 2 Credits issued and returns processed.
- 3 Assumed or established in connection with acquisition.

Signatures

Pursuant to the requirements of Section 13 or 15(d) 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.

/s/GEORGE ARISTIDES ----- George Aristides Chief Executive Officer	March 16, 2001 -----
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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/GEORGE ARISTIDES ----- George Aristides Chief Executive Officer (Principal Executive Officer)	March 16, 2001 -----
--	-------------------------

/s/MARK W. SHEAHAN ----- Mark W. Sheahan Vice President and Treasurer (Principal Financial Officer)	March 16, 2001 -----
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/s/JAMES A. GRANER ----- James A. Graner Vice President and Controller (Principal Accounting Officer)	March 16, 2001 -----
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D. A. Koch	Director, Chairman of the Board
G. Aristides	Director
R. O. Baukol	Director
R. G. Bohn	Director
W. J. Carroll	Director
D. D. Johnson	Director
L. R. Mitau	Director
M. A.M. Morfitt	Director
M. H. Rauenhorst	Director
J. L. Scott	Director
W. G. Van Dyke	Director

George Aristides, by signing his name hereto, does hereby sign this document on behalf of himself and each of the above named directors of the Registrant pursuant to powers of attorney duly executed by such persons.

/s/GEORGE ARISTIDES ----- George Aristides (For himself and as attorney-in-fact)	March 16, 2001 -----
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Exhibit Index

Exhibit Number -----	Description -----
3.1	Restated Articles of Incorporation as amended December 8, 2000.
3.2	Restated Bylaws as amended September 29, 2000.
4.1	Rights Agreement dated as of February 25, 2000, between the Company and Norwest Bank Minnesota, National Association, as Rights Agent, including as Exhibit A the form of the Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Shares. (Incorporated by reference to Exhibit 4 to the Company's Report on Form 8-K dated February 25, 2000.)
4.2	Credit Agreement dated July 2, 1998, between the Company and U.S. Bank National Association, as Agent for a combination of banks. (Incorporated by reference to Exhibit 4 to the Company's Report on Form 10-Q for the thirty-nine weeks ended September 25, 1998.)
4.3	Amendment dated August 31, 1999 to Credit Agreement dated June 26, 1998 between the Company and Wachovia Bank, N.A. (Incorporated by reference to Exhibit 4 to the Company's Report on Form 10-Q for the thirty-nine weeks ended September 24, 1999.)
*10.1	2000 Corporate and Business Unit Annual Bonus Plan. (Incorporated by reference to Exhibit 10 to the Company's Report on Form 10-Q for the thirteen weeks ended March 31, 2000.)
*10.2	Deferred Compensation Plan Restated, effective December 1, 1992. (Incorporated by reference to Exhibit 2 to the Company's Report on Form 8-K dated March 11, 1993.) Amendment 1 dated September 1, 1996. (Incorporated by reference to the Company's Report on Form 10-Q for the twenty-six weeks ended June 27, 1997.)
*10.3	Executive Deferred Compensation Agreement. Form of supplementary agreement entered into by the Company which provides a retirement benefit to selected executive officers, as amended by Amendment 1, effective September 1, 1990. (Incorporated by reference to Exhibit 3 to the Company's Report on Form 8-K dated March 11, 1993.)
*10.4	Chairman's Award Plan. (Incorporated by reference to Exhibit 3 to the Company's Report on Form 8-K dated March 7, 1988.)
*10.5	Long Term Stock Incentive Plan, as amended and restated December 10, 1999. (Incorporated by reference to Exhibit 10.5 to the Company's 1999 Annual Report on Form 10-K.)
*10.6	Retirement Plan for Non-Employee Directors. (Incorporated by reference to Attachment C to Item 5 to the Company's Report on Form 10-Q for the thirteen weeks ended March 29, 1991.)
*10.7	Restoration Plan 1998 Restatement. (Incorporated by reference to Exhibit 10.8 to the Company's 1997 Annual Report on Form 10-K.)
*10.8	Stock Option Agreement. Form of agreement used for award of non-incentive stock options to executive officers, dated May 2, 1994. (Incorporated by reference to Exhibit 10.3 to the Company's Report on Form 10-Q for the twenty-six weeks ended July 1, 1994.)
*10.9	Stock Option Agreement. Form of agreement used for award of non-incentive stock options to selected officers, dated December 15, 1994, December 27, 1994 and February 23, 1995. (Incorporated by reference to Exhibit 10.16 to the Company's 1994 Annual Report on Form 10-K.)
*10.10	Stock Option Agreement. Form of agreement used for award of non-incentive stock option to one executive officer, dated December 15, 1995. (Incorporated by reference to Exhibit 10.18 to the Company's 1995 Annual Report on Form 10-K.)
*10.11	Form of salary protection arrangement between the Company and executive officers. (Incorporated by reference to Exhibit 10.21 to the Company's 1995 Annual Report on Form 10-K.)

- *10.12 Non-employee Director Stock Option Plan, as amended and restated November 6, 1997. (Incorporated by reference to Exhibit 10.18 to the Company's 1997 Annual Report on Form 10-K.)
- *10.13 Stock Option Agreement. Form of agreement used for award of nonstatutory stock options to non-employee directors, dated May 7, 1996. (Incorporated by reference to Exhibit 10.4 to the Company's Report on Form 10-Q for the twenty-six weeks ended June 28, 1996.)
- *10.14 Stock Option Agreement Amendment. Form of amendment, dated March 8, 1997, used to remove alternative stock appreciation right from incentive stock option agreement dated February 25, 1993, for selected officers. (Incorporated by reference to Exhibit 10.25 to the Company's 1996 Annual Report on Form 10-K.)
- *10.15 Stock Option Agreement Amendment. Form of amendment, dated March 8, 1997, used to remove alternative stock appreciation right from non-incentive stock option agreement dated May 4, 1993, for selected officers. (Incorporated by reference to Exhibit 10.26 to the Company's 1996 Annual Report on Form 10-K.)
- *10.16 Key Employee Agreement. Form of agreement with officers and other key employees relating to change of control, dated April 2, 1997. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the twenty-six weeks ended June 27, 1997.)
- *10.17 Stock Option Agreement Amendment. Form of amendment, dated April 14, 1997, used to add change of control provision to non-incentive stock options to executive officer dated May 2, 1994, March 1, 1995 and March 1, 1996. (Incorporated by reference to Exhibit 10.6 to the Company's Report on Form 10-Q for the twenty-six weeks ended June 27, 1997.)
- *10.18 Stock Option Agreement Amendment. Form of amendment, dated April 14, 1997, used to add change of control provision to non-incentive stock options to selected officers dated December 15, 1994. (Incorporated by reference to Exhibit 10.7 to the Company's Report on Form 10-Q for the twenty-six weeks ended June 27, 1997.)
- *10.19 Stock Option Agreement Amendment. Form of amendment, dated April 14, 1997, used to add change of control provision to non-incentive stock options to one executive officer dated December 15, 1995. (Incorporated by reference to Exhibit 10.8 to the Company's Report on Form 10-Q for the twenty-six weeks ended June 27, 1997.)
- *10.20 Stock Option Agreement. Form of agreement used for award of non-incentive stock option to one executive officer, dated April 23, 1997. (Incorporated by reference to Exhibit 10.9 to the Company's Report on Form 10-Q for the twenty-six weeks ended June 27, 1997.)
- *10.21 Stock Option Agreement. Form of agreement used for award of nonstatutory stock options to non-employee directors, dated May 6, 1997. (Incorporated by reference to Exhibit 10.10 to the Company's Report on Form 10-Q for the twenty-six weeks ended June 27, 1997.)
- *10.22 Executive Long Term Incentive Agreement. Form of restricted stock award agreement used for award to one executive officer, dated May 6, 1997. (Incorporated by reference to Exhibit 10.11 to the Company's Report on Form 10-Q for the twenty-six weeks ended June 27, 1997.)
- *10.23 Stock Option Agreement. Form of agreement used for award of non-incentive stock option to two executive officers, dated May 6, 1997. (Incorporated by reference to Exhibit 10.12 to the Company's Report on Form 10-Q for the twenty-six weeks ended June 27, 1997.)
- *10.24 Stock Option Agreement. Form of agreement used for award of nonstatutory stock options to non-employee director, dated September 5, 1997. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirty-nine weeks ended September 26, 1997.)
- *10.25 Trust Agreement dated September 30, 1997, between the Company and Norwest Bank Minnesota, N.A. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirty-nine weeks ended September 26, 1997.)
- *10.26 Key Employee Agreement Amendment. Form of amendment dated

January 9, 1998, revising payment reduction provisions. (Incorporated by reference to Exhibit 10.33 to the Company's 1997 Annual Report on Form 10-K.)

- *10.27 Non-employee Director Stock Plan, as amended and restated June 18, 1999. (Incorporated by reference to Exhibit 10 to the Company's Report on Form 10-Q for the twenty-six weeks ended June 25, 1999.)
- *10.28 Retirement and Release Agreement between Clayton R. Carter and the Company dated June 26, 1999. (Incorporated by reference to Exhibit 10 to the Company's Report on Form 10-Q for the thirty-nine weeks ended September 24, 1999.)
- *10.29 Separation and Release Agreement between Roger L. King and the Company dated August 10, 1999. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirty-nine weeks ended September 24, 1999.)
- *10.30 Separation and Release Agreement between James A. Earnshaw and the Company dated December 31, 1999. (Incorporated by reference to Exhibit 10.30 to the Company's 1999 Annual Report on Form 10-K.)
- *10.31 Stock Option Agreement. Form of agreement under the Long Term Stock Incentive Plan dated December 12, 1997. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended March 26, 1999.)
- *10.32 Executive Long Term Incentive Agreement between the Company and one executive officer dated February 22, 1999. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirteen weeks ended March 26, 1999.)
- *10.33 Key Employee Agreement between the Company and one executive officer dated March 1, 1999. (Incorporated by reference to Exhibit 10.3 to the Company's Report on Form 10-Q for the thirteen weeks ended March 26, 1999.)
- *10.34 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to one executive officer, dated March 1, 1999. (Incorporated by reference to Exhibit 10.4 to the Company's Report on Form 10-Q for the thirteen weeks ended March 26, 1999.)
- *10.35 Executive Officer Annual Incentive Bonus Plan. (Incorporated by reference to Exhibit 10.35 to the Company's 1999 Annual Report on Form 10-K.)
- *10.36 Stock Option Agreement. Form of agreement under the Long Term Stock Incentive Plan dated December 12, 1997. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended March 31, 2000.)
- *10.37 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to one executive officer dated February 9, 2000. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirteen weeks ended March 31, 2000.)
- *10.38 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to one executive officer dated February 24, 2000. (Incorporated by reference to Exhibit 10.3 to the Company's Report on Form 10-Q for the thirteen weeks ended March 31, 2000.)
- *10.39 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to one executive officer dated February 23, 2001.
- *10.40 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to one executive officer dated February 23, 2001.
- *10.41 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to selected officers, dated February 23, 2001.
- 11 Statement of Computation of Earnings per share included in Note I on page 27.
- 21 Subsidiaries of the Registrant included herein on page 37.
- 23 Independent Auditors' Consent included herein on page 37.
- 24 Power of Attorney included herein on page 38.
- 99 Cautionary Statement Regarding Forward-Looking Statements.

*Management Contracts, Compensatory Plans or Arrangements.

Pursuant to Item 601(b)(4)(iii) of Regulation S-K, copies of certain instruments defining the rights of holders of certain long-term debt of the Company and its subsidiaries are not filed as exhibits because the amount of debt authorized under any such instrument does not exceed 10 percent of the total assets of the Company and its subsidiaries. The Company agrees to furnish copies thereof to the Securities and Exchange Commission upon request.

Exhibit 21

Subsidiaries of Graco Inc.

The following are subsidiaries of the Company:

Subsidiary	Jurisdiction of Organization	Percentage of Voting Securities Owned by the Company
-----	-----	-----
Equipos Graco Argentina S.A.	Argentina	100%*
Graco Barbados FSC Limited	Barbados	100%
Graco Canada Inc.	Canada	100%
Graco do Brasil Limitada	Brazil	100%*
Graco Europe N.V.	Belgium	100%*
Graco GmbH	Germany	100%
Graco Hong Kong Limited	Hong Kong	100%*
Graco K.K.	Japan	100%
Graco Korea Inc.	Korea	100%
Graco Limited	England	100%*
Graco Minnesota Inc.	United States	100%
Graco N.V.	Belgium	100%*
Graco S.A.S.	France	100%
Graco South Dakota Inc.	United States	100%***
Graco S.r.l.	Italy	100%*
Graco Verfahrenstechnik GmbH	Germany	100%**
-----	-----	-----

* Includes shares held by selected directors and/or executive officers of the Company or the relevant subsidiary to satisfy the requirements of local law.

** Shares 100% held by Graco N.V.

***Shares 100% held by Graco Minnesota Inc.

Exhibit 23

Independent Auditors' Consent

We consent to the incorporation by reference in Registration Statements No. 333-17691, No. 333-17787, No. 33-54205, No. 333-03459, and No. 333-7530 on Form S-8 of our report dated January 22, 2001, appearing in this Annual Report on Form 10-K of Graco Inc. for the year ended December 29, 2000.

/s/Deloitte & Touche LLP
 Deloitte & Touche LLP
 Minneapolis, Minnesota
 March 16, 2001

Exhibit 24

Power of Attorney

Know all by these presents, that each person whose signature appears below hereby constitutes and appoints George Aristides or Mark W. Sheahan, that person's true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution for that person and in that person's name, place and stead, in any and all capacities, to sign the Report on Form 10-K for the year ended December 29, 2000, of Graco Inc. (and any and all amendments thereto) and to file the same with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent, full power and authority to do and perform each and every act and thing requisite or necessary to be done in and about the premises, as fully to all intents and purposes as that person might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, or his substitutes, may lawfully do or cause to be done by virtue hereof.

In witness whereof, this Power of Attorney has been signed by the following persons on the date indicated.

	Date
/s/G. Aristides	February 23, 2001
----- G. Aristides	-----
/s/R. O. Baukol	February 23, 2001
----- R. O. Baukol	-----
/s/R. G. Bohn	February 23, 2001
----- R. G. Bohn	-----
/s/W. J. Carroll	February 23, 2001
----- W. J. Carroll	-----
/s/J. K. Gilligan	February 23, 2001
----- J. K. Gilligan	-----
/s/D. D. Johnson	February 23, 2001
----- D. D. Johnson	-----
/s/D. A. Koch	February 23, 2001
----- D. A. Koch	-----
/s/L. R. Mitau	February 23, 2001
----- L. R. Mitau	-----
/s/M. A.M. Morfitt	February 23, 2001
----- M. A.M. Morfitt	-----
/s/M. H. Rauenhorst	February 23, 2001
----- M. H. Rauenhorst	-----
/s/J. L. Scott	February 23, 2001
----- J. L. Scott	-----
/s/W. G. Van Dyke	February 23, 2001
----- W. G. Van Dyke	-----

ARTICLES OF AMENDMENT
RESTATING
ARTICLE OF INCORPORATION OF
GRACO INC.

INCIDENT TO A STOCK SPLIT BY
BOARD OF DIRECTORS

The undersigned, Robert M. Mattison, Secretary of Graco Inc., a Minnesota corporation, (the "Company"), hereby certifies:

- (i) that Article 4.1(a) of the Company's Articles of Incorporation has been amended to read in its entirety as follows:

"4.1(a) The total number of shares which this corporation shall be authorized to issue is Forty-eight Million Twenty-two Thousand Five Hundred Forty-nine (48,022,549) shares of which Forty-five Million (45,000,000) shares of the par value of \$1.00 per share shall be Common Shares, Three Million (3,000,000) shares of the par value of \$1.00 per share shall be Preferred Shares and Twenty-two Thousand Five Hundred Forty-nine (22,249) shares of the par value of \$100.00 per share shall be Cumulative Preferred Shares."

- (ii) That such amendment has been adopted in accordance with the requirements of, and pursuant to, Chapter 302A of the Minnesota Statutes;
- (iii) That such amendment was adopted pursuant to Section 302A.402 of the Minnesota Statutes in connection with a division of the Company's Common Stock; and
- (iv) That such amendment will not adversely affect the rights or preferences of the holders of the outstanding shares of any class or series of the Company and will not result in the percentage of authorized shares of any class or series that remains unissued after such division exceeding the percentage of authorized shares of the same class or series remaining unissued before the division.

The division giving rise to the amendment set forth above concerns a three for two split of the Common Stock of the Company. Such division is being effected as follows:

- (i) on February 6, 2001, (the "Effective Date") each share of Common Stock outstanding on January 15, 2001 (the "Record Date") will be split and converted into one and one-half (1-1/2) shares of Common Stock of the Company; and
- (ii) on or before the Effective Date, the Company's transfer agent and registrar will sign and register a certificate or certificates representing one share of the authorized but unissued Common Stock of the Company for every two shares of Common Stock held of record by each common shareholder of record on the Record Date, and will deliver or mail such certificates to each holder; and
- (iii) in settlement of fractional interests which may arise as a result of common shareholders of record on the Record Date holding a number shares not divisible by two, such common shareholders of record will be entitled to cash in an amount equal to the product of (a) the fraction one-half (1/2) multiplied by (b) 66-2/3% of the closing sale price of the Company's Common Stock as reported by the New York Stock Exchange on the Effective Date.

The document entitled "Restated Articles of Incorporation of Graco Inc." marked as Exhibit A and attached hereto contains the full text of the Articles of Incorporation of Graco Inc., incorporating in its entirety the amendment of Article 4.1(a) adopted by the Board of Directors on December 8, 2000.

The document entitled "Restated Articles of Incorporation of Graco Inc.", attached hereto as Exhibit A, correctly sets forth, without change, the corresponding provisions of the existing articles as previously amended and merely restates the existing articles, plus the instant amendment to Article 4.1(a), in their entirety.

The "Restated Articles of Incorporation of Graco Inc.", attached hereto as Exhibit A, supersedes the prior restated Articles of Incorporation and all amendments thereto.

IN WITNESS WHEREOF, the undersigned, the Secretary of Graco Inc., being duly authorized on behalf of Graco Inc., has executed this document this 15th day of December, 2000.

/s/Robert M. Mattison

Robert M. Mattison

STATE OF MINNESOTA

SS

COUNTY OF HENNEPIN

The foregoing instrument was acknowledged before me on December 15, 2000, by Robert M. Mattison, as Secretary of Graco Inc., on behalf of such corporation.

/s/Brenda L. Colsch

Brenda L. Colsch
Notary Public

Exhibit A
RESTATED ARTICLES OF INCORPORATION
OF
GRACO INC.

(Approved by the Board of Directors on December 8, 2000)

ARTICLE I

1. The name of this corporation shall be Graco Inc.

ARTICLE 2

2. Corporation Service Company, is this corporation's registered agent in the State of Minnesota, and Multifoods Tower, 33 South Sixth Street, Minneapolis, Minnesota 55402, the business office address of Corporation Service Company, is the registered office of this corporation.

ARTICLE 3

3. Any action required or permitted to be taken at a meeting of the Board of Directors of this corporation not needing approval by the shareholders under Minnesota Statutes, Chapter 302A, may be taken by written action signed by the number of directors that would be required to take such action at a meeting of the Board of Directors at which all directors are present.

ARTICLE 4

4.1 (a) The total number of shares which this corporation shall be authorized to issue is Forty-eight Million Twenty-two Thousand Five Hundred Forty-nine (48,022,549) shares of which Forty-five Million (45,000,000) shares of the par value of \$1.00 per share shall be Common Shares, Three Million (3,000,000) shares of the par value of \$1.00 per share shall be Preferred Shares and Twenty-two Thousand Five Hundred Forty-nine (22,249) shares of the par value of \$100.00 per share shall be Cumulative Preferred Shares.

(b) Preferred Shares may be issued from time to time in one or more series as the Board of Directors may determine, as hereinafter provided. The Board of Directors is hereby authorized by resolution or resolutions, to provide from time to time for series of Preferred Shares out of the unissued Preferred Shares not then allocated to any series of Preferred Shares. Before any shares of any such series are issued, the Board of Directors shall fix and determine, and is hereby expressly empowered to fix and determine, by resolution or resolutions, the designations and the relative rights and preferences thereof, of the shares of such series. Preferred Shares will be senior to the Cumulative Preferred Shares in terms of dividend and liquidation rights unless the Board of Directors specifically provides otherwise in the resolution or resolutions establishing a series of Preferred Shares.

The Board of Directors is expressly authorized to vary the provisions relating to the foregoing matters among the various series of Preferred Shares.

Preferred Shares of any series that shall be issued and thereafter acquired by the corporation through purchase, redemption (whether through the operation of a sinking fund or otherwise), conversion, exchange or otherwise, shall, upon appropriate filing and recording to the extent required by law, have the status of authorized and unissued Preferred Shares and may be reissued as part of such series or as part of any other series of Preferred Shares. Unless otherwise provided in the resolution or resolutions of the Board of Directors providing for the issue thereof, the number of authorized shares of any series of Preferred Shares may be increased or decreased (but not below the number of shares thereof then outstanding) by resolution or resolutions of the Board of Directors and appropriate filing and recording to the extent required by law. In case the number of shares of any such series of Preferred Shares shall be

decreased, the shares representing such decrease shall, unless otherwise provided in the resolution or resolutions of the Board of Directors providing for the issuance thereof, resume the status of authorized but unissued Preferred Shares, undesignated as to series.

4.2 The designations, relative rights, voting powers, preferences and restrictions granted to or imposed upon the Common Shares and Cumulative Preferred Shares, which shall be subject to the rights granted to any series of Preferred Shares in the resolutions authorizing the series, are as follows:

(a) Voting. Except as expressly set forth in sub-division (f) below and except as otherwise provided in the resolutions authorizing any series of Preferred Shares or by law, the holders of Common Shares shall have the sole voting rights of shareholders of the corporation and shall be entitled to one vote for each share held. The shareholders of the corporation shall have no right to cumulate votes for the election of directors.

(b) No Pre-emptive Rights. Except as provided in the resolutions authorizing any series of Preferred Shares, no holders of any share of stock of any class of this corporation shall have any pre-emptive right to subscribe to any issue of shares of any class of this corporation now or hereafter authorized or any security hereafter issued by this corporation convertible into shares of this corporation.

(c) Dividends. The holders of Cumulative Preferred Shares shall be entitled to receive out of any assets legally available therefor, when and as declared by the Board of Directors, fixed cumulative dividends at the rate of five percent (5%) per annum upon the par value thereof, and no more, payable semiannually on January 1 and July 1 of each year. Such dividends shall be cumulative from January 1, 1969.

In no event shall any dividend be paid or declared (other than dividends payable in Common Shares of any class), nor shall any distribution be made on the Common Shares of any class of the corporation, nor shall any Common Shares of any class be purchased, redeemed or otherwise acquired by the corporation for value unless all dividends on the Cumulative Preferred Shares for all past semiannual dividend periods and for the then current semiannual dividend period shall have been paid, or declared and a sum sufficient for the payment thereof set apart for payment.

Subject to the provisions of this Article 5 and not otherwise, dividends may be declared by the Board of Directors and paid from time to time, out of any funds legally available therefor, upon the Common Shares, and the holders of Cumulative Preferred Shares shall not be entitled to participate in any such dividends.

(d) Redemption. The Cumulative Preferred Shares of the corporation may be redeemed as a whole at any time or in part from time to time at the option of the corporation by resolution of the Board of Directors at the redemption price of \$105 per share together with an amount equal to all accrued and unpaid cumulative dividends thereon from the date on which dividends thereon became cumulative to the redemption date. If less than all of the outstanding Cumulative Preferred Shares are to be redeemed, the shares to be redeemed shall be selected by the Board of Directors or by a person appointed for such purpose by the Board of Directors.

Notice of every redemption of Cumulative Preferred Shares shall be mailed addressed to the holders of record of the shares to be redeemed at their respective addresses as they appear on the stock books of the corporation not less than thirty (30) and not more than sixty (60) days prior to the date fixed for redemption.

If notice of redemption shall have been duly given as aforesaid and if on or before the redemption date specified in the notice, all funds necessary for the redemption shall have been deposited in trust with a bank or trust company in good standing and doing business at any place within the United States, and designated in the notice of redemption, for the pro rata benefit of the shares so called for redemption, so as to be and continue to be available therefor, then, from and after the date of such deposit, notwithstanding that any certificate for Cumulative Preferred Shares so called for redemption shall not have been surrendered for cancellation, the shares represented thereby shall no longer be deemed outstanding, and the dividends thereon shall cease to accumulate from and after the date fixed for redemption, and all rights with respect to the Cumulative Preferred Shares so called for redemption shall forthwith, on the date of such deposit, cease and terminate except only the right of the holders thereof to receive the redemption price of the shares so redeemed, including accrued cumulative dividends to the redemption date, but without interest. Any funds deposited by the corporation pursuant to this paragraph and unclaimed at the end of six (6) years after the date fixed for redemption shall be repaid to the corporation upon its request expressed in a resolution of its Board of Directors, after which repayment the holders of the shares so called for redemption shall look only to the corporation for the payment thereof.

(e) Dissolution, Liquidation, etc. In the event of any dissolution, liquidation or winding up of the affairs of the corporation, before any

distribution or payment shall be made to the holders of Common Shares, the holders of the Cumulative Preferred Shares shall be entitled to be paid in full the par value thereof if such liquidation, dissolution or winding up shall be involuntary, and the sum of \$105 per share if such liquidation, dissolution or winding up shall be voluntary, together, in either event, with a sum, in the case of each share, equal to the cumulative accrued and unpaid dividends thereon to the date fixed for such distribution or payment. If such distribution or payment shall have been made to the holders of the Cumulative Preferred Shares or moneys made available for such payment in full, the remaining assets and funds of the corporation shall be distributed ratably to the holders of the Common Shares. If there shall be insufficient assets to make full payment to the holders of Cumulative Preferred Shares as above provided, the assets of the corporation shall be distributed among the holders of Cumulative Preferred Shares ratably. Except as herein otherwise expressly provided, the Cumulative Preferred Shares shall not be entitled to participate in any of the profits, surplus or assets of the corporation. The consolidation or merger of the corporation into or with any other corporation or corporations pursuant to the statutes of the State of Minnesota shall not be deemed a liquidation, dissolution or winding up of the affairs of the corporation within the meaning of any of the provisions of this paragraph.

(f) Special Voting Rights. The holders of Cumulative Preferred Shares shall not be entitled as such to vote at any meeting of the shareholders of the corporation except as required by law or as hereinafter otherwise provided.

(i) If an amendment to the Articles of Incorporation of the corporation would adversely affect the rights of the holders of Cumulative Preferred Shares, then in addition to the vote thereon by the holders of the Common Shares, the holders of Cumulative Preferred Shares shall be entitled to vote separately as a class thereon, and such amendment shall be adopted only if it receives the affirmative vote of the holders of a majority of the Cumulative Preferred Shares.

(ii) After an amount equivalent to three (3) full semi-annual dividend installments of the Cumulative Preferred Shares shall be in default, the holders of Cumulative Preferred Shares at the time outstanding, voting separately as a class shall, at any annual meeting of the shareholders or any special meeting of the shareholders called as herein provided occurring during such period, elect two (2) members of the Board of Directors, and the holders of the Common Shares, voting separately as a class, shall elect the remaining directors of the corporation.

(iii) After an amount equivalent to six (6) full semi-annual dividend installments of the Cumulative Preferred Shares shall be in default, the holders of Cumulative Preferred Shares, voting separately as a class, shall, at any annual meeting of the shareholders or any special meeting of the shareholders called as herein provided occurring during such period, elect the smallest number of directors necessary to constitute a majority of the full Board of Directors, and the holders of the Common Shares, voting separately as a class, shall elect the remaining directors of the corporation.

At any annual meeting or special meeting of shareholders for the election of directors occurring after all cumulative dividends then in default on the Cumulative Preferred Shares then outstanding, including the dividend for the then current semi-annual period, shall have been paid, or declared and set apart for payment, the Cumulative Preferred Shares shall thereupon be divested of any rights with respect to the election of directors as above provided, but always subject to the same provisions for the revesting of such voting power in the Cumulative Preferred Shares in the case of a future like default or defaults in dividends on Preferred Shares.

Voting power for the election of directors vested in the holders of the Cumulative Preferred Shares as above provided may be exercised at any annual meeting of shareholders or at a special meeting of shareholders held for such purpose, which special meeting of shareholders shall be called by the proper officers of the corporation at any time when such voting power shall be vested within twenty (20) days after written request therefor signed by the holder or holders of not less than ten percent (10%) of the Cumulative Preferred Shares then outstanding, the date of such special meeting to be not more than twenty (20) days from the date of giving notice thereof, and such notice shall be given to all holders of Cumulative Preferred Shares and Common Shares not less than ten (10) days prior to said meeting. In each such case such notice shall direct attention to the voting rights of the holders of Cumulative Preferred Shares. At any such meeting the presence in person or by proxy of the holders of a majority of the Cumulative Preferred Shares outstanding shall be required to constitute a quorum for the election of directors whom the holders of Cumulative Preferred Shares are entitled to elect and, likewise, the presence in person or by proxy of the holders of a majority of the Common Shares outstanding shall be required to constitute a quorum for the election of directors whom the holder of Common Shares are entitled to elect; provided that either the Cumulative Preferred

shareholders or the Common shareholders who are present in person or by proxy at such a meeting shall have power to adjourn such meeting for the election of directors to be elected by them from time to time, without notice other than announcement at the meeting and, provided further, that the adjournment of the meeting for lack of a quorum of the Common shareholders shall not prevent the election at that meeting of the directors whom the Cumulative Preferred shareholders are entitled to elect if there is a quorum of the Cumulative preferred shareholders.

If at any time the holders of Cumulative Preferred Shares shall become entitled to elect two (2) directors or a majority of the Board of Directors as aforesaid, the terms of all incumbent directors shall expire whenever such two (2) directors or such majority have been duly elected and qualified.

Whenever the Cumulative Preferred Shares shall be divested of voting power with respect to the election of directors the terms of all then incumbent directors shall expire upon the election of a new board by the holders of Common Shares at the next annual or special meeting for the election of directors.

If a vacancy or vacancies in the Board of Directors shall exist with respect to a director or directors elected by the Cumulative Preferred shareholders, the remaining director or directors elected by the Cumulative Preferred shareholders may, by the vote of such remaining director if there be but one, or by the vote of a majority of such remaining directors if there be more than one, elect a successor or successors to hold office for the unexpired term. Likewise, a vacancy or vacancies existing with respect to directors elected by the Common shareholders may be filled by the remaining director or directors elected by the Common shareholders.

ARTICLE 5

5.1 Whether or not a vote of shareholders is otherwise required, the affirmative vote of the holders of not less than two-thirds of the outstanding shares of "Voting Stock" (as hereafter defined) of the corporation shall be required for the approval or authorization of any "Business Combination" (as hereafter defined) with any Related Person (as hereafter defined) involving the corporation or the approval or authorization by the corporation in its capacity as a shareholder of any Business Combination involving a "Subsidiary" (as hereafter defined) which requires the approval or authorization of the shareholders of the Subsidiary; provided, however, that the two-thirds voting requirement shall not be applicable if:

(a) The "Continuing Directors" (as hereafter defined) by a majority vote have expressly approved the Business Combination; or

(b) The Business Combination is a merger, consolidation, exchange of shares or sale of all or substantially all of the assets of the corporation and the cash or fair market value (determined as of the effective date of such Business Combination or, in the case of a sale of assets as of the date of the distribution of the proceeds of the sale to the shareholders of the corporation) of the property, securities or other consideration to be received per share by holders of common stock of the corporation other than the Related Person is not less than the highest per share price (with appropriate adjustments for recapitalizations, stock splits, stock dividends and like distributions), paid by the Related Person in acquiring any of its holdings of the corporation's common stock during the two-year period prior to the effective date of the Business Combination or the distribution of the proceeds of a sale of assets.

5.2 For the purposes of this Article 6:

(a) The term "Business Combination" shall mean

(i) any merger or consolidation of the corporation or a Subsidiary with or into a Related Person,

(ii) any exchange of shares of the corporation or a Subsidiary for shares of a Related Person which, in the absence of this Article, would have required the affirmative vote of at least a majority of the voting power of the outstanding shares of the corporation entitled to vote or the affirmative vote of the corporation, in its capacity as a shareholder of the Subsidiary,

(iii) any sale, lease, exchange, transfer or other disposition (in one transaction or a series of transactions), including, without limitation, a mortgage or any other security device, of all or any "Substantial Part" (as hereinafter defined) of the assets either of the corporation (including, without limitation, any voting securities of a Subsidiary) or of a Subsidiary, to or with a Related Person,

(iv) any sale, lease, exchange, transfer or other disposition

(in one transaction or a series of transactions) of all or any Substantial Part of the assets of a Related Person to or with the corporation or a Subsidiary,

(v) the issuance of any securities to a Related Person (except pursuant to stock dividends, stock splits or similar transactions which would not have the effect of increasing the proportionate voting power of a Related Person) of the corporation, or of a Subsidiary (except pursuant to a pro rata distribution to all holders of common stock of the corporation),

(vi) any recapitalization or reclassification that would have the effect of increasing the voting power of a Related Person, and

(vii) any agreement, contract or other arrangement providing for any of the transactions described in this definition of Business Combination.

(b) The term "Related Person" shall mean and include any individual, corporation, partnership or other person or entity which, together with its "Affiliates" and "Associates" (as defined on February 24, 1984 by Rule 12b-2 under the Securities Exchange Act of 1934), "Beneficially Owns" (as defined on February 24, 1984 by Rule 13d-3 under the Securities Exchange Act of 1934) in the aggregate 15 percent or more of the outstanding Voting Stock of the corporation, and any Affiliate or Associate (other than the corporation or a wholly-owned subsidiary of the corporation) of any such individual, corporation, partnership or other person or entity.

(c) The term "Substantial Part" shall mean more than 30 percent of the fair market value of the total assets of the corporation in question, as of the end of its most recent fiscal year ending prior to the time the determination is being made.

(d) Without limitation, any shares of common stock of the corporation that any Related Person has the right to acquire pursuant to any agreement, or upon exercise of conversion rights, warrants or options, or otherwise, shall be deemed beneficially owned by the Related Person.

(e) The term "Subsidiary" shall mean any corporation, a majority of the equity securities of any class of which are owned by the corporation, by another Subsidiary, or in the aggregate by the corporation and one or more of its Subsidiaries.

(f) The term "Voting Stock" shall mean all outstanding shares of capital stock of the corporation entitled to vote generally in the election of directors and each reference to a proportion of shares of Voting Stock shall refer to such proportion of the votes entitled to be cast by such shares.

(g) The term "Continuing Director" shall mean (i) a director who was a member of the Board of Directors of the corporation either on February 24, 1984 or immediately prior to the time that any Related Person involved in the Business Combination in question became a Related Person and (ii) any person becoming a director whose election, or nomination for election by the corporation's shareholders, was approved by a vote of a majority of the Continuing Directors; provided, however, that in no event shall a Related Person involved in the Business Combination in question be deemed to be a Continuing Director.

5.3 For the purposes of this Article 6 the Continuing Directors by a majority vote shall have the power to make a good faith determination, on the basis of information known to them, of: (i) the number of shares of Voting Stock of the corporation that any person or entity Beneficially Owns, (ii) whether a person or entity is an Affiliate or Associate of another, (iii) whether the assets subject to any Business Combination constitute a Substantial Part, (iv) whether any business transaction is one in which a Related Person has an interest, (v) whether the cash or fair market value of the property, securities or other consideration to be received per share by holders of capital stock of the corporation other than the Related Person in a Business Combination is an amount at least equal to the highest per share price paid by the Related Person and (vi) such other matters with respect to which a determination is required under this Article 6.

5.4 The provisions set forth in this Article 6 may not be repealed or amended in any respect, unless such action is approved by the affirmative vote of the holders of not less than two-thirds of the outstanding shares of Voting Stock of the corporation.

ARTICLE 6

6.1 The number of directors shall initially be ten and, thereafter, shall be fixed from time to time by the Board of Directors or by the affirmative vote of the holders of two-thirds of the voting power of the outstanding capital stock of the corporation, voting together as a single class. The directors shall be divided into three classes, as nearly equal in number as reasonably possible, with the term of office of the first class to expire at the 1988 annual meeting of shareholders, the term of office of the second class to expire at the 1989

annual meeting of shareholders and the term of office of the third class to expire at the 1990 annual meeting of shareholders. At each annual meeting of shareholders following such initial classification and election, directors elected to succeed those directors whose terms expire shall be elected for a term of office to expire at the third succeeding annual meeting of shareholders after their election.

6.2 Subject to the rights of the holders of any series of Preferred Stock then outstanding, newly created directorships resulting from any increase in the authorized number of directors or any vacancies in the Board of Directors resulting from death, resignation, retirement, disqualification, removal from office or other cause may be filled by a majority vote of the directors then in office though less than a quorum, and directors so chosen shall hold office for a term expiring at the next annual meeting of shareholders. No decrease in the number of directors constituting the Board of Directors shall shorten the term of any incumbent director.

6.3 Any directors, or the entire Board of Directors, may be removed from office at any time, but only for cause and only by the affirmative vote of the holders of the proportion or number of the voting power of the shares of the classes or series the director represents sufficient to elect them.

6.4 The provisions of this Article 7 may not be repealed or amended in any respect, unless such action is approved by the affirmative vote of the holders of not less than two-thirds of the outstanding shares of the capital stock of the corporation entitled to vote generally in the election of directors, voting together as a single class.

ARTICLE 7

7. No director of the corporation shall be personally liable to the corporation or its shareholders for monetary damages for breach of fiduciary duty by such director as a director; provided, however, that this Article 8 shall not eliminate or limit the liability of a director (i) for any breach of the director's duty of loyalty to the corporation or its shareholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 302A.559 of the Minnesota Business Corporation Act or Section 80A.23 of the Minnesota Securities Law, or (iv) for any transaction from which the director derived an improper personal benefit. No amendment to or repeal of this Article 8 shall apply to or have any effect on the liability or alleged liability of any director of the corporation for or with respect to any acts or omissions of such director occurring prior to such amendment or repeal.

ARTICLE 8

8. The Board of Directors of the corporation (the "Board"), when evaluating any offer of another party, (a) to make a tender or exchange offer for any Voting Stock (as defined in Article 6) of the corporation or (b) to effect a Business Combination (as defined in Article 6), shall, in connection with the exercise of its judgment in determining what is in the best interests of the corporation as a whole, be authorized to give due consideration to such factors as the Board determines to be relevant, including, without limitation:

- (i) the interests of the corporation's shareholders;
- (ii) the social, legal and economic effects upon employees, suppliers, customers and others having similar relationships with the corporation, and the communities in which the corporation conducts its business;
- (iii) whether the proposed transaction might violate federal or state laws; and
- (iv) not only the consideration being offered in the proposed transaction, in relation to the then current market price for the outstanding capital stock of the corporation, but also the market price for the capital stock of the corporation over a period of years, the estimated price that might be achieved in a negotiated sale of the corporation as a whole or in part of through orderly liquidation, the premiums over market price for the securities of other corporations in similar transactions, current political, economic or other factors bearing on securities prices and the corporation's financial condition and future prospects.

In connection with any such evaluation, the Board is authorized to conduct such investigations and to engage in such legal proceedings as the Board may determine.

RESTATED BYLAWS

GRACO INC.
(Adopted September 29, 2000)

ARTICLE I.
OFFICES, CORPORATE SEAL

Section 1.01. Offices. The principal executive office of the corporation shall be at 88 - 11th Avenue NE, Minneapolis, Minnesota 55413. The corporation may have such other offices, within or without the State of Minnesota, as the directors shall, from time to time, determine.

Section 1.02. Corporate Seal. The corporate seal shall be circular in form and shall have inscribed thereon the name of the corporation and the word "Minnesota" and the words "Corporate Seal".

ARTICLE II.
MEETINGS OF SHAREHOLDERS

Section 2.01. Place of Meetings. Meetings of the shareholders shall be held at the principal executive office of the corporation or at such other place as may be designated by the directors, except that any meeting called by or at the demand of a shareholder shall be held in the county in which the principal executive office of the corporation is located.

Section 2.02. Regular Meetings. A regular meeting of the shareholders shall be held on an annual basis on such date and at such time as the Board of Directors shall by resolution establish. At a regular meeting the shareholders shall elect qualified successors for directors whose terms have expired or are due to expire within six months after the date of the meeting and shall transact such other business as may properly come before them.

Section 2.03. Special Meetings. Special meetings of the shareholders may be held at any time and for any purpose and may be called by the chief executive officer, the chief financial officer, two or more directors or a shareholder or shareholders holding 10% or more of the voting power of all shares entitled to vote, except that a special meeting called by a shareholder or shareholders for the purpose of considering any action to directly or indirectly facilitate or effect a business combination, including any action to change or otherwise affect the composition of the Board of Directors for that purpose, must be called by a shareholder or shareholders holding 25% or more of the voting power of all shares entitled to vote. A shareholder or shareholders holding the requisite percentage of the voting power may demand a special meeting of the shareholders by written notice given to the chief executive officer or chief financial officer of the corporation stating the purposes of the meeting. Within 30 days after receipt of such a demand by one of those officers, the Board of Directors shall cause a special meeting of shareholders to be called and held on notice not later than 90 days after receipt of the demand, at the expense of the corporation. Special meetings shall be held on the date and at the time and place fixed by the chief executive officer, the chief financial officer or the Board of Directors, except that a special meeting called by or at demand of a shareholder or shareholders shall be held in the county where the principal executive office is located. The business transacted at a special meeting shall be limited to the purposes stated in the notice of the meeting.

Section 2.04. Quorum, Action by Shareholders. The holders of a majority of the shares entitled to vote shall constitute a quorum for the transaction of business at any regular or special meeting. All questions shall be decided by a majority vote of the number of shares entitled to vote and represented at the meeting at the time of the vote unless otherwise required by statute, the Articles of Incorporation, or these Bylaws.

Section 2.05. Adjourned Meetings. In case a quorum shall not be present at a meeting, those present may adjourn the meeting to such day as they shall, by majority vote, agree upon, and a notice of such adjournment and the date and time at which such meeting shall be reconvened shall be mailed to each shareholder entitled to vote at least 5 days before such adjourned meeting. If a quorum is present, a meeting may be adjourned from time to time without notice other than announcement at the meeting. At adjourned meetings at which a quorum is present, any business may be transacted which might have been transacted at the meeting as originally noticed. If a quorum is present, the shareholders may continue to transact business until adjournment notwithstanding the withdrawal of enough shareholders to leave less than a quorum.

Section 2.06. Voting. At each meeting of the shareholders every shareholder having the right to vote shall be entitled to vote either in person or by proxy. Each shareholder shall have one vote for each share having voting power registered in such shareholder's name on the books of the corporation. Jointly owned shares may be voted by any joint owner unless the corporation receives written notice from any one of them denying the authority of that person to vote the shares. Upon the demand of any shareholder, the vote upon any question before the meeting shall be by ballot.

Section 2.07. Closing of Books. The Board of Directors may fix a date not more than 60 days preceding the date of any meeting of shareholders, as the date (the "record date") for the determination of the shareholders entitled to notice of, and to vote at, such meeting. When a record date is so fixed, only shareholders as of that date are entitled to notice of and permitted to vote at that meeting of shareholders.

Section 2.08. Notice of Meetings. Except as otherwise specified in Section 2.05 or required by law, written notice of each meeting of the shareholders, stating the date, time and place and, in the case of a special meeting, the purpose or purposes, shall be given at least ten days and not more than sixty days prior to the meeting to every holder of shares entitled to vote at such meeting. The business transacted at a special meeting of shareholders is limited to the purposes stated in the notice of the meeting.

Section 2.09. Waiver of Notice. Notice of any regular or special meeting may be waived by any shareholder either before, at or after such meeting orally or in a writing signed by such shareholder or a representative entitled to vote the shares of such shareholder. Attendance by a shareholder, at any meeting of shareholders, is a waiver of notice of such meeting, except where the shareholder objects at the beginning of the meeting to the transaction of business because the meeting is not lawfully called or convened or the item may not lawfully be considered at that meeting and the shareholder does not participate in the consideration of the item at that meeting.

Section 2.10. Advance Notice of Shareholder Proposals. As provided in Section 2.03, the business conducted at any special meeting of shareholders of the corporation shall be limited to the purposes stated in the notice of the special meeting pursuant to Section 2.08. At any regular meeting of shareholders of the corporation, only such business (other than the nomination and election of directors, which shall be subject to Section 3.15) may be conducted as shall be appropriate for consideration at the meeting of shareholders and shall have been brought before the meeting (i) by or at the direction of the Board of Directors, or (ii) by any shareholder of the corporation entitled to vote at the meeting who complies with the notice procedures hereinafter set forth in this section.

- (a) Timing of Notice. For such business to be properly brought before any regular meeting by a shareholder, the shareholder must have given timely notice thereof in writing to the secretary of the corporation. To be timely, a shareholder's notice of any such business to be conducted at an annual shareholders meeting must be delivered to the secretary of the corporation, or mailed and received at the principal executive office of the corporation, not less than 90 days before the first anniversary of the date of the preceding year's annual shareholders meeting of shareholders. If, however, the date of the annual shareholders meeting of shareholders is more than 30 days before or after such anniversary date, notice by a shareholder shall be timely only if so delivered or so mailed and received not less than 90 days before such annual shareholders meeting or, if later, within 10 days after the first public announcement of the date of such annual shareholders meeting. To be timely, a shareholder's notice of any such business to be conducted at a regular meeting other than an annual shareholders meeting must be delivered to the secretary of the corporation, or mailed and received at the principal executive office of the corporation, not less than 90 days before such regular meeting or, if later, within 10 days after the first public announcement of the date of such regular meeting. Except to the extent otherwise required by law, the adjournment of a regular meeting of shareholders shall not commence a new time period for the giving of a shareholder's notice as required above.
- (b) Content of Notice. A shareholder's notice to the corporation shall set forth as to each matter the shareholder proposes to bring before the regular meeting (i) a brief description of the business desired to be brought before the meeting and the reasons for conducting such business at the meeting, (ii) the name and address, as they appear on the corporation's books, of the shareholder proposing such business, (iii) the class of series (if any) and number of shares of the corporation that are beneficially owned by the shareholder, (iv) any material interest of the shareholder in such business, and (v) a representation that the shareholder is a holder of record of shares entitled to vote at the meeting and intends to appear in person or by proxy at the meeting to make the proposal.
- (c) Consequences of Failure to Give Timely Notice. Notwithstanding anything in these Bylaws to the contrary, no business (other than the nomination and election of directors) shall be conducted at any regular meeting except in accordance with the procedures set forth in this Section. The officer of the corporation chairing the meeting shall, if the facts warrant, determine and declare to the meeting that business was not properly brought before the meeting in accordance with the procedures described in this Section and, if such officer should so determine, such officer shall so declare to the meeting, and any such business not properly brought before the meeting shall not be transacted.

Nothing in this Section shall be deemed to preclude discussion by any shareholder of any business properly brought before the meeting in accordance with these Bylaws.

- (d) Public Announcement. For purposes of this Section and Section 3.15, "public announcement" means disclosure (i) when made in a press release reported by the Dow Jones News Service, Associated Press, or comparable national news service, (ii) when filed in a document publicly filed by the corporation with the Securities and Exchange Commission pursuant to Section 13, 14, or 15(d) of the Securities Exchange Act of 1934, as amended, or (iii) when mailed as the notice of the meeting pursuant to Section 2.08.
- (e) Compliance with Law. Notwithstanding the foregoing provisions of this Section, a shareholder shall also comply with all applicable requirements of Minnesota law and the Securities Exchange Act of 1934, as amended, and the rules and regulations thereunder with respect to the matters set forth in this Section.

ARTICLE III. DIRECTORS

Section 3.01. General Powers. The business and affairs of the corporation shall be managed by or under the direction of the Board of Directors.

Section 3.02. Number, Qualification and Term of Office. The number of directors shall initially be ten and, thereafter, shall be fixed from time to time by the Board of Directors or by the affirmative vote of the holders of two-thirds of the voting power of the outstanding capital stock of the corporation, voting together as a single class. The directors shall be divided into three classes, as nearly equal in number as reasonably possible, with the term of office of the first class to expire at the 1988 annual meeting of shareholders, the term of office of the second class to expire at the 1989 annual meeting of shareholders and the term of office of the third class to expire at the 1990 annual meeting of shareholders. At each annual meeting of shareholders following such initial classification and election, directors elected to succeed those directors whose terms expire shall be elected for a term of office to expire at the third succeeding annual meeting of shareholders after their election.

Section 3.03. Board Meetings. Meetings of the Board of Directors may be held from time to time at such time and place as may be designated in the notice of such meeting.

Section 3.04. Calling Meetings; Notice. Meetings of the Board of Directors may be called by the chief executive officer by giving at least twenty-four hours' notice, or by any other director by giving at least five day's notice, of the date, time and place thereof to each director by mail, telephone, telegram or in person. If the day or date, time and place of a Board meeting have been announced at a previous meeting of the Board, no notice is required. Notice of an adjourned meeting need not be given other than by announcement at the meeting at which adjournment is taken of the date, time and place at which the meeting will be reconvened.

Section 3.05. Waiver of Notice. Notice of any meeting of the Board of Directors may be waived by any director either before, at, or after such meeting orally or in a writing signed by such director. A director, by his attendance at any meeting of the Board of Directors, shall be deemed to have waived notice of such meeting, except where the director objects at the beginning of the meeting to the transaction of business because the meeting is not lawfully called or convened and does not participate thereafter in the meeting.

Section 3.06. Quorum. A majority of the directors holding office immediately prior to a meeting of the Board of Directors shall constitute a quorum for the transaction of business at such meeting.

Section 3.07. Absent Directors. A director may give advance written consent or opposition to a proposal to be acted on at a meeting of the Board of Directors. If such director is not present at the meeting, consent or opposition to a proposal does not constitute presence for purposes of determining the existence of a quorum, but consent or opposition shall be counted as a vote in favor of or against the proposal and shall be entered in the minutes or other record of action at the meeting, if the proposal acted on at the meeting is substantially the same or has substantially the same effect as the proposal to which the director has consented or objected.

Section 3.08. Conference Communications. Any or all directors may participate in any meeting or conference of the Board of Directors, or of any duly constituted committee thereof, by any means of communication through which the directors may simultaneously hear each other during such meeting. For the purposes of establishing a quorum and taking any action, such directors participating pursuant to this Section 3.08 shall be deemed present in person at the meeting.

Section 3.09. Vacancies. Subject to the rights of the holders of any series of Preferred Stock then outstanding, newly created directorships resulting from any increase in the authorized number of directors or any

vacancies in the Board of Directors resulting from death, resignation, retirement, disqualification, removal from office or other cause may be filled by a majority vote of the directors then in office though less than a quorum, and directors so chosen shall hold office for a term expiring at the next annual meeting of shareholders. No decrease in the number of directors constituting the Board of Directors shall shorten the term of any incumbent director.

Section 3.10. Removal. Any directors, or the entire Board of Directors, may be removed from office at any time, but only for cause and only by the affirmative vote of the holders of the proportion or number of the voting power of the shares of the classes or series the director represents sufficient to elect them.

Section 3.11. Committees. A resolution approved by the affirmative vote of a majority of the Board of Directors may establish committees having the authority of the Board in the management of the business of the corporation to the extent provided in the resolution. A committee shall consist of one or more persons, who need not be directors, appointed by affirmative vote of a majority of the directors present. Committees are subject to the direction and control of, and vacancies in the membership thereof shall be filled by, the Board of Directors, except as provided by Section 3.12 and by Minnesota Statutes Section 302A.243. A majority of the members of the committee holding office immediately prior to a meeting of the committee shall constitute a quorum for the transaction of business, unless a larger or smaller proportion or number is provided in the resolution establishing the committee.

Section 3.12. Committee of Disinterested Persons. Pursuant to the procedure set forth in Section 3.11, the Board may establish a committee composed of two or more disinterested directors or other disinterested persons to determine whether it is in the best interests of the corporation to pursue a particular legal right or remedy of the corporation and whether to cause the dismissal or discontinuance of a particular proceeding that seeks to assert a right or remedy on behalf of the corporation. The committee, once established, is not subject to the direction or control of, or termination by, the Board. A vacancy on the committee may be filled by a majority of the remaining committee members. The good faith determinations of the committee are binding upon the corporation and its directors, officers and shareholders. The committee terminates when it issues a written report of its determination to the Board.

Section 3.13. Written Action. Any action which might be taken at a meeting of the Board of Directors, or any duly constituted committee thereof, may be taken without a meeting if done in writing and signed by all of the directors or committee members, unless the Articles provide otherwise and the action need not be approved by the shareholders.

Section 3.14. Compensation. The Board may fix the compensation, if any, of directors.

Section 3.15. Nomination of Director Candidates. Only persons who are nominated in accordance with the procedures set forth in this Section 3.15 shall be eligible for election as directors. Nominations of persons for election to the Board of Directors of the corporation may be made at a meeting of shareholders (i) by or at the direction of the Board of Directors, or (ii) by any shareholder of the corporation entitled to vote for the election of directors at the meeting who complies with the notice procedures hereinafter set forth in this Section.

- (a) Timing of Notice. Nominations by shareholders shall be made pursuant to timely notice in writing to the secretary of the corporation. To be timely, a shareholder's notice of nominations to be made at an annual shareholders meeting of shareholders must be delivered to the secretary of the corporation, or mailed and received at the principal executive office of the corporation, not less than 90 days before the first anniversary date of the preceding year's annual shareholders meeting of shareholders. If, however, the date of the annual shareholders meeting of shareholders is more than 30 days before or after such anniversary date, notice by a shareholder shall be timely only if so delivered or so mailed and received not less than 90 days before such annual shareholders meeting or, if later, within 10 days after the first public announcement of the date of such annual shareholders meeting. If a special meeting of shareholders of the corporation is called in accordance with Section 2.03 for the purpose of electing one or more directors to the Board of Directors or if a regular meeting other than an annual shareholders meeting is held, for a shareholder's notice of nominations to be timely it must be delivered to the secretary of the corporation, or mailed and received at the principal executive office of the corporation, not less than 90 days before such special meeting or such regular meeting or, if later, within 10 days after the first public announcement of the date of such special meeting or such regular meeting. Except to the extent otherwise required by law, the adjournment of a regular or special meeting of shareholders shall not commence a new time period for the giving of a shareholder's notice as described above.
- (b) Content of Notice. A shareholder's notice to the corporation of nominations for a regular or special meeting of shareholders

shall set forth (x) as to each person whom the shareholder proposes to nominate for election or re-election as a director: (i) such person's name, age, business address and residence address and principal occupation or employment, (ii) all other information relating to such person that is required to be disclosed in solicitations of proxies for election of directors, or that is otherwise required, pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, and (iii) such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected; and (y) as to the shareholder giving the notice: (i) the name and address, as they appear on the corporation's books, or such shareholder, (ii) the class or series (if any) and number of shares of the corporation that are beneficially owned by such shareholder, and (iii) a representation that the shareholder is a holder of record of shares of the corporation entitled to vote for the election of directors and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice. At the request of the Board of Directors, any person nominated by the Board of Directors for election as a director shall furnish to the secretary of the corporation the information required to be set forth in a shareholder's notice of nomination that pertains to a nominee.

- (c) Consequences of Failure to Give Timely Notice. Notwithstanding anything in these Bylaws to the contrary, no person shall be eligible for election as a director of the corporation unless nominated in accordance with the procedures set forth in this Section. The officer of the corporation chairing the meeting shall, if the facts warrant, determine and declare to the meeting that a nomination was not made in accordance with the procedures prescribed in this Section and, if such officer should so determine, such officer shall so declare to the meeting, and the defective nomination shall be disregarded.

ARTICLE IV. OFFICERS

Section 4.01. Number and Designation. The corporation shall have one or more natural persons exercising the functions of the offices of chief executive officer and chief financial officer. The Board of Directors may elect or appoint such other officers or agents as it deems necessary for the operation and management of the corporation, with such powers, rights, duties and responsibilities as may be determined by the Board, including, without limitation, a Chairman of the Board, a President, one or more Vice Presidents, a Secretary, A Treasurer, and such assistant officers or other officers as may from time to time, be elected or appointed by the Board. Each such officer shall have the powers, rights, duties and responsibilities set forth in these Bylaws unless otherwise determined by the Board. Any number of offices may be held by the same person.

Section 4.02. Chief Executive Officer. Either the Chairman of the Board, the President or another officer of the corporation may be designated from time to time by the Board to be the chief executive officer of the corporation. Unless provided otherwise by a resolution adopted by the Board of Directors, the chief executive officer (a) shall have general active management of the business of the corporation; (b), shall, when present, preside at all meetings of the shareholders; (c) shall see that all orders and resolutions of the Board are carried into effect; (d) shall sign and deliver in the name of the corporation any deeds, mortgages, bonds, contracts or other instruments pertaining to the business of the corporation, except in cases in which the authority to sign and deliver is required by law to be exercised by another person or is expressly delegated by these Bylaws or the Board to some other officer or agent of the corporation; (e) may maintain records of and certify proceedings of the Board and shareholders; and (f) shall perform such other duties as may from time to time be assigned to him by the Board.

Section 4.03. Chief Operating Officer. The chief operating officer (if one is elected by the Board) shall be either the President or a Vice President. He shall be responsible for the management of all of the operations of the corporation's business and shall have such other authority and duties as the Board of Directors or the chief executive officer from time to time may prescribe. He shall report to the chief executive officer and be responsible to him. He may also execute and deliver in the name of the corporation any instruments or documents pertaining to the business of the corporation which could be executed by the chief executive officer.

Section 4.04. Chief Financial Officer. Unless provided otherwise by a resolution adopted by the Board of Directors, the chief financial officer (a) shall keep accurate financial records for the corporation; (b) shall deposit all monies, drafts and checks in the name of and to the credit of the corporation in such banks and depositories as the Board of Directors shall designate from time to time; (c) shall endorse for deposit all notes, checks and drafts received by the corporation as ordered by the Board, making proper vouchers therefor; (d) shall disburse corporate funds and issue checks and drafts in the name of the corporation, as ordered by the Board; (e) shall render to the chief executive officer and the Board of Directors, whenever requested, an account of all of his transactions as chief financial officer and of the financial condition of the corporation; and (f) shall perform such other duties as may be prescribed by the

Board of Directors or the chief executive officer from time to time.

Section 4.05. Chairman of the Board. The Chairman of the Board, if one is elected, shall preside at all meetings of the directors and shall have such other duties as may be prescribed, from time to time, by the Board of Directors.

Section 4.06. President. Unless otherwise determined by the Board, the President shall be the chief executive officer of the corporation and shall supervise and control the business affairs of the corporation. If an officer other than the President is designated chief executive officer, the President shall perform such duties as may from time to time be assigned to him by the Board.

Section 4.07. Vice President. The Board of Directors may designate one or more Vice Presidents, who shall have such designations and powers and shall perform such duties as prescribed by the Board of Directors or by the President. In the event of the absence or disability of the President, Vice Presidents shall succeed to his power and duties in the order designated by the Board of Directors.

Section 4.08. Secretary. The Secretary shall be secretary of and shall attend all meetings of the shareholders and Board of Directors and shall record all proceedings of such meetings in the minute book of the corporation. Except as otherwise required or permitted by statute or by these Bylaws, the Secretary shall give notice of meetings of shareholders and directors. The Secretary shall perform such other duties as may, from time to time, be prescribed by the Board of Directors or by the chief executive officer.

Section 4.09. Treasurer. Unless otherwise determined by the Board, the Treasurer shall be the Chief Financial Officer of the Corporation. If an officer other than the Treasurer is designated Chief Financial Officer, the Treasurer shall perform such duties as may from time to time be assigned to him by the Board.

Section 4.10. Authority and Duties. In addition to the foregoing authority and duties, all officers of the corporation shall respectively have such authority and perform such duties in the management of the business of the corporation as may be determined from time to time by the Board of Directors. Unless prohibited by a resolution of the Board of Directors, an officer elected or appointed by the Board may, without specific approval of the Board, delegate some or all of the duties and powers of an office to other persons.

Section 4.11. Removal and Vacancies. Any officer may be removed from his office by the Board of Directors at any time, with or without cause. Such removal, however, shall be without prejudice to the contract rights of the person so removed. If there be a vacancy among the officers of the corporation by reason of death, resignation or otherwise, such vacancy shall be filled for the unexpired term by the Board of Directors.

Section 4.12. Compensation. The officers of this corporation shall receive such compensation for their services as may be determined by or in accordance with resolutions of the Board of Directors.

ARTICLE V. SHARES AND THEIR TRANSFER

Section 5.01. Certificates for Shares. All shares of the corporation shall be certificated shares. Every owner of shares of the corporation shall be entitled to a certificate, to be in such form as shall be prescribed by the Board of Directors, certifying the number of shares of the corporation owned by such shareholder. The certificates for such shares shall be numbered in the order in which they shall be issued and shall be signed, in the name of the corporation, by the President or any Vice President and by the Secretary or an Assistant Secretary or by such officers as the Board of Directors may designate. If the certificate is signed by a transfer agent or registrar, such signatures of the corporate officers may be facsimiles, engraved or printed. Every certificate surrendered to the corporation for exchange or transfer shall be canceled, and no new certificate or certificates shall be issued in exchange for any existing certificate until such existing certificate shall have been so canceled, except in cases provided for in Section 5.03.

Section 5.02. Transfer of Shares. Transfer of shares on the books of the corporation may be authorized only by the shareholder named in the certificate, or the shareholder's legal representative, or the shareholder's duly authorized attorney-in-fact, and upon surrender of the certificate or the certificates for such shares. The corporation may treat as the absolute owner of shares of the corporation, the person or persons in whose name shares are registered on the books of the corporation. The Board of Directors may appoint one or more transfer agents and registrars to maintain the share records of the corporation and to effect share transfers on its behalf.

Section 5.03. Loss of Certificates. Any shareholder claiming a certificate for shares to be lost, stolen or destroyed shall make an affidavit of that fact in such form as the Board of Directors shall require and shall, if the Board of Directors so requires, give the corporation a bond of indemnity in form, in an amount, and with one or more sureties satisfactory to the Board of Directors, to indemnify the corporation against any claim which may be made against it on account of the reissue of such certificate, whereupon a new certificate may be

issued in the same tenor and for the same number of shares as the one alleged to have been lost, stolen or destroyed.

ARTICLE VI.
DIVIDENDS, RECORD DATE

Section 6.01. Dividends. The Board of Directors shall have the authority to declare dividends and other distributions upon shares to the extent permitted by law.

Section 6.02. Record Date. The Board of Directors may fix a date not exceeding 60 days preceding the date fixed for the payment of any dividend as the record date for the determination of the shareholders entitled to receive payment of the dividend and, in such case, only shareholders of record on the date so fixed shall be entitled to receive payment of such dividend.

ARTICLE VII.
SECURITIES OF OTHER CORPORATIONS.

Section 7.01. Voting Securities Held by the Corporation. The chief executive officer shall have full power and authority on behalf of the corporation (a) to attend any meeting of security holders of other corporations in which the corporation may hold securities and to vote such securities on behalf of this corporation; (b) to execute any proxy for such meeting on behalf of the corporation; or (c) to execute a written action in lieu of a meeting of such other corporation on behalf of this corporation. At such meeting, the chief executive officer shall possess and may exercise any and all rights and powers incident to the ownership of such securities that the corporation possesses. The Board of Directors or the chief executive officer may, from time to time, confer or delegate such powers to one or more other persons.

Section 7.02. Purchase and Sale of Securities. The chief executive officer shall have full power and authority on behalf of the corporation to purchase, sell, transfer or encumber any and all securities of any other corporation owned by the corporation, and may execute and deliver such documents as may be necessary to effectuate such purchase, sale, transfer or encumbrance. The Board of Directors or the chief executive officer may, from time to time, confer or delegate such powers to one or more other persons.

ARTICLE VIII.
INDEMNIFICATION OF CERTAIN PERSONS

Section 8.01. The corporation shall indemnify officers and directors, for such expenses and liabilities, in such manner, under such circumstances, and to such extent as permitted by Minnesota Statutes Section 302A.521, as now enacted or hereafter amended.

ARTICLE IX.
AMENDMENTS

Section 9.01. These Bylaws may be amended or altered by the Board of Directors at any meeting if notice of such proposed amendment shall have been given in the notice of such meeting. Such authority in the Board of Directors is subject to (a) the limitations imposed by Minnesota Statutes Section 302A.181, as now enacted or hereafter amended, or other applicable law and (b) the power of the shareholders to change or repeal such Bylaws by a majority vote of the shareholders present or represented at any meeting of shareholders called for such purpose.

STOCK OPTION AGREEMENT
(NON-ISO)

THIS AGREEMENT, made this 23rd day of February, 2001, by and between Graco Inc., a Minnesota corporation (the "Company") and George Aristides (the "Employee").

WITNESSETH THAT:

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

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

1. Grant of Option

The Company hereby grants to Employee the right and option (hereinafter called the "option") to purchase all or any part of an aggregate of 40,000 shares of Common Stock of the Company, par value \$1.00 per share, at the price of \$26.35 per share on the terms and conditions set forth herein.

2. Duration and Exercisability

- A. This option may not be exercised by Employee until the expiration of one (1) year from the date of grant (except as provided in Section 2B(ii) below). On the first anniversary of the date of grant, 25% of the option shall become exercisable. This option shall in all events terminate ten (10) years after the date of grant.
- B. If (i) on May 6, 2002, Employee is a member of the Board of Directors, (ii) Employee resigns from the Board of Directors prior to May 6, 2002, pursuant to a request of the Board of Directors by resolution that the Employee resign from the Board of Directors, or (iii) Employee dies while a member of the Board of Directors, the option shall become fully exercisable if it has not already become fully exercisable under Section 3C hereof, and shall remain exercisable for a period equal to the duration of the option (i.e., 10 years from the date of grant) notwithstanding anything to the contrary in Section 3B or 3C hereof.
- C. In the event that Employee does not purchase in any one year the full number of shares of Common Stock of the Company to which he is entitled under this option, he may, subject to the terms and conditions of Section 3 hereof, purchase such shares of Common Stock in any subsequent year during the term of this option. During the lifetime of the Employee, the option shall be exercisable only by him and shall not be assignable or transferable by him otherwise than by will or the laws of descent and distribution.

3. Effect of Termination of Employment or Board Membership

- A. In the event that Employee shall cease to be employed by the Company or its subsidiaries, or ceases to be a member of the Board of Directors, by reason of his gross and willful misconduct, including but not limited to wrongful appropriation of Company funds or the commission of a felony, the option shall be terminated as of the date of the misconduct.
- B. If the Employee shall die while in the employ of the Company and shall not have fully exercised the option, all remaining shares shall become immediately exercisable and such option may be exercised at any time within twelve months after his death by the executors or administrators of the Employee or by any person or persons to whom the option is transferred by will or the applicable laws of descent and distribution, and subject to the condition that no option shall be exercisable after the expiration of the term of the option.
- C. If the Employee's termination of employment is due to retirement or due to disability within the meaning of the provisions of the Graco Long-Term Disability Plan, subject to the condition that no option shall be exercisable after the expiration of the terms of the option, all remaining shares shall become immediately exercisable and the option may be exercised by the Employee at any time within three years of the Employee's retirement, subject to the condition that no option shall be exercisable after the expiration of the term of the option. In the event of the death

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

- D. In the event of the death of the Employee prior to the option becoming fully exercisable pursuant to Section 2B above, if the Employee at the time of his death is a member of the Board of Directors, the periods for exercisability of the option in the event of death in Sections 3B and 3C shall be the term of the option - i.e., 10 years from the date of grant.

4. Manner of Exercise

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

5. Payment of Withholding Taxes

Upon exercise of any portion of this option, Employee shall pay to the Company an amount sufficient to satisfy any federal, state, or local withholding tax requirements which arise as a result of the exercise of the option or provide the Company with satisfactory indemnification for such payment. If the Committee, as defined in the Company's Long Term Stock Incentive Plan, has in its discretion determined that the Employee may do so, such amount may be paid by the Employee by delivering to the Company for cancellation shares of Common Stock of the Company with a fair market value equal to the minimum amount of such withholding tax requirement by (i) electing to have the Company withhold common shares otherwise to be delivered with a fair market value equal to the amount of such tax obligation, or (ii) electing to surrender to the Company previously owned common shares with a fair market value equal to the amount of such minimum tax obligation.

6. Change of Control

- A. Notwithstanding Section 2 hereof, the entire option shall become immediately and fully exercisable on the day following a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:
- (1) acquisition by any individual, entity, or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the beneficial ownership by such Person of 25% or more of either

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

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

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

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

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

governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation) excluding, however, such a Business combination pursuant to which

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

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

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

- (1) the acquisition of the 25% or greater interest referred to in subparagraph A.(1) of this Section 6 is by a group, acting in concert, that includes the Employee or
- (2) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding Company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subsections (4) or (5) of this section by a group, acting in concert, that includes that Employee.

7. Adjustments

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

8. Miscellaneous

- A. This option is issued pursuant to the Company's Long-Term Stock Incentive Plan and is subject to its terms. A copy of the Plan has been given to the Employee. The terms of the Plan are also available for inspection during business hours at the principal offices of the Company.
- B. This Agreement shall not confer on Employee any right with respect to continuance of employment by the Company or any of its subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time. Employee shall have none of the rights of a shareholder with respect to shares subject to this option until such shares shall have been

issued to him/her upon exercise of this option.

- C. The Company shall at all times during the term of the option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.

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

GRACO INC.

By:

/S/GEORGE ARISTIDES

Employee

STOCK OPTION AGREEMENT
(NON-ISO)

THIS AGREEMENT, made this 23rd day of February, 2001, by and between Graco Inc., a Minnesota corporation (the "Company") and George Aristides ("Mr. Aristides").

WITNESSETH THAT:

WHEREAS, the Company pursuant to its Long-Term Stock Incentive Plan wishes to grant this stock option to Mr. Aristides;

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

1. Grant of Option

The Company hereby grants to Mr. Aristides the right and option (hereinafter called the "option") to purchase all or any part of an aggregate of 60,000 shares of Common Stock of the Company, par value \$1.00 per share, at the price of \$26.35 per share on the terms and conditions set forth herein.

2. Duration and Exercisability

A. This option shall become exercisable in full (i) on May 6, 2002, if Mr. Aristides remains a member of the Board of Directors until that date, or (ii) upon the date of the resignation of Mr. Aristides from the Board of Directors prior to May 6, 2002, but only if the Board of Directors has requested by resolution that Mr. Aristides resign from the Board of Directors. If the option becomes fully exercisable pursuant to this Section 2A, it shall remain exercisable for a period equal to the duration of the option (i.e., 10 years from the date of grant).

B. In the event that Mr. Aristides does not purchase in any one year the full number of shares of Common Stock of the Company to which he is entitled under this option, he may, subject to the terms and conditions of Section 3 hereof, purchase such shares of Common Stock in any subsequent year during the term of this option. During the lifetime of Mr. Aristides, the option shall be exercisable only by him and shall not be assignable or transferable by him otherwise than by will or the laws of descent and distribution.

3. Effect of Termination of Board Membership

A. In the event that Mr. Aristides shall cease to be a member of the Board of Directors, by reason of his gross and willful misconduct, including but not limited to wrongful appropriation of Company funds or the commission of a felony, the option shall be terminated as of the date of the misconduct.

B. If Mr. Aristides shall die while a member of the Board of Directors of the Company and the option granted hereunder shall not have become fully exercisable, such option shall become fully exercisable and may be exercised at any time within the term of this option by the executors or administrators of Mr. Aristides or by any person or persons to whom the option is transferred by will or the applicable laws of descent and distribution.

4. Manner of Exercise

A. The option can be exercised only by Mr. Aristides or other proper party within the option period delivering written notice to the Company at its principal office in Minneapolis, Minnesota, stating the number of shares as to which the option is being exercised and, except as provided in Section 4. C., accompanied by payment-in-full of the option price for all shares designated in the notice.

B. Mr. Aristides may, at Mr. Aristides' election, pay the option price either by check (bank check, certified check, or personal check) or by delivering to the Company for cancellation shares of Common Stock of the Company which have been held by Mr. Aristides for not less than six (6) months with a fair market value equal to the option price. For these purposes, the fair market value of the Company's Common Stock shall be the closing price of the Common Stock on the date of exercise on the New York Stock Exchange (the "NYSE") or on the principal national securities exchange on which such shares are traded if the shares are not then traded on the NYSE. If there is not a quotation available

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

- C. Mr. Aristides may, with the consent of the Company, pay the option price by arranging for the immediate sale of some or all of the shares issued upon exercise of the option by a securities dealer and the payment to the Company by the securities dealer of the option exercise price.

5. Payment of Withholding Taxes

Upon exercise of any portion of this option, Mr. Aristides 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. If the Committee, as defined in the Company's Long Term Stock Incentive Plan, has in its discretion determined that Mr. Aristides may do so, such amount may be paid by Mr. Aristides by delivering to the Company for cancellation shares of Common Stock of the Company with a fair market value equal to the minimum amount of such withholding tax requirement by (i) electing to have the Company withhold common shares otherwise to be delivered with a fair market value equal to the amount of such tax obligation, or (ii) electing to surrender to the Company previously owned common shares with a fair market value equal to the amount of such minimum tax obligation.

6. Change of Control

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

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

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

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

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

- (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or
- (3) The commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; or
- (4) The approval by the shareholders of the Company of a reorganization, merger, consolidation, or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation) excluding, however, such a Business combination pursuant to which
 - (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,
 - (b) no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and
 - (c) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial Agreement, or of the action of the Board, providing for such Business Combination; or

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

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

- (1) the acquisition of the 25% or greater interest referred to in subparagraph A.(1) of this Section 6 is by a group, acting in concert, that includes Mr. Aristides or
- (2) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding Company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subsections (4) or (5) of this section by a group, acting in concert, that includes Mr. Aristides.

7. Adjustments

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

8. Miscellaneous

- A. This option is issued pursuant to the Company's Long-Term Stock Incentive Plan and is subject to its terms. A copy of the Plan has been given to Mr. Aristides. The terms of the Plan are also available for inspection during business hours at the principal offices of the Company.
- B. This Agreement shall not confer on Mr. Aristides 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. Mr. Aristides shall have none of the rights of a shareholder with respect to shares subject to this option until such shares shall have been issued to him/her upon exercise of this option.
- C. The Company shall at all times during the term of the option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.

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

GRACO INC.

By:

/s/GEORGE ARISTIDES

George Aristides

STOCK OPTION AGREEMENT
(NON-ISO)

THIS AGREEMENT, made this 23rd day of February, 2001, by and between Graco Inc., a Minnesota corporation (the "Company") and _____
(the "Employee").

WITNESSETH THAT:

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

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

1. Grant of Option

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

2. Duration and Exercisability

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

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

In the event that Employee does not purchase in any one year the full number of shares of Common Stock of the Company to which he/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.

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

3. Effect of Termination of Employment

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

B. In the event that Employee shall cease to be employed by the Company or its subsidiaries by reason of his/her gross and willful misconduct during the course of his/her employment, including but not limited to wrongful appropriation of Company funds or the commission of a felony, the option shall be terminated as of the date of the misconduct.

C. If the Employee shall die while in the employ of the Company or a subsidiary or within one month after termination of employment for any reason other than gross and willful misconduct and shall not have fully exercised the option, all remaining shares shall become immediately exercisable and such option may be exercised at any time within twelve months after his/her death by the executors or administrators of the Employee or by any person or persons to whom the option is transferred by will or the

applicable laws of descent and distribution, and subject to the condition that no option shall be exercisable after the expiration of the term of the option.

- D. If the Employee's termination of employment is due to retirement (either after attaining age 55 with 10 years of service, or attaining age 65), or due to disability within the meaning of the provisions of the Graco Long-Term Disability Plan subject to the conditions that no option shall be exercisable after the expiration of the terms of the option, all remaining shares shall become immediately exercisable and the option may be exercised by the Employee at any time within three years of the Employee's retirement, subject to the condition that no option shall be exercisable after the expiration of the term of the option. In the event of the death of the Employee within the three-year period after retirement, the option may be exercised at any time within twelve months after his/her death by the executors or administrators of the Employee or by any person or persons to whom the option is transferred by will or the applicable laws of descent and distribution, to the extent of the full number of shares he/she was entitled to purchase under the option on the date of death, and subject to the condition that no option shall be exercisable after the expiration of the term of the option.
- E. Notwithstanding anything to the contrary contained in this Section 3, if the Employee chooses to terminate his/her employment by retirement (as defined in Section 3. D. above) and has not given the Company written notice, by correspondence to his/her immediate supervisor and the Chief Executive Officer, of said 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 said termination of employment shall be deemed to be not a retirement but a termination subject to the provisions of Section 3. A. above, provided, however, that in the event that the Chief Executive Officer, in his/her sole discretion and judgement, determines that termination of employment by retirement of the Employee without six (6) months prior written notice is in the best interests of the Company, then such retirement shall be subject to Section 3. D. above.

4. Manner of Exercise

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

5. Payment of Withholding Taxes

Upon exercise of any portion of this option, Employee shall pay to the Company an amount sufficient to satisfy any federal, state, or local withholding tax requirements which arise as a result of the exercise of the option or provide the Company with satisfactory indemnification for such payment. If the Committee, as defined in the Company's Long Term Stock Incentive Plan, has in its discretion determined that the Employee may do so, such amount may be paid by the Employee by delivering to the Company for cancellation shares of Common Stock of

the Company with a fair market value equal to the minimum amount of such withholding tax requirement by (i) electing to have the Company withhold common shares otherwise to be delivered with a fair market value equal to the amount of such tax obligation, or (ii) electing to surrender to the Company previously owned common shares with a fair market value equal to the amount of such minimum tax obligation.

6. Change of Control

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

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

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

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

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

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

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

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

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

(3) The commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; or

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

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

(b) no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and

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

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

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

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

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

7. Adjustments -----

If there shall be any change in the number or character of the Common

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

8. Miscellaneous

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- A. This option is issued pursuant to the Company's Long-Term Stock Incentive Plan and is subject to its terms. A copy of the Plan has been given to the Employee. The terms of the Plan are also available for inspection during business hours at the principal offices of the Company.
 - B. This Agreement shall not confer on Employee any right with respect to continuance of employment by the Company or any of its subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time. Employee shall have none of the rights of a shareholder with respect to shares subject to this option until such shares shall have been issued to him/her upon exercise of this option.
 - C. The Company shall at all times during the term of the option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.

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

GRACO INC.

By Its Chief Executive Officer

Employee

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Graco Inc. (the "Company") wishes to take advantage of the "safe harbor" provisions regarding forward-looking statements of the Private Securities Litigation Reform Act of 1995 and is filing this Cautionary Statement in order to do so.

From time to time various forms filed by the Company with the Securities and Exchange Commission, including the Company's Form 10-K, Form 10-Q and Form 8-K, its Annual Report to Shareholders, and other written documents or oral statements released by the Company, may contain forward-looking statements. Forward-looking statements generally use words such as "expect," "foresee," "anticipate," "believe," "project," "should," "estimate," "will", and similar expressions, and reflect the Company's expectations concerning the future. Such statements are based upon currently available information, but various risks and uncertainties may cause the Company's actual results to differ materially from those expressed in these statements. Among the factors which management believes could affect the Company's operating results are the following:

- o With respect to the Company's business as a whole, the Company's prospects and operating results may be affected by:
 - changing economic conditions in the United States and other major world economies, including economic downturns or recessions, capital goods investment activity, interest rates and foreign currency exchange rate fluctuations;
 - international trade factors, including changes in international trade policy, such as export controls, trade sanctions, increased tariff barriers and other restrictions; weaker protection of the Company's proprietary technology in certain foreign countries, the burden of complying with foreign laws and standards; and potentially burdensome taxes;
 - the ability of the Company to develop new products and technologies; maintain and enhance its market position relative to its competitors; maintain and enhance its distribution channels; identify and enter into new markets; successfully conclude and integrate acquisitions; realize productivity and product quality improvements; and continue to control expenses.
 - disruption in operations, transportation, communication, sources of supply, customer operations or payment, caused by political or economic instability, acts of God, labor disputes, war, embargo, fire or other cause beyond its reasonable control.
 - changes in the markets in which the Company participates, including consolidation of competitors and major customers, and price competition
- o The prospects and operating results of the Company's Contractor Equipment Division may be affected by: variations in the level of residential, commercial and institutional building and remodeling activity; the availability and cost of financing; changes in the environmental regulation of coatings; consolidation in the paint equipment manufacturing industry; changes in the business practices (including inventory management) of the major distributors of contractor equipment; changes in construction materials and techniques; the cost of labor in foreign markets; the regional market strength of certain competitors; the level of government spending on infrastructure development and road construction, maintenance and repair; and the nature and extent of highway safety regulation.
- o The prospects and operating results of the Company's Industrial/Automotive Equipment Division may be affected by: the capital equipment spending levels of industrial customers; the availability and cost of customer financing; changes in the environmental regulation of coatings; changes in the technical characteristics of materials; changes in application technology; the ability of the Company to meet changing customer requirements; consolidation in the fluid handling equipment manufacturing industry; the equipment purchase plans of major automobile manufacturers worldwide (which are in turn impacted by the level of automotive sales worldwide); changes in automotive manufacturing processes; the pricing strategies of competitors; consolidation in the automobile manufacturing industry worldwide; and the success of the Company in moving its automotive customers from custom-designed systems to the purchase of the Company's package modules sold through integrators and distributors.
- o The prospects and operating results of the Company's Lubrication Equipment Division may be affected by consolidation in the oil industry; the development of extended life lubricants for vehicles; the reduction in the need for changing vehicle lubricants; consumer trends in "do-it-yourself" vs. "do-it-for-me" oil changes; consolidation of automotive dealerships; trends in spending by state

and local governments, and variations in the equipment spending levels of the major oil companies.