

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended **March 28, 2003**

Commission File Number: 001-9249

GRACO INC.

(Exact name of Registrant as specified in its charter)

Minnesota
(State of incorporation)

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

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

55413
(Zip Code)

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

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

Yes No

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

Yes No

45,660,000 common shares were outstanding as of April 25, 2003.

GRACO INC. AND SUBSIDIARIES

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PART I

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

	<u>Thirteen Weeks Ended</u>	
	<u>March 28, 2003</u>	<u>March 29, 2002</u>
Net Sales	\$119,660	\$107,857
Cost of products sold	<u>56,657</u>	<u>52,694</u>
Gross Profit	63,003	55,163
Product development	4,473	4,161
Selling, marketing and distribution	22,897	19,792
General and administrative	<u>8,512</u>	<u>7,717</u>
Operating Earnings	27,121	23,493
Interest expense	128	150
Other expense (income), net	<u>(101)</u>	<u>(3)</u>
Earnings before Income Taxes	27,094	23,346
Income taxes	<u>8,900</u>	<u>7,800</u>
Net Earnings	<u>\$ 18,194</u>	<u>\$ 15,546</u>
Basic Net Earnings per Common Share	\$.39	\$.33
Diluted Net Earnings per Common Share	\$.38	\$.32
Cash Dividends Declared per Common Share	\$.08	\$.07

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Unaudited)
(In thousands)

	<u>March 28, 2003</u>	<u>Dec. 27, 2002</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 58,169	\$ 103,333
Accounts receivable, less allowances of \$5,200 and \$4,500	93,881	93,617
Inventories	35,943	30,311
Deferred income taxes	13,172	12,022
Other current assets	<u>1,331</u>	<u>1,241</u>
Total current assets	202,496	240,524
Property, Plant and Equipment:		
Cost	221,215	219,427
Accumulated depreciation	<u>(126,984)</u>	<u>(124,474)</u>
	94,231	94,953
Intangible Assets, net	11,449	11,860
Other Assets	<u>7,941</u>	<u>8,513</u>
	<u>\$ 316,117</u>	<u>\$ 355,850</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Notes payable to banks	\$ 8,149	\$ 13,204
Trade accounts payable	12,910	13,031
Salaries, wages and commissions	9,426	14,490
Accrued insurance liabilities	10,668	10,251
Accrued warranty and service liabilities	6,331	6,294
Income taxes payable	13,605	5,583
Dividends payable	3,930	3,922
Other current liabilities	<u>10,208</u>	<u>13,439</u>
Total current liabilities	75,227	80,214
Retirement Benefits and Deferred Compensation	28,627	28,578
Deferred Income Taxes	1,814	1,652
Shareholders' Equity		
Common stock	45,609	47,533
Additional paid-in capital	73,405	71,277
Retained earnings	92,677	128,125
Other, net	<u>(1,242)</u>	<u>(1,529)</u>
Total shareholders' equity	<u>210,449</u>	<u>245,406</u>
	<u>\$ 316,117</u>	<u>\$ 355,850</u>

See notes to consolidated financial statements.

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

	<u>Thirteen Weeks</u>	
	<u>March 28, 2003</u>	<u>March 29, 2002</u>
Cash Flows from Operating Activities		
Net Earnings	\$ 18,194	\$ 15,546
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	4,401	4,592
Deferred income taxes	(966)	(332)
Tax benefit related to stock options exercised	500	2,500
Change in:		
Accounts receivable	388	(6,015)
Inventories	(5,561)	(1,319)
Trade accounts payable	(142)	(19)
Salaries, wages and commissions	(5,142)	(3,029)
Retirement benefits and deferred compensation	640	(9)
Other accrued liabilities	5,124	403
Other	30	40
	<u>17,466</u>	<u>12,358</u>
Cash Flows from Investing Activities		
Property, plant and equipment additions	(3,276)	(1,639)
Proceeds from sale of property, plant and equipment	76	13
	<u>(3,200)</u>	<u>(1,626)</u>
Cash Flows from Financing Activities		
Borrowings on notes payable and lines of credit	5,826	8,512
Payments on notes payable and lines of credit	(10,977)	(6,632)
Payments on long-term debt	-	(50)
Common stock issued	5,216	9,151
Common stock retired	(55,258)	(686)
Cash dividends paid	(3,922)	(3,424)
	<u>(59,115)</u>	<u>6,871</u>
Effect of exchange rate changes on cash	<u>(315)</u>	<u>92</u>
Net increase (decrease) in cash and cash equivalents	(45,164)	17,695
Cash and cash equivalents		
Beginning of year	<u>103,333</u>	<u>26,531</u>
End of period	<u>\$ 58,169</u>	<u>\$ 44,226</u>

See notes to consolidated financial statements.

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

1. The consolidated balance sheet of Graco Inc. and Subsidiaries (the Company) as of March 28, 2003 and the related statements of earnings and cash flows for the thirteen weeks then ended have been prepared by the Company without being audited.

In the opinion of management, these consolidated statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of Graco Inc. and Subsidiaries as of March 28, 2003, and the results of operations and cash flows for all periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. Therefore, these statements should be read in conjunction with the financial statements and notes thereto included in the Company's 2002 Form 10-K.

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

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

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

	<u>Thirteen Weeks Ended</u>	
	<u>March 28, 2003</u>	<u>March 29, 2002</u>
Net earnings		
As reported	\$ 18,194	\$ 15,546
Stock-based compensation, net of related tax effects	<u>1,037</u>	<u>1,058</u>
Pro forma	<u>\$ 17,157</u>	<u>\$ 14,488</u>
Net earnings per common share		
Basic as reported	\$.39	\$.33
Basic pro forma	.36	.31
Diluted as reported	.38	.32
Diluted pro forma	.36	.30

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

3. Total comprehensive income for the quarter was \$18.4 million in 2003 and \$15.6 million in 2002. There have been no significant changes to the components of comprehensive income from those noted on the 2002 Form 10-K.
4. The Company has three reportable segments; Industrial/Automotive, Contractor and Lubrication. The Company does not identify assets by segment. Sales and operating earnings by segment for the thirteen weeks ended March 28, 2003 and March 29, 2002 were as follows (in thousands):

	<u>Thirteen Weeks Ended</u>	
	<u>March 28, 2003</u>	<u>March 29, 2002</u>
Net Sales		
Industrial/Automotive	\$ 52,417	\$ 46,103
Contractor	54,838	51,135
Lubrication	<u>12,405</u>	<u>10,619</u>
Consolidated	<u>\$119,660</u>	<u>\$107,857</u>
Operating Earnings		
Industrial/Automotive	\$ 13,988	\$ 11,737
Contractor	10,757	10,865
Lubrication	3,147	2,392
Unallocated corporate expenses	<u>(771)</u>	<u>(1,501)</u>
Consolidated	<u>\$ 27,121</u>	<u>\$ 23,493</u>

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

	<u>March 28, 2003</u>	<u>Dec. 27, 2002</u>
Finished products and components	\$ 31,766	\$ 26,199
Products and components in various stages of completion	17,327	17,219
Raw materials and purchased components	<u>17,788</u>	<u>18,021</u>
	66,881	61,439
Reduction to LIFO cost	<u>(30,938)</u>	<u>(31,128)</u>
	<u>\$ 35,943</u>	<u>\$ 30,311</u>

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

6. Components of intangible assets were (in thousands):

	<u>March 28, 2003</u>	<u>Dec. 27, 2002</u>
Goodwill	\$ 7,939	\$ 7,939
Other identifiable intangibles, net of accumulated amortization of \$6,500 and \$6,100	<u>3,510</u>	<u>3,921</u>
	<u>\$ 11,449</u>	<u>\$ 11,860</u>

Amortization of intangibles during the first quarter of 2003 was \$411,000. Estimated annual amortization is as follows: \$1,600,000 in 2003, \$900,000 in 2004, \$400,000 in 2005, \$300,000 in 2006 and \$200,000 in 2007.

7. **Subsequent Event:** On March 31, 2003, the Company purchased certain assets and assumed certain liabilities of Sharpe Manufacturing Company for approximately \$13 million cash. The purchase price will be allocated to assets acquired based on the results of an independent appraisal. Sharpe manufactures spray guns and related parts and accessories for the automotive refinishing market. Sharpe had sales of approximately \$11 million in 2002.

Item 2.

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

Results of Operations

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

	<u>Thirteen Weeks Ended</u>	
	<u>March 28, 2003</u>	<u>March 29, 2002</u>
Net Sales	100.0%	100.0%
Cost of products sold	47.3	48.9
Product development	3.8	3.9
Selling, marketing and distribution	19.1	18.3
General and administrative	<u>7.1</u>	<u>7.1</u>
Operating Earnings	22.7	21.8
Interest expense	0.1	0.2
Other (income) expense, net	<u>(0.1)</u>	<u>0.0</u>
Earnings Before Income Taxes	22.7	21.6
Income taxes	<u>7.5</u>	<u>7.2</u>
Net Earnings	<u>15.2%</u>	<u>14.4%</u>

Net Sales

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

	<u>Thirteen Weeks Ended</u>	
	<u>March 28, 2003</u>	<u>March 29, 2002</u>
By Segment		
Industrial/Automotive	\$ 52,417	\$ 46,103
Contractor	54,838	51,135
Lubrication	<u>12,405</u>	<u>10,619</u>
Consolidated	<u>\$ 119,660</u>	<u>\$ 107,857</u>
By Geographic Area		
Americas	\$ 82,191	\$ 78,578
Europe	23,564	19,802
Asia Pacific	<u>13,905</u>	<u>9,477</u>
Consolidated	<u>\$ 119,660</u>	<u>\$ 107,857</u>

Currency exchange rates had a significant effect on first quarter sales. Sales increased 7 percent in local currencies; 11 percent when translated to U.S. dollars. Most of the translation effect came from Europe, where sales were flat in local currencies but increased by 19 percent when translated to U.S. dollars. In Asia Pacific, sales increased 40 percent in local currencies; 47 percent when translated to U.S. dollars. Most of the translation effect is reflected in the Industrial/Automotive segment, which has more sales in Europe and Asia Pacific than the Contractor and Lubrication segments.

Strong demand for the Company's products resulted in higher sales in Asia Pacific. All regions in Asia Pacific except for Japan had sales gains, with the largest increase in China. The Company's investment in additional sales personnel, marketing programs, and expenditures to obtain new distributors have contributed to increased sales.

Contractor segment sales were higher than last year in all regions. In the Americas, sales were higher in the professional paint store channel and slightly lower in the home center channel. Successful new product launches in the paint store channel more than offset the impact of poor weather conditions and a weak commercial construction market in the United States.

Lubrication segment sales increased by 17% primarily due to successful new product introductions and a February sales promotion.

Gross Profit

Gross profit percentage of sales increased to 52.7 percent from 51.1 percent primarily due to favorable currency translation rates. Changes in exchange rates have less impact on the cost of products sold than on sales because most product costs are incurred in U.S. dollars, which

had the effect of increasing gross profit rate in the first quarter of 2003 when compared to the same period last year.

Operating Expenses

Increases in operating expenses resulted from higher spending levels required to generate profitable sales growth. First quarter expenses are consistent with the level of spending in the fourth quarter of 2002 but are higher than first quarter of 2002, when spending was restricted due to uncertainties following September 11. Much of the increase from first quarter of 2002 is from payroll-related costs (salaries, incentives and benefits) and also includes higher sales meeting, travel and product introduction expenses. Changes in exchange rates used to translate expenses incurred in foreign currencies also had the effect of increasing expenses as reported in U.S. dollars. General and administrative expenses in 2002 included a \$700,000 contribution to the Graco Foundation – no contribution was made in the first quarter of 2003.

Liquidity and Capital Resources

In March 2003, the Company repurchased 2.2 million shares of its common stock for \$54.8 million from David A. Koch, a current Board member, and former Chairman and Chief Executive Officer of the Company, his wife, and a family trust and family foundation. The Company used available cash balances to fund the repurchase.

The Company had unused lines of credit available at March 28, 2003 totaling \$55 million. Cash balances of \$58 million at March 28, 2003, internally generated funds and unused financing sources provide the Company with the financial flexibility to meet liquidity needs, including approximately \$13 million cash used in fiscal April 2003 for the acquisition of Sharpe Manufacturing operations.

Outlook

While management believes that 2003 will be a year of modest underlying growth for the major industrialized countries, the Company is aggressively pursuing its growth strategies to increase its revenues and earnings at a faster rate. New products, distribution initiatives, new market activities and strategic acquisitions should add revenues and earnings for the balance of this year.

SAFE HARBOR CAUTIONARY STATEMENT

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

The Company desires to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 by making cautionary statements concerning any forward-looking statements made by or on behalf of the Company. The Company cannot give any assurance that the results forecasted in any forward-looking statement will actually be achieved. Future results could differ materially from those expressed, due to the impact of changes in various factors. These risk factors include, but are not limited to: economic conditions in the United States and other major world economies, currency fluctuations, political instability, changes in laws and regulations, and changes in product demand. Please refer to Exhibit 99 to the Company's Annual Report on Form 10-K for fiscal year 2002 for a more comprehensive discussion of these and other risk factors.

Item 4.**CONTROLS AND PROCEDURES****Evaluation of disclosure controls and procedures**

Within the 90 days prior to the filing date of this report, the Company carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. This evaluation was done under the supervision and with the participation of the Company's President and Chief Executive Officer, Vice President and Controller, Vice President and Treasurer, and Vice President, General Counsel and Secretary. Based upon that evaluation, they concluded that the Company's disclosure controls and procedures are effective in gathering, analyzing and disclosing information needed to satisfy the Company's disclosure obligations under the Exchange Act.

Changes in internal controls

There were no significant changes in the Company's internal controls or in other factors that could significantly affect those controls since the most recent evaluation of such controls.

PART II

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

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- 10.1 2003 Corporate & SBU Bonus Plan
- 10.2 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to executive officers under the Graco Inc. Stock Incentive Plan with schedule of awards current as of March 28, 2003
- 10.3 Executive Long Term Incentive Agreement. Form of agreement used for award of restricted stock to one executive officer, dated January 6, 2003
- 10.4 Stock Purchase Agreement dated March 13, 2003, between Graco Inc. and David A. Koch, Barbara Koch, Paul M. Torgerson and U.S. Bank Trust National Association SD, as Trustees of the Trust administered pursuant to Article V of the Last Will and Testament and Codicil thereto of Clarissa L. Gray deceased, and Greycoach Foundation (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K dated March 20, 2003)
- 11 Computation of Net Earnings per Common Share
- 99 Certification of President and Chief Executive Officer, Vice President and Controller, and Vice President and Treasurer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

The following Current Report on Form 8-K was filed during the quarter ended March 28, 2003:

On March 20, 2003, Graco Inc. filed a current report on Form 8-K to disclose a stock repurchase.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GRACO INC.

Date: _____

Officer

By: _____

David A. Roberts
President & Chief Executive

Date: _____

By: _____

James A. Graner
Vice President & Controller
Chief Accounting Officer

Date: _____

By: _____

Mark W. Sheahan
Vice President & Treasurer
Principal Financial Officer

CERTIFICATIONS

I, David A. Roberts, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared.
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors:
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: _____

Executive Officer

David A. Roberts
President and Chief

CERTIFICATIONS

I, James A. Graner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared.
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors:
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: _____

James A. Graner
Vice President and Controller

CERTIFICATIONS

I, Mark W. Sheahan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared.
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors:
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors

that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: _____

Mark W. Sheahan
Vice President and Treasurer

2003 CORPORATE & SBU BONUS PLAN

Objectives

- ***To create shareholder value through achievement of annual financial objectives.***
- ***To motivate and retain those key executives and managers who work in positions where they can impact the Company's annual financial objectives.***

Plan Design

The Plan links the size of each individual's award to specific financial objectives. These objectives are tailored for the Corporation and for each Business Unit. These objectives are:

- ***Corporation***
 - ***Corporate Sales and/or Net Earnings objectives***
- ***Business Units***
 - ***Sales and/or Contribution Growth objectives***

Eligibility Requirements

Only those positions which carry clear managerial responsibility for directly contributing to Graco's Corporate Sales and/or Net Earnings objective and Business Unit Sales and/or Contribution Growth objectives are eligible to be included in this Plan.

Only those individuals in eligible positions who have demonstrated and are maintaining a performance level that meets the supervisor's normal expectations for that position are eligible for annual participation in this Plan as well as the receipt of any annual Bonus Payments.

2003 CORPORATE & SBU BONUS PLAN

Participation

The top executive in each organizational unit may nominate managers for participation in this Plan when the established position and individual eligibility requirements have been met.

The Management Organization and Compensation Committee of the Graco Inc. Board of Directors has sole authority to approve the participation of the Chief Executive Officer in the Plan.

The Chief Executive Officer of Graco Inc. has sole authority to select and approve all other Plan participants.

Bonus Maximum

Taken in conjunction with base salary market comparisons, bonus maximum for all positions will be:

- **Commensurate with the position's ability to impact the annual Corporate Sales and/or Net Earnings objective and Business Unit Sales and/or Contribution Growth objectives.**
- **Consistent with total compensation levels prevalent for similar positions in the market place.**

Based on these criteria, bonus maximums ranging from 10% to 90% have been established for each individual.

Bonus Payment

The determination of a participant's annual Bonus Payment will be calculated by adding the bonus results attained for Corporate Sales and/or Net Earnings performance (expressed in percent) to the bonus results attained for any applicable Business Unit's Sales and/or Contribution Growth performance (expressed in percent). These bonus results are then multiplied by the participant's Maximum Bonus Percentage and then multiplied by the participant's Base Salary for the Plan Year, to determine the total Bonus Payment.

Example:

Annual Corporate Performance Results	+	Annual Business Unit Performance Results	x	Participant's Maximum Bonus Salary	x	Participant's Annual Base Salary	=	Bonus
---	----------	---	----------	---	----------	---	----------	--------------

%

(if applicable)
%

\$

\$

\$

2003 CORPORATE & SBU BONUS PLAN

Administration

The following rules have been established to ensure equitable administration of Graco's Annual Bonus Plan (the Plan):

- 1. The Plan will be administered by the Management Organization and Compensation Committee of the Board of Directors. The Committee may cancel the Plan and interpret the Plan.**
- 2. The Management Organization and Compensation Committee shall establish the Annual Corporate Bonus Plan financial objectives. Within the basic framework of the Plan, the Chief Executive Officer may establish the annual bonus plan financial objectives for individual Business Units. The CEO may also establish deadlines for filing administrative forms and adopt other administrative rules.**

The CEO has established the Bonus Administrative Committee consisting of the CEO, the Vice President, Human Resources, and the Compensation Manager. This Committee is responsible for making approval recommendations on all Annual Bonus Program administrative matters, such as participation award payments, performance measures, and performance results. All requests for adjustments or exceptions are to be formally submitted to this Committee for review through the Compensation Manager.

- 3. Key executives and managers selected to participate in the Plan after its annual effective date (January 1st) may be included on a pro-rata basis.**
- 4. Participation in the Plan one year does not necessarily assure participation in subsequent years. Eligibility requirements for both the position and individual performance must be met continually.**
- 5. Participation continues during any paid time off such as short-term disability (up to six months). Participation ceases with retirement, death, or long-term disability (over six months). In the event participation ceases due to retirement, death, or long term disability, the Participant will be eligible for a Bonus Payment, calculated using the Maximum Bonus Percent and Base Salary up to the time of retirement, death, or long-term disability and the annual performance results for the year in which retirement, death, or long-term disability occurs.**
- 6. A participant who transfers to a position (e.g. through job posting or job elimination) that is not eligible for inclusion in the Plan will be eligible for a pro-rata award based on the actual time employed in the eligible position during the year.**

2003 CORPORATE & SBU BONUS PLAN

Administration (continued)

If, due to unique skills possessed by a participant, the company requests that the participant accept a transfer to a non-bonus eligible position, the participant will remain on the Plan. The participant's eligibility will be reviewed annually as noted in Administrative Rule #4.

- 7. A participant must be an employee in good standing on 12/31 of the Plan Year in order to receive a bonus. A participant who resigns or is terminated effective during the Plan Year is ineligible for a bonus.***

Participants must maintain satisfactory performance throughout the Plan year in order to be eligible to receive a bonus award payment.

In addition, a participant whose employment termination has been requested due to job elimination, performance or otherwise for cause will be ineligible for a bonus payment even though the participant is still employed at year-end.

- 8. Targets and actual performance for Corporate and Division measures will be at actual exchange rates. Targets and actual performance for international measures where business is conducted in foreign currency will be at prior year's actual rates.***
- 9. Acquisitions and divestitures not included in the annual business plan for the Plan Year will be excluded from the Corporate Sales and/or Net Earnings calculations.***
- 10. Significant changes in historical FASB accounting practices or income tax rates will be included in corporate earnings calculations at the discretion of the Management Organization and Compensation Committee of the Board of Directors.***
- 11. Payments will be made by March 15th of the year following each successive Corporate and Business Unit performance year.***

These Administrative Rules indicate Graco's intent. Situations may arise which are not specifically covered by these rules and will require the use of judgment and discretion. Final responsibility for interpretation of these Administrative Rules rests solely with the Vice President, Human Resources.

**STOCK OPTION AGREEMENT
(NON-ISO)**

THIS AGREEMENT, made this ___ day of _____, 2_____, by and between Graco Inc., a Minnesota corporation (the "Company") and _____ (the "Employee").

WITNESSETH THAT:

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

NOW THEREFORE, in consideration of the premises and of the mutual covenants 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:

<u>Date</u>	<u>Total Portion of Option Which is Exercisable</u>
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

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

5. Payment of Withholding Taxes

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

6. Change of Control

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

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

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

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

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

- (i) an acquisition directly from the Company,
- (ii) an acquisition by the Company,
- (iii) an acquisition by an employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
- (iv) an acquisition by any Person who is deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of

either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 6, a Trust Person shall not be deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by The Graco Foundation or any employee benefit plan of the Company, including, without limitations, the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,

- (v) an acquisition by the Employee or any group that includes the Employee, or
- (vi) an acquisition by any corporation pursuant to a transaction that complies with clauses (a), (b), and (c) of subsection (4) below; and

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

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

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

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

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

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

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

7. Adjustments

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

8. Miscellaneous

A. This option is issued pursuant to the 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

Stock Incentive Plan
Schedule Identifying Non-ISO Stock Option Agreements Executed and
Material Details in which Executed Agreements Differ from Agreement Copy Filed
Current as of March 28, 2003

DATE	NAME	SHARES	PRICE
June 25, 2001	David A. Roberts*	50,000	\$31.20
February 22, 2002	David M. Lowe	7,500	\$41.38
February 22, 2002	David A. Roberts*	40,000	\$41.38
February 22, 2002	James A. Graner	5,000	\$41.38
February 22, 2002	D. Christian Koch	7,500	\$41.38
February 22, 2002	Robert M. Mattison	5,000	\$41.38
February 22, 2002	Mark W. Sheahan	5,000	\$41.38
February 22, 2002	Steve L. Bauman	5,000	\$41.38
February 22, 2002	Patrick J. McHale	7,500	\$41.38
February 22, 2002	Fred A. Sutter	7,500	\$41.38
February 22, 2002	Charles L. Rescorla	10,000	\$41.38
February 22, 2002	Dale D. Johnson	10,000	\$41.38
February 21, 2003	David M. Lowe	15,000	\$26.01
February 21, 2003	David A. Roberts*	72,000	\$26.01
February 21, 2003	Karen P. Gallivan	10,000	\$26.01
February 21, 2003	James A. Graner	12,000	\$26.01
February 21, 2003	D. Christian Koch	15,000	\$26.01
February 21, 2003	Robert M. Mattison	10,000	\$26.01
February 21, 2003	Mark W. Sheahan	12,000	\$26.01
February 21, 2003	Patrick J. McHale	15,000	\$26.01
February 21, 2003	Fred A. Sutter	15,000	\$26.01
February 21, 2003	Charles L. Rescorla	18,000	\$26.01
February 21, 2003	Dale D. Johnson	18,000	\$26.01

* Option agreement does not contain Section 3.E.

GRACO EXECUTIVE
LONG TERM INCENTIVE AGREEMENT
RESTRICTED STOCK AWARD

This Agreement is made as of the 6th day of January, 2003, between Graco Inc., a Minnesota corporation (the "Company"), and Karen Park Gallivan (the "Employee") pursuant to the Graco Inc. Stock Incentive Plan (the "Plan"). Unless otherwise defined herein, terms used herein shall have the meanings assigned to them under the Plan.

WITNESSETH:

WHEREAS, the Management Organization and Compensation Committee of the Board of Directors (the "Committee"), in order to provide further incentive to the Employee to continue her service to the Company and to more closely align her interests with those of the shareholders, believes that it is appropriate to make an award of restricted Common Shares to the Employee; and

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

NOW THISEFORE, in consideration of the premises and mutual agreements hereinafter set forth, the Employee and the Company hereby agree as follows:

1. Award.

The Company, effective as of the date of this Agreement, hereby grants to the Employee an award (the "Award") of **1200** Common Shares, \$1.00 par value, of the Company ("Common Shares") subject to the restrictions, terms and conditions set forth below and in the Plan.

2. Vesting of Stock.

- (a) The Common Shares awarded by this Agreement shall vest in the Employee as of the third anniversary of the date of this Agreement, except as otherwise provided herein.
- (b) In the event of a "Change of Control", the Award shall immediately vest in full. A "Change of Control" means:

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

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

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

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

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

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

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

- A. all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,
 - B. no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and
 - C. at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or
- (v) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.
- (vi) A Change of Control shall not be deemed to have occurred with respect to The Employee_ if:
- (A) the acquisition of the 25% or greater interest referred to in Section 2(b)(i) is by a group, acting in concert, that includes The Employee; or

- (B) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subsections (v) and (vi) of this Section 2(b) by a group, acting in concert, that includes the Employee.
- (c) Until the Common Shares awarded hereunder vest, the Employee acknowledges that he may not, and agrees that he shall not, transfer her rights to such Common Shares. Until Common Shares awarded hereunder vest, no attempt to transfer such Common Shares, whether voluntary or involuntary, by operation of law or otherwise, shall vest the transferee with any interest or right in or with respect to such Common Shares.

3. Termination.

- (a) If the Employee: (i) is terminated by the Company for any reason other than gross and willful misconduct; (ii) quits or resigns because her compensation or benefits are reduced (other than reductions in benefits resulting from changes in Graco's employee benefit programs affecting officers generally), her responsibilities, duties or position are substantially diminished; (iii) retires in accordance with Section 3(c) below; or (iv) dies or becomes disabled (as determined under the Company's Long Term Disability Plan) before the vesting date under Section 2(a), then upon such event the Common Stock awarded by this Agreement shall vest.
- (b) If the Employee terminates employment with the Company for any other reason, including a termination by the Company for gross and willful misconduct, her rights to any unvested portion of this Award shall be immediately and irrevocably forfeited. For purposes of this Agreement, gross and willful misconduct includes wrongful appropriation of Company funds, serious violation of Company policy, breach of fiduciary duty or conviction of a felony.
- (c) If the Employee chooses to terminate her employment by retirement, which for purposes of this Agreement is defined as a voluntary termination after attaining age 55 with 10 years of service with the Company or after attaining age 65, the Common Stock award granted by this Agreement shall vest only in the event that: (i) the Employee has given written notice to the Chief Executive Officer of said intention to retire not less than six (6) months prior to the date of her proposed retirement; and (ii) the Chief Executive Officer, in her sole discretion and judgement, determines that termination of employment by retirement of the Employee is in the best interests of

the Company. If the Chief Executive Officer does not so determine, the retirement shall be considered a termination subject to Section 3(b) above. If the Chief Executive Officer does so determine, he/she may allow, in her sole judgment and discretion, the termination by retirement to occur prior to the end of the six (6) month notice period.

4. Issuance and Custody of Certificate.

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

The shares of stock represented by this certificate are subject to forfeiture and the transferability of this certificate and the shares of stock represented hereby are subject to the restrictions, terms and conditions (including restrictions against transfer) contained in the Graco Inc. Stock Incentive Plan and an Agreement entered into between the registered owner of such shares and Graco Inc. A copy of the Plan and Agreement is on file in the office of the Secretary of Graco Inc., 88 11th Ave. N.E., Minneapolis, MN. 55413.

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

5. Agreements of The Employee.

The Employee acknowledges and agrees that: (a) this Agreement is not a contract of employment and the terms of the Employee's employment shall not be affected in any way by this Agreement except as specifically provided in the Agreement; (b) the Award made by this Agreement shall not confer any legal rights upon the Employee for continuation of employment or interfere with or limit the right of the Company to terminate the Employee's

employment at any time; (c) the Board may amend, suspend or terminate the Plan or any part thereof at any time provided that no amendment, suspension or termination shall be made or effected which would adversely affect any right of the Employee with respect to the Award made by this Agreement without the written consent of the Employee unless such amendment, termination or suspension is required by applicable law; and (e) the Employee shall not make an election pursuant to Section 83(b) of the Internal Revenue Code of 1986, with respect to the Award.

6. Legal Compliance Restrictions.

The Company shall not be obligated to issue or deliver any certificates evidencing Common Shares awarded by this Agreement unless and until the Company is advised by its counsel that the issuance and delivery of such certificates are in compliance with all applicable laws, regulations of governmental authorities and the requirements of the New York Stock Exchange or any other exchange upon which Common Shares are traded.

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

7. Withholding Taxes.

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

8. Stock Splits, Recapitalizations, Acquisitions, etc.

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

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

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

9. Notices.

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

- (a) if to the Company:

Graco Inc.
P.O. Box 1441
Minneapolis, MN 55440-1441
Attention: Vice President, General Counsel & Secretary

- (b) if to the Committee:

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

(c) if to The Employee:

Karen Park Gallivan
Graco Inc.
P.O. Box 1441
Minneapolis, MN 55440-1441

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

10. Minnesota Law.

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

11. Binding Effect.

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

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

GRACO INC.

EMPLOYEE

By: _____

—
David A. Roberts
President and Chief Executive Officer

Karen Park Gallivan

GRACO INC. AND SUBSIDIARIES

COMPUTATION OF NET EARNINGS PER COMMON SHARE

(Unaudited)

	Thirteen Weeks Ended	
	<u>March 28, 2003</u>	<u>March 29, 2002</u>
	(in thousands except per share amounts)	
Net earnings applicable to common shareholders for basic and diluted earnings per share	\$18,194	\$15,546
Weighted average shares outstanding for basic earnings per share	47,233	46,959
Dilutive effect of stock options computed using the treasury stock method and the average market price	666	921
Weighted average shares outstanding for diluted earnings per share	47,899	47,880
Basic earnings per share	\$0.39	\$0.33
Diluted earnings per share	\$0.38	\$0.32

CERTIFICATION UNDER SECTION 906 OF THE
SARBANES-OXLEY ACT OF 2002

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, each of the undersigned certifies that this periodic report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in this periodic report fairly presents, in all material respects, the financial condition and results of operations of Graco Inc.

A signed original of this written statement required by Section 906 has been provided to Graco Inc. and will be retained by Graco Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

Date: _____

David A. Roberts
President & Chief Executive Officer

Date: _____

James A. Graner
Vice President & Controller
Chief Accounting Officer

Date: _____

Mark W. Sheahan
Vice President & Treasurer
Principal Financial Officer

May 2, 2003

Electronically Filed

Securities and Exchange Commission
Judiciary Plaza
450 Fifth Street NW
Washington, DC 20549

Re: Graco Inc.
First Quarter Report on Form 10-Q
File No. 001-9249
CIK No. 0000042888

Gentlemen/Ladies:

Enclosed for filing is the Graco Inc. Quarterly Report on Form 10-Q for the Quarter ended March 28, 2003.

Sincerely,

Robert M. Mattison
Vice President, General Counsel and Secretary

Enclosure

RMM/blc