

**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 28, 2007**, 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. 001-09249

Graco Inc.

(Exact name of Registrant as specified in its charter)

Minnesota
(State or other jurisdiction of incorporation or organization)

41-0285640
(I.R.S. Employer Identification No.)

**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

Indicate by a check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by a check mark if the registrant is not required to file reports pursuant to Section 13 of Section 15(d) of the Act. Yes No

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 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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one): Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by a check mark whether the registrant is a shell company, as defined by Rule 12b-2 of the Act.
Yes No

The aggregate market value of approximately 65,000,000 shares held by non-affiliates of the registrant was approximately \$2.6 billion on June 29, 2007.

As of February 11, 2008, 61,120,603 shares of Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive Proxy Statement for its Annual Meeting of Shareholders to be held on April 25, 2008, are incorporated by reference into Part III, as specifically set forth in said Part III.

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ON FORM 10-K**

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ACCESS TO REPORTS

Investors may obtain access free of charge to the Graco Inc. annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and other reports by visiting the Graco website at www.graco.com. These reports will be available as soon as reasonably practicable following electronic filing with, or furnishing to, the Securities and Exchange Commission.

PART I

ITEM 1 – BUSINESS

Our Company was originally incorporated in the state of South Dakota in 1926 as Gray Company, Inc. and in the state of Minnesota in 1947. It began business as a Minneapolis, Minnesota-based manufacturer of grease guns and lubricating pumps primarily for servicing vehicles. Our Company changed its name to Graco Inc. and first offered its common stock to the public in 1969. Today we provide fluid handling solutions to organizations involved in manufacturing, processing, construction and maintenance throughout the world.

Graco Inc. and its subsidiaries (which we refer to in this Form 10-K as us, we, our Company or the Company) sell a full line of products in each of the following geographic markets: the Americas (North and South America), Europe (including the Middle East and Africa), and Asia Pacific. Sales in the Americas represent approximately 60 percent of our Company's total sales; sales in Europe approximately 25 percent; and sales in Asia Pacific approximately 15 percent. Part II, Item 7, *Results of Operations* and Note B to the Consolidated Financial Statements of this Form 10-K contain financial information about these geographic areas. Our Company provides marketing, product design and application assistance to, and employs sales personnel in, each of these geographic markets. Subsidiaries located in Belgium, the People's Republic of China ("P.R.C."), Japan, and Korea distribute our Company's products in their local geographies. The majority of our manufacturing occurs in the United States, but limited lines of products are assembled in the P.R.C., the United Kingdom ("U.K.") and Belgium.

For more information about our Company, our products, services and solutions, visit our website at www.graco.com. The information on the website is not part of this report nor any other report filed or furnished to the Securities and Exchange Commission (SEC).

Business Segments

Our Company classifies its business into three reportable segments, each with a world-wide focus: Industrial, Contractor and Lubrication. Financial information concerning these segments is set forth in Part II, Item 7, *Results of Operations* and Note B to the Consolidated Financial Statements of this Form 10-K.

The equipment developed and distributed by our Company's segments is broadly described as fluid handling equipment. It is used to spray, dispense, measure and move a wide variety of fluids and semi-solids in a wide variety of applications in manufacturing, processing, construction and maintenance industries. Our Company's products enable customers to reduce their use of labor, material and energy, improve quality and achieve environmental compliance.

The development of technologically superior, multiple-featured, reliable products is a key strategy of our Company. Our Company strives to generate 30 percent of its annual sales from products introduced in the prior three years. In 2007, we generated 21 percent of our sales from new products. In 2006 and 2005, the percentage of sales represented by new products was 21 and 29 percent, respectively. Major product development efforts are carried out in facilities located in Minneapolis and Rogers, Minnesota, North Canton, Ohio and on Lubrication equipment in Suzhou, P.R.C. The product development and engineering group in each segment focuses on new product design, product improvements, applied engineering and strategic technologies for its specific customer base. Total product development expenditures for all segments were \$30 million, \$30 million and \$27 million in 2007, 2006 and 2005 respectively.

Manufacturing is a key competency of Graco. Our Company invests significant resources in maximizing the quality, responsiveness and cost-effectiveness of our production operations by purchasing state-of-the-art equipment and doing most machining, assembly and testing in-house. Principal products are manufactured in vertically integrated focused factories and product cells. Raw materials and purchased components are sourced from suppliers around the world. The segments manage operations devoted to the manufacture of their product lines. Oversight and direction of manufacturing strategy is provided by our vice president of manufacturing and distribution operations. He also manages those factories not fully aligned with a single segment, the warehouses, customer service, and other shared corporate manufacturing functions.

Other primary objectives of our Company include the expansion of distribution, the penetration of new markets and the completion of acquisitions. These subjects are discussed below in the context of each segment's business operations.

Our Company's headquarters are located in a 142,000 sq. ft. facility in Minneapolis, Minnesota. In 2007, the visitors' entrance area was renovated and general office space was added. The facility is also occupied by the management, marketing and product development personnel for the Industrial segment. Information systems, accounting services and purchasing for our Company are housed in a 42,000 sq. ft. office building nearby.

A large percentage of our Company's facilities are devoted to manufacturing and distribution of the various products offered for sale by the business segments.

Products marketed by the Industrial segment are manufactured in owned facilities in Minneapolis, Minnesota (405,000 sq. ft. manufacturing/warehouse/office), Sioux Falls, South Dakota (149,000 sq. ft. manufacturing/office), and North Canton, Ohio (132,000 sq. ft. manufacturing/office), and leased facilities in Mississauga, Ontario (11,760 sq. ft. assembly/office) and Vilanova, Spain (29,000 sq. ft. manufacturing/warehouse/office). Limited lines of products are assembled in owned facilities in Suzhou, P.R.C. (79,000 sq. ft. assembly/warehouse/office), Wellingborough, U.K. (12,500 sq. ft. manufacturing/office) and Maasmechelen, Belgium (75,000 sq. ft. assembly/warehouse/office). During the first half of 2007, our Company ceased manufacturing in Vilanova, Spain. Products formerly manufactured there are now manufactured in Minneapolis. The lease on the Vilanova facility will terminate at the end of February 2008 and operations will move to a new facility (7,280 sq. ft. office/warehouse). The new facility will continue to warehouse and distribute products to Spanish customers. At the end of 2007, we announced that the mobile spray rig manufacturing and customer service functions would move from Mississauga, Ontario to North Canton, Ohio. The move was completed in January 2008. The lease for the Mississauga facility will expire at the end of June 2008. The lease for the Lakewood, New Jersey, facilities where Gusmer and Decker foam and polyurethane equipment was formerly manufactured terminated in April 2007. A 50,000 sq. ft. addition to the facility in North Canton was completed in March 2007. Some Industrial segment products are assembled for the European market in an owned facility located in Maasmechelen, Belgium, the site of our Company's European headquarters (75,000 sq. ft. assembly/warehouse/office). A 50,000 sq. ft. warehouse addition to the Maasmechelen facility is expected to be completed in July 2008.

Products marketed by the Contractor segment are manufactured in owned facilities in Rogers, Minnesota (333,000 sq. ft. manufacturing/warehouse/office). Segment management, marketing, engineering, customer service, warehouse, shipping, sales and training are also located at the Rogers facility. The Sioux Falls, South Dakota, plant also manufactures spray guns and accessories for the Contractor segment.

During 2007, the Lubrication segment moved its manufacturing operations in Madison, Wisconsin, Cleveland, Ohio and Minneapolis, Minnesota and its segment management, marketing, engineering, customer service, warehouse, shipping, sales and training functions to an owned facility in Anoka, Minnesota (207,000 sq. ft. manufacturing/office). The lease for the facility in Madison terminated at the end of January 2008 and the sale of the owned facility in Cleveland is pending. A limited line of Lubrication products are being assembled in our owned facility in Suzhou, P.R.C. The output of the Suzhou plant is shipped to Minneapolis, Minnesota, for subsequent worldwide distribution. The plant is expected to produce products designed specifically for the Asia Pacific market sometime in the future.

Industrial Segment

The Industrial segment is the largest part of our Company's businesses and represents approximately 53 percent of our total sales. This segment includes the Industrial Products and the Applied Fluid Technologies divisions. These divisions were created in 2005. While both divisions market their equipment and services to customers who manufacture, assemble, repair and refinish products such as appliances, vehicles, airplanes, electronics, cabinets and furniture and other articles, the divisions focus on different fluids and application methods in these industries.

Most Industrial segment equipment is sold worldwide through general and specialized distributors, integrators and original equipment manufacturers. Distributors promote and sell the equipment, provide product application expertise and offer on-site service, technical support and integration capabilities. Integrators implement large individual installations in manufacturing plants where products and services from a number of different vendors are aggregated into a single system. Original equipment manufacturers incorporate our Company's Industrial segment products into the systems and assemblies that they supply to customers. In-plant polyurethane and Liquid Control™ equipment is sold through distribution and directly to manufacturers.

Industrial Products

The Industrial Products division focuses its development and sales efforts on three main product families: equipment to apply paint and other coatings to products such as motor vehicles, appliances, furniture and other industrial and consumer products; equipment to move and dispense chemicals and liquid and semi-solid foods; and equipment to refinish and repair automobiles.

Finishing equipment for applying paints, varnishes and other coatings includes paint circulating and paint supply pumps, plural component coating proportioners, various accessories to filter, transport, agitate and regulate the fluid, spare parts such as spray tips, seals and filter screens, and a variety of applicators that use different methods of atomizing and spraying the paint or other coating depending on the viscosity of the fluid, the type of finish desired, and the need to maximize transfer efficiency, minimize overspray and prevent the release of volatile organic compounds (VOCs) into the air.

We offer double diaphragm and piston transfer pumps to the chemical, petroleum, general manufacturing and food processing industries, pumps for sanitary applications including FDA-compliant 3-A sanitary pumps for use in dairies, diaphragm pumps, transfer pumps and drum and bin unloaders. Our sanitary pumps are used in pharmaceutical, cosmetic, beverage and food processing applications. Sharpe® spray guns are used in the refinishing of automobiles.

Applied Fluid Technologies

The Applied Fluid Technologies division directs its engineering, sales and marketing efforts toward three broad product families: equipment to apply high performance coatings and foam (protective coatings); equipment to apply sealants and adhesives; and equipment to create reaction injection molded polyurethane parts.

Our Company offers a full line of plural component proportioning equipment to apply foam and protective coatings to a wide variety of surfaces. The Reactor® line of plural component pumps is used to apply foam to insulate walls and roofs as well as apply polyurea to coat tanks, pipes, roofs, truck beds and foundations where accurate temperatures and pressures are required to achieve optimal results. The XtremeMix™ plural component sprayers provide on-demand mixing, ratio assurance and job site portability to spray high solid epoxies, urethanes and protective coatings with a short pot life. These pumps are incorporated into systems with our Company's heated hose, diaphragm supply pumps and Fusion® spray guns with accurate mix capability. The Reactor systems are also available installed in trailer rigs for mobility and flexibility at remote job sites.

Our Company offers pumps, applicators and accessories, to supply and precisely dispense sealants and adhesives in automotive assembly, furniture assembly, insulated glass and window manufacturing, bookbinding and other industrial assembly operations. The Therm-O-Flow® bulk hot melt drum unloader system was introduced during 2006 and among other uses, supplies adhesive to roll coaters used in the manufacture of tapes and labels. The line was expanded with a pail version in 2007 for use in the manufacture of insulating glass, carrying the CE mark to permit distribution in Europe. The Therm-O-Flow offers a new generation air motor called the NXT® with an embedded control structure (provides runaway protection, diagnostics and material usage data), modular air valve, and integrated air controls. The Liquid Control line of equipment meters, mixes and dispenses precision beads of sealants and adhesives and is customized for use in the electronics and automotive industries and in bonding, molding, sealing, doming and gasketing other products. In 2007, we introduced the Liquid Control™ PR70, the first meter, mix and dispense plural components system with Graco Control Architecture™ for quick troubleshooting and a compact modular design that is broadly configurable. In-plant polyurethane equipment and systems are used to reduce road noise and vibration in motor vehicles and to produce a wide variety of injection molded parts for automobiles, trucks, consumer products and general industrial use. Material suppliers and end-user customers play a significant role in the development of in-plant polyurethane systems for specific applications.

We work closely with major material manufacturers to identify and configure Graco equipment suitable for the handling of their materials. For example, our equipment is used to supply a catalyzed plastic resin for the formation of the blades used on turbines for generating electricity from wind and adhesive for cementing parts of the blades together.

Contractor Segment

The Contractor segment generated approximately 36 percent of our Company's 2007 total sales. This segment markets a complete line of airless paint and texture sprayers (air, gas, hydraulically- and electrically-powered), accessories such as spray guns, hoses and filters and spare parts such as tips and seals, to professional and semi-professional painters in the construction and maintenance industries. The products are distributed primarily through stores whose main products are paint and other coatings. Contractor products are also sold through general equipment distributors. A limited line of sprayers are distributed through the home center channel.

Contractor equipment includes a wide variety of sprayers, including sprayers that apply markings on roads, parking lots, fields and floors; texture to walls and ceilings; highly viscous coatings to roofs; and paint to walls and structures. Many of these sprayers and their accessories contain one or more advanced technological features such as micro-processor based controls for consistent spray and protective shut-down, a pump that may be removed and re-installed without tools, an easy clean feature, gas/electric convertibility, and an extremely durable pump finish. Continual technological innovation and broad product families with multiple offerings are characteristic of our Company's Contractor equipment business. Painters are encouraged to upgrade their equipment regularly to take advantage of the new and/or more advanced features. A new line of sprayers for

the application of fine finishes to cabinets and other wood surfaces was introduced in 2007. The FinishPro™ air-assisted airless sprayer provides a finish quality comparable to high volume low pressure (HVLP) sprayers, the production speed of an airless sprayer and the ability to switch from airless to air-assisted airless with the flip of a switch. These sprayers are equipped with one of the first air-assisted airless spray guns that uses a reversible spray tip.

A large percentage of our Contractor sales come from the North American market, although Contractor products are marketed and sold in all major geographic areas. In recent years, the segment has increased its effort to appeal to customers outside of North America by developing products specifically for these markets, like the Mark X™ texture sprayer, a 240 volt, 2.4 gallons per minute electric sprayer used to fill in rough areas on plaster and concrete walls and designed to be sold in Europe and Asia Pacific where less drywall is used.

In Europe and Asia Pacific, we are pursuing a broad strategy of converting contractors accustomed to the manual application of paint and other coatings by brush and roller to spray technology. This requires extensive in-person demonstration of the productivity advantages, cost savings and finish quality of our spray equipment. This also requires the conversion of local paint distributors who may have a different method of selling their product. For example, in the P.R.C. some paint companies include spray application in the price they charge for their paint.

Lubrication Segment

The Lubrication segment represented approximately 11 percent of our Company's sales during 2007. Traditionally, the Lubrication segment has focused on pumps, applicators and accessories, such as meters and hose reels, for the motor vehicle lubrication market. In this market, our Company's customers include fast oil change facilities, service garages, fleet service centers, automobile dealerships, and auto parts stores. Recent acquisitions have expanded the segment's product offering, providing access to new markets. Small electric fuel and oil transfer pumps for use in remote locations to supply fuel and oil to ranch, farm and construction machinery and off-road vehicles and automatic lubrication systems are examples.

The Lubriquip® product line consists of systems for the automatic lubrication of factory machine tools, compressors and pumps used in petrochemical and gas transmissions plants; bearings and gears on equipment in metal, pulp and paper mills; conveyors and material handling equipment; and off-road and over-the-road trucks. Lubriquip products are primarily sold through distribution. During 2007, the manufacture of Lubriquip products was transferred from facilities in Madison, Wisconsin and Cleveland, Ohio to the facility in Anoka, Minnesota.

Although the bulk of the Lubrication segment's sales come from North America, the segment is responsible for world-wide marketing and sales of our lubrication equipment. Products are distributed in each of our Company's major geographic markets, primarily through independent distributors serviced by independent sales representatives, a dedicated sales force in the automatic lubrication systems market and direct sales generalists in foreign markets. Some automatic lubrication systems are marketed to original equipment manufacturers (OEMs). Fuel and oil transfer pumps are marketed through OEMs, select home centers, auto parts stores and our traditional distribution channel.

Raw Materials

The primary materials and components used in the manufacturing process are steel of various alloys, sizes and hardness; specialty stainless steel and aluminum bar stock, tubing and castings; tungsten carbide; electric motors; injection molded plastics; sheet metal; forgings; powdered metal; hoses; and electronic components. In general, the raw materials and components used are adequately available through multiple sources of supply. In order to manage cost, our Company continues to increase its global sourcing of materials and components, primarily in the Asia Pacific region.

During 2007, our Company experienced significant volatility in the price of stainless steel, copper, plastic and rubber and the commodities that contained these materials. Our Company endeavors to address fluctuations in the price and availability of various materials and components through close management of current suppliers, agreements and an intensive search for new suppliers.

Intellectual Property

We own a number of patents and have patent applications pending both in the United States and in other countries, license our patents to others, and are a licensee of patents owned by others. In our opinion, our business is not materially dependent upon any one or more of these patents or licenses. Our Company also owns a number of trademarks in the United States and foreign countries, including registered trademarks for “GRACO,” several forms of a capital “G,” “Decker,” “Gusmer,” “Lubriquip” and various product trademarks which are material to our business, inasmuch as they identify Graco and our products to our customers.

Competition

We face substantial competition in all of our markets. The nature and extent of this competition varies in different markets due to the depth and breadth of our Company’s product lines. Product quality, reliability, design, customer support and service, personal relationships, specialized engineering and pricing are the major competitive factors in our markets. Although no competitor duplicates all of our products, some competitors are larger than our Company, both in terms of sales of directly competing products and in terms of total sales and financial resources. We also face competitors with different cost structures and expectations of profitability and these companies offer competitive products at lower prices. We believe we are one of the world’s leading producers of high-quality specialized fluid handling equipment in the markets we serve. It is not possible to determine our relative market position because of the absence of reliable industry-wide third-party data.

Environmental Protection

Our compliance with federal, state and local environmental laws and regulations did not have a material effect upon our capital expenditures, earnings or competitive position during the fiscal year ended December 28, 2007.

Employees

As of December 28, 2007, we employed approximately 2,200 persons on a full-time basis. Of this total, approximately 400 were employees based outside the United States, and 900 were hourly factory workers in the United States. None of our Company’s U.S. employees are 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 our Company or its operations.

Item 1A. Risk Factors

Foreign Operations — Conditions in foreign countries and changes in foreign exchange rates may impact our sales volume, rate of growth or profitability.

In 2007, approximately 48 percent of our sales was generated by customers located outside the United States. Sales to customers located outside the United States expose us to special risks, including the risk of terrorist activities, civil disturbances, and special taxes, regulations and restrictions. We are increasing our presence in the Asia Pacific region, South America, Eastern Europe and the Middle East. We assemble products at our factory in Suzhou, P.R.C. and source an increasing number of the components and materials used in the assembly process from the local market. Sales in Eastern Europe, Russia and the former socialist republics are increasing at a faster rate than in Western Europe. Our revenues and net income may be adversely affected by more volatile economic and political conditions in Asia, South America, Eastern Europe and the Middle East. Changes in exchange rates between the U.S. dollar and other currencies will impact our reported sales and earnings.

Foreign Suppliers – Our Company has increased its sourcing of raw materials and components from vendors located outside the United States. Interruption or delays in delivery may adversely affect our profitability.

We are sourcing an increasing percentage of our materials and components from suppliers outside the United States. Long lead times may reduce our flexibility and make it more difficult to respond promptly to fluctuations in demand. Changes in exchange rates between the U.S. dollar and other currencies may impact the manufacturing costs of our products and affect our profitability.

Major Customers — Our Contractor Equipment segment depends on a few large customers for a significant portion of its sales. Significant declines in the level of purchases by these customers could reduce our sales.

We derive a significant amount of revenue from a few large customers. Substantial decreases in purchases by these customers, difficulty in collecting amounts due or the loss of their business would adversely affect the profitability of our Company's Contractor Equipment segment. The business of these customers is dependent upon the economic vitality of the construction and home maintenance markets. If these markets decline, the business of our customers could be adversely affected and their purchases of our equipment could decrease. In 2007, one of these large customers informed us that it would reduce the number of stores through which the Graco line would be offered. As a result, it is expected that 2008 sales to this customer will be lower.

Acquisitions — Our growth strategy includes acquisitions. Suitable acquisitions must be located, completed and integrated into our existing businesses in order for this strategy to be successful.

We have identified acquisitions as one of the strategies by which we intend to grow our business. If we do not successfully acquire and integrate businesses into our current business model, or realize projected efficiencies and cost-savings from acquired businesses, we may be unable to meet our growth or profit objectives.

Natural Disasters — Our operations are at risk of damage or destruction by natural disasters, such as earthquakes, tornadoes or unusually heavy precipitation.

The loss of, or substantial damage to, one of our facilities could make it difficult to supply our customers with product and provide our employees with work. Our manufacturing and distribution facility in Minneapolis is on the banks of the Mississippi River where it is exposed to flooding. Flooding could also damage our European headquarters and warehouse in Maasmechelen, Belgium or our factory in Suzhou, P.R.C. Tornadoes could damage or destroy our facilities in Sioux Falls, Rogers, Minneapolis or Anoka and a typhoon could do the same to our facility in Suzhou. An earthquake may adversely impact our operations in Suzhou.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The information concerning the location and general character of the physical properties of our Company contained under the heading "Business-Business Segments" in Part I of this 2007 Annual Report on Form 10-K is incorporated herein by reference.

Sales activities in the countries of Japan, Korea, and the P.R.C. are conducted out of leased facilities – Yokohama, Japan (18,500 gross sq. ft. office) and Gwangju-Gun, Korea (15,750 sq. ft. total for two separate facilities-warehouse and office). Our Company also leases space for liaison offices in the P.R.C. and India and for a sales office in Australia.

Our Company's facilities are in satisfactory condition, suitable for their respective uses and are generally adequate to meet current needs. Manufacturing capacity generally met business demand during 2007. Production requirements in the immediate future are expected to be met through existing facilities, the installation of new automatic and semi-automatic machine tools, efficiency and productivity improvements, and the use of available subcontract services.

Item 3. Legal Proceedings

Our Company is engaged in routine litigation incident to our business, which management believes will not have a material adverse effect upon our 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 2007.

Executive Officers of Our Company

The following are all the executive officers of Graco Inc. as of February 18, 2008:

Patrick J. McHale, 46, is President and Chief Executive Officer, a position he has held since June 2007. He served as Vice President and General Manager, Lubrication Equipment Division from June 2003 to June 2007. He was Vice President of Manufacturing and Distribution Operations from April 2001 to June 2003. He served as Vice President, Contractor Equipment Division from February 2000 to March 2001. Prior to becoming Vice President, Lubrication Equipment Division in September 1999, he held various manufacturing management positions in Minneapolis, Minnesota; Plymouth, Michigan; and Sioux Falls, South Dakota. Mr. McHale joined the Company in December 1989.

Caroline M. Chambers, 43, became Vice President and Controller in December 2006 and has served as the Company's principal accounting officer since September 2007. She was Corporate Controller from October 2005 to December 2006 and Director of Information Systems from July 2003 through September 2005. Prior to becoming Director of Information Systems, she held various management positions in the internal audit and accounting departments. Prior to joining Graco, Ms. Chambers was an auditor with Deloitte & Touche in Minneapolis, Minnesota and Paris, France. Ms. Chambers joined the Company in 1992.

Karen Park Gallivan, 51, became Vice President, General Counsel and Secretary in September 2005. She was Vice President, Human Resources from January 2003 to September 2005. Prior to joining Graco, she was Vice President of Human Resources and Communications at Syngenta Seeds, Inc., from January 1999 to January 2003. From 1988 through January 1999, she was the general counsel of Novartis Nutrition Corporation. Prior to joining Novartis, Ms. Gallivan was an attorney with the law firm of Rider, Bennett, Egan and Arundel. She joined the Company in January 2003.

James A. Graner, 63, became Chief Financial Officer and Treasurer in September 2005. He was Vice President and Controller from March 1994 to September 2005. He was Treasurer from May 1993 through February 1994. Prior to becoming Treasurer, he held various managerial positions in the treasury, accounting and information systems departments. He joined the Company in 1974. Mr. Graner has announced his intention to retire in 2008.

Dale D. Johnson, 53, became Vice President and General Manager, Contractor Equipment Division in April 2001. From January 2000, through March 2001, he served as President and Chief Operating Officer. 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.

Jeffrey P. Johnson, 48, is Vice President and General Manager, Asia Pacific, a position he has held since February 2008. He served as Director of Sales and Marketing, Applied Fluid Technologies Division, from June 2006 until February 2008. Prior to joining Graco, he held various sales and marketing positions, including, most recently, President of Johnson Krumwiede Roads, a full-service advertising agency, and European sales manager at General Motors Corp. He joined the Company in 2006.

David M. Lowe, 52, became Vice President and General Manager, Industrial Products Division in February 2005. He was Vice President and General Manager, European Operations from September 1999 to February 2005. Prior to becoming Vice President, Lubrication Equipment Division in December 1996, he was Treasurer. Mr. Lowe joined the Company in February 1995.

Simon J. W. Paulis, 60, became Vice President and General Manager, Europe in September 2005. From February 2005 to September 2005, he served as Director and General Manager, Europe. He served as Sales and Marketing Director, Contractor Equipment Europe from January 1999 to September 2005. Prior to joining Graco, he served as business unit manager for Black & Decker N.V., general sales manager for Alberto Culver, and marketing manager for Ralston Purina/Quaker Oats. Mr. Paulis joined the Company in January 1999.

Charles L. Rescorla, 56, became Vice President of Manufacturing and Distribution Operations in September 2005. He served as Vice President, Manufacturing/Distribution Operations and Information Services from June 2003 to September 2005. From April 2001 until June 2003, he was Vice President of the Industrial/Automotive Equipment Division. Prior to June 2003, he held various positions in manufacturing and engineering management. Mr. Rescorla joined the Company in June 1988.

Mark W. Sheahan, 43, became Vice President and General Manager, Applied Fluid Technologies Division in February 2008. He served as Chief Administrative Officer from September 2005 until February 2008, and was Vice President and Treasurer from December 1998 to September 2005. Prior to becoming Treasurer in December 1996, he was Manager, Treasury Services, where he was responsible for strategic and financial activities. He joined the Company in September 1995.

Brian J. Zumbolo, 38, became Vice President and General Manager, Lubrication Equipment Division in August 2007. He was Director of Sales and Marketing, Lubrication Equipment and Applied Fluid Technologies, Asia Pacific, from November 2006 through July 2007. From February 2005 to November 2006, he was the Director of Sales and Marketing, High Performance Coatings & Foam, Applied Fluid Technologies Division. Mr. Zumbolo was the Director of Sales and Marketing, Finishing Equipment from May 2004 to February 2005. Prior to May 2004, he held various marketing positions in the Industrial Equipment Division. Mr. Zumbolo joined the Company in 1999.

With the exception of Patrick J. McHale, Brian J. Zumbolo, Caroline M. Chambers, Jeffrey P. Johnson and Mark W. Sheahan, the Board of Directors elected each of the above executive officers on April 21, 2006, to hold office for the next year or until their successors are elected and qualify. Mr. McHale was elected President and Chief Executive Officer effective June 11, 2007; Mr. Zumbolo was elected Vice President and General Manager, Lubrication Equipment Division, effective August 1, 2007; Ms. Chambers was elected Vice President and Controller, effective December 8, 2006; Jeffrey P. Johnson was elected Vice President and General Manager, Asia Pacific, effective February 15, 2008; and Mark W. Sheahan was elected Vice President and General Manager, Applied Fluid Technologies Division, effective February 15, 2008.

PART II

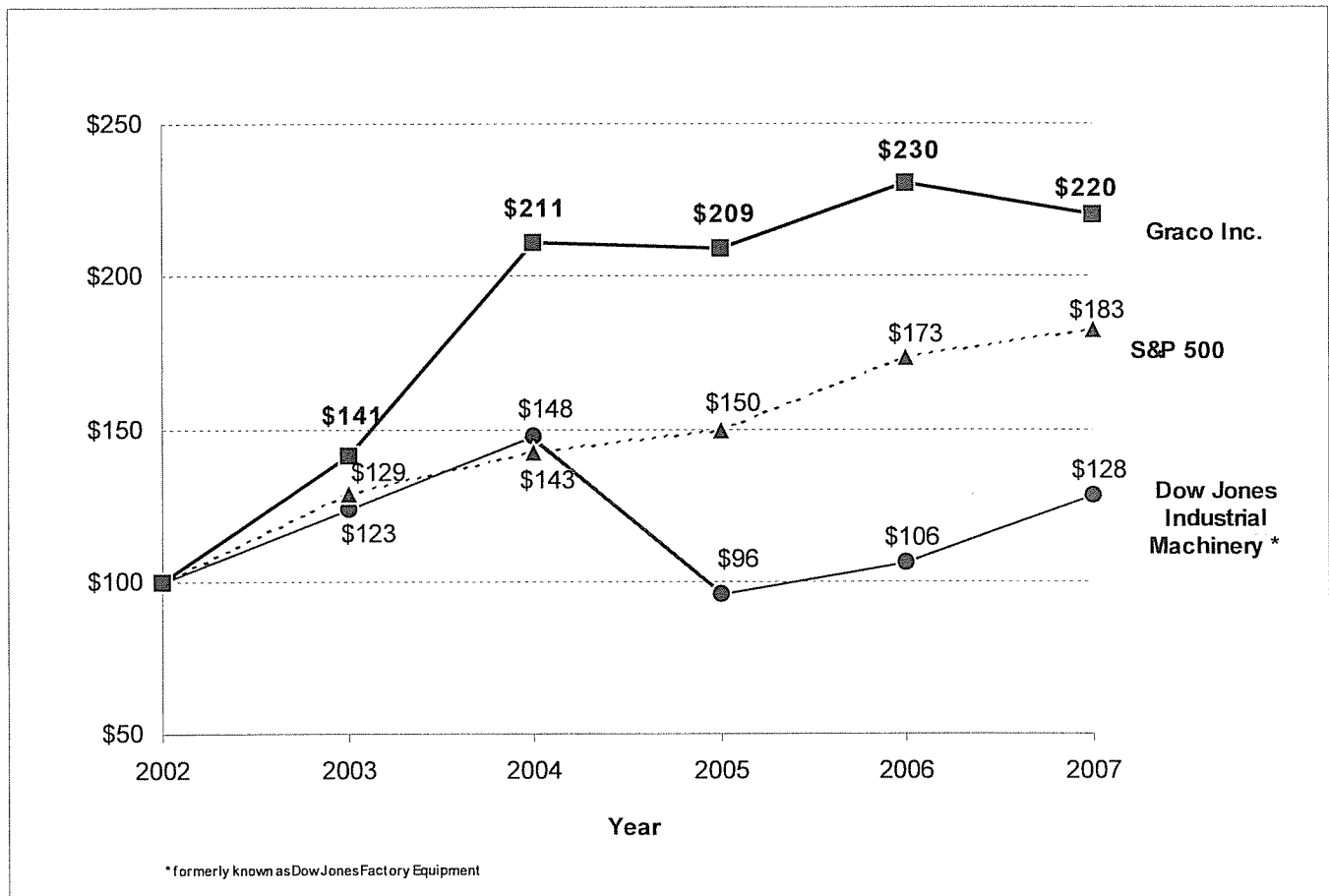
Item 5. Market for the Company’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

Graco Common Stock

Graco common stock is traded on the New York Stock Exchange under the ticker symbol “GGG.” As of February 11, 2008, the share price was \$35.47 and there were 61,120,603 shares outstanding and 2,641 common shareholders of record, which includes nominees or broker dealers holding stock on behalf of an estimated 31,000 beneficial owners.

The graph below compares the cumulative total shareholder return on the common stock of the Company for the last five fiscal years with the cumulative total return of the S&P 500 Index and the Dow Jones Industrial Machinery Index over the same period (assuming the value of the investment in Graco common stock and each index was \$100 on December 31, 2002, and all dividends were reinvested).

Five Year* Cumulative Total Shareholder Return



*Fiscal Year Ended Last Friday in December

Quarterly Financial Information (Unaudited)

(In thousands, except per share amounts)

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|-------------------------|------------------|-------------------|------------------|-------------------|
| 2007 | | | | |
| Net sales | \$197,495 | \$231,384 | \$207,270 | \$205,190 |
| Gross profit | 104,862 | 122,232 | 110,646 | 109,686 |
| Net earnings | 33,735 | 44,180 | 39,263 | 35,658 |
| Per common share | | | | |
| Basic net earnings | .51 | .67 | .61 | .57 |
| Diluted net earnings | .50 | .66 | .60 | .56 |
| Dividends declared | .17 | .17 | .17 | .19 |
| Stock price (per share) | | | | |
| High | \$42.27 | \$42.07 | \$46.07 | \$40.50 |
| Low | 38.44 | 38.27 | 37.84 | 36.25 |
| Close ¹ | 39.16 | 40.28 | 39.11 | 37.26 |
| Volume (# of shares) | 22,604 | 40,254 | 46,605 | 28,941 |
| | | | | |
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| 2006 | | | | |
| Net sales | \$192,216 | \$218,632 | \$202,199 | \$203,421 |
| Gross profit | 103,227 | 116,946 | 106,611 | 107,173 |
| Net earnings | 35,422 | 41,335 | 37,392 | 35,617 |
| Per common share | | | | |
| Basic net earnings | .52 | .61 | .55 | .53 |
| Diluted net earnings | .51 | .60 | .54 | .52 |
| Dividends declared | .15 | .15 | .15 | .17 |
| Stock price (per share) | | | | |
| High | \$45.43 | \$48.95 | \$46.37 | \$43.60 |
| Low | 36.50 | 42.50 | 37.00 | 38.61 |
| Close ¹ | 45.43 | 45.98 | 39.06 | 39.62 |
| Volume (# of shares) | 19,428 | 21,925 | 24,882 | 26,326 |

¹ As of the last trading day of the calendar quarter.

Issuer Purchases of Equity Securities

On February 17, 2006, the Board of Directors authorized the Company to purchase up to a total of 7,000,000 shares of its outstanding common stock, primarily through open-market transactions. This authorization expires on February 29, 2008. On September 28, 2007, the Board of Directors authorized the Company to purchase up to a total of an additional 7,000,000 shares. This authorization expires on September 30, 2009.

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

Information on issuer purchases of equity securities follows:

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (at end of period) |
|-----------------------------|--|---|---|---|
| Sep 29, 2007 – Oct 26, 2007 | 709,700 | \$39.47 | 709,700 | 7,047,920 |
| Oct 27, 2007 – Nov 23, 2007 | 259,544 | \$37.11 | 259,544 | 6,788,376 |
| Nov 24, 2007 – Dec 28, 2007 | 640,843 | \$37.82 | 640,843 | 6,147,533 |

Item 6. Selected Financial Data

Graco Inc. and Subsidiaries

| (In thousands, except per share amounts) | 2007 | 2006 | 2005 | 2004 | 2003 |
|--|-----------|-----------|-----------|-----------|-----------|
| Net sales | \$841,339 | \$816,468 | \$731,702 | \$605,032 | \$535,098 |
| Net earnings | 152,836 | 149,766 | 125,854 | 108,681 | 86,713 |
| Per common share ¹ | | | | | |
| Basic net earnings | \$ 2.35 | \$ 2.21 | \$ 1.83 | \$ 1.57 | \$ 1.25 |
| Diluted net earnings | 2.32 | 2.17 | 1.80 | 1.55 | 1.23 |
| Total assets | \$536,724 | \$511,603 | \$445,630 | \$371,714 | \$397,390 |
| Long-term debt (including current portion) | 107,060 | — | — | — | — |
| Cash dividends declared per common share ^{1,2} | .68 | .60 | .54 | .41 | 1.76 |

¹ All share and per share data has been restated for the three-for-two stock split distributed in 2004.

² 2003 includes a special dividend of \$1.50 per share declared on December 12, 2003, paid on March 25, 2004, to shareholders of record as of March 11, 2004.

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

The following Management's Discussion and Analysis (MD&A) reviews significant factors affecting the consolidated results of operations, financial condition and liquidity for the three-year period ended December 28, 2007. This discussion should be read in conjunction with our financial statements and the accompanying notes to the financial statements ("Notes"). The discussion is organized in the following sections:

- Overview
- Results of Operations
- Segment Results
- Financial Condition
- Significant Accounting Policies and Estimates
- Forward-Looking Statements

Overview

Our Company's key strategies include development of new products, expansion of distribution, new market penetration and completion of acquisitions. Long-term financial growth targets accompany these strategies, including 10 percent revenue growth, 12 percent net earnings and earnings per share growth.

Graco's business is classified by management into three reportable segments, each responsible for product development, marketing and sales of their products. The segments are headquartered in North America. They have responsibility for sales and marketing in the Americas and joint responsibility with Europe and Asia Pacific regional management for sales and marketing in those geographic areas.

Manufacturing is a key competency of the Company, and to facilitate our growth we are aligning manufacturing responsibility with our divisions. Strategic manufacturing expertise will continue to be provided by a management team in Minneapolis, who will also be responsible for factories not fully aligned with a single division. Our primary manufacturing facilities are in the United States and distribution facilities are located in the United States, Belgium, Japan, Korea and China. In 2007 manufacturing activities for the Lubrication division were centralized in Anoka, Minnesota and in 2006, a new assembly factory in Suzhou, China began production.

Results of Operations

| (In millions, except per share amounts) | 2007 | 2006 | 2005 |
|---|---------|---------|---------|
| Net Sales | \$841.3 | \$816.5 | \$731.7 |
| Operating Earnings | 232.5 | 226.0 | 191.1 |
| Net Earnings | 152.8 | 149.8 | 125.9 |
| Diluted Net Earnings per Common Share | \$ 2.32 | \$ 2.17 | \$ 1.80 |

Highlights include:

- Sales grew by 3 percent in 2007 and 12 percent in 2006, with continued strong growth in Europe and Asia Pacific of 23 percent and 18 percent, respectively, in 2007. Sales in the Americas decreased by 6 percent in 2007, primarily due to the weak housing and construction industries.
- Sales were higher in the Industrial and Lubrication segments, with growth in 2007 of 7 percent and 13 percent respectively, offset by a 4 percent decline in Contractor.
- Net sales increased by approximately \$17 million in 2007 and \$5 million in 2006 from favorable currency translation.
- Net earnings grew 2 percent in 2007 and 19 percent in 2006. Currency translation increased net earnings by approximately \$7 million in 2007 and \$2 million in 2006.
- Investment in new products was 3.6 percent of sales in 2007 and 3.7 percent of sales in 2006.
- The full year impact of the Lubriquip acquisition increased net sales by \$11 million or 1 percent in 2007. In 2006, the Lubriquip acquisition and the full year impact of businesses acquired in 2005 (Gusmer, Liquid Control and PBL) increased net sales by \$18 million or 2 percent.
- Increased cash flows from operations in each year.

The following table presents net sales by geographic region.

| (In millions) | 2007 | 2006 | 2005 |
|-------------------------|----------------|----------------|----------------|
| Geographic Sales | | | |
| Americas ¹ | \$500.4 | \$534.9 | \$486.2 |
| Europe ² | 215.5 | 175.7 | 151.0 |
| Asia Pacific | 125.4 | 105.9 | 94.5 |
| Total | \$841.3 | \$816.5 | \$731.7 |

¹ North and South America, including the United States. Sales in the United States were \$434 million in 2007, \$474 million in 2006 and \$435 million in 2005.

² Europe, Africa and Middle East

Sales in the Americas declined by 6 percent overall and by 4 percent and 14 percent in the Industrial and Contractor segments, respectively, in 2007 as compared to the prior year. Lubrication sales in the Americas increased by 10 percent, primarily due to the full year impact of the Lubriquip acquisition. Strong growth in Europe and Asia Pacific in all three segments reflects a favorable business environment, continued emphasis on expanding sales and marketing resources in those regions and focus on new distribution as well as the positive effect of foreign currency translation rates.

The following table presents components of net sales change:

| | 2007 | | | | 2006 | | | |
|----------------|------------|-------------|-------------|--------------|-------------|------------|--------------|--------------|
| | Industrial | Contractor | Lubrication | Consolidated | Americas | Europe | Asia Pacific | Consolidated |
| Volume & price | 4% | (6%) | (2%) | 0% | (8%) | 13% | 16% | 0% |
| Acquisitions | 0% | 0% | 14% | 1% | 2% | 1% | 1% | 1% |
| Currency | 3% | 2% | 1% | 2% | 0% | 9% | 1% | 2% |
| Total | 7% | (4%) | 13% | 3% | (6%) | 23% | 18% | 3% |

| | 2006 | | | | 2005 | | | |
|----------------|------------|------------|-------------|--------------|------------|------------|--------------|--------------|
| | Industrial | Contractor | Lubrication | Consolidated | Americas | Europe | Asia Pacific | Consolidated |
| Volume & price | 12% | 4% | 8% | 9% | 6% | 14% | 11% | 9% |
| Acquisitions | 1% | 0% | 25% | 2% | 3% | 1% | 1% | 2% |
| Currency | 1% | 1% | 1% | 1% | 1% | 1% | 0% | 1% |
| Total | 14% | 5% | 34% | 12% | 10% | 16% | 12% | 12% |

The following table presents an overview of components of operating earnings as a percentage of net sales:

| | 2007 | 2006 | 2005 |
|-------------------------------------|--------------|--------------|--------------|
| Net Sales | 100.0 | 100.0 | 100.0 |
| Cost of products sold | 46.8 | 46.8 | 48.2 |
| Gross profit | 53.2 | 53.2 | 51.8 |
| Product development | 3.6 | 3.7 | 3.7 |
| Selling, marketing and distribution | 14.8 | 14.6 | 15.0 |
| General and administrative | 7.2 | 7.2 | 7.0 |
| Operating earnings | 27.6 | 27.7 | 26.1 |
| Interest expense | 0.4 | 0.1 | 0.2 |
| Other expense, net | 0.0 | 0.1 | 0.0 |
| Earnings before income taxes | 27.2 | 27.5 | 25.9 |
| Income taxes | 9.0 | 9.2 | 8.7 |
| Net Earnings | 18.2 | 18.3 | 17.2 |

Operating expenses in 2007 were \$215 million compared to \$208 million in the prior year. Although spending increased for selling, marketing and distribution (increase of \$5 million) and general and administrative (increase of \$1 million), total operating expenses as a percentage of sales was consistent with the prior year at 26 percent. Included in cost of goods sold and operating expenses were costs and expenses related to the closure and move of the Lubriquip operations in Cleveland, Ohio and Madison, Wisconsin to the Anoka, Minnesota factory totaling \$2.3 million in 2007. Operating expenses included \$7 million of stock compensation in 2007.

Operating expenses in 2006 were \$208 million versus \$188 million in 2005. Acquired businesses had approximately \$4 million of operating expenses in 2006. Although spending increased for product development (increase of \$3 million), selling (increase of \$9 million) and general and administrative (increase of \$8 million), total operating expenses as a percentage of sales was consistent with the prior year at 26 percent. Included in cost of goods sold and operating expenses were costs and inventory charges related to closure of the Gusmer New Jersey facility and move of production totaling \$5 million for the year. Operating expenses included \$7 million of stock compensation due to adoption of SFAS No. 123(R) in 2006.

Consolidated operating earnings increased 3 percent to \$232 million, or 28 percent of sales in fiscal 2007, with growth in sales of 3 percent as compared to the prior year and consistent gross profit margins and expenses. Gross profit margin as a percentage was consistent with the prior year, as the favorable impact of pricing and foreign currency translation offset higher spending and material costs.

Consolidated operating earnings increased 18 percent to \$226 million, or 28 percent of sales in fiscal 2006, compared to \$191 million, or 26 percent of sales in fiscal 2005. The increase in earnings as a percentage of sales was primarily due to stronger gross profit margin of 53.2 percent in 2006 compared to 51.8 percent in 2005. A substantial portion of this difference is due to the higher cost of inventory of the acquired businesses in 2005. Improved manufacturing efficiencies and higher sales volume more than offset the negative impact of higher material, labor and overhead costs.

Interest expense increased by \$2.5 million in 2007 as the Company increased its utilization of credit lines to purchase Company stock.

The Company's effective tax rate was 33 percent in 2007, consistent with the effective tax rate in 2006. The rate in both periods is lower than the U.S. federal statutory rate of 35 percent due primarily to U.S. business credits and the Domestic Production Deduction (DPD).

Segment Results

The following table presents net sales and operating earnings by business segment:

| (In millions) | 2007 | 2006 | 2005 |
|-----------------------------------|---------|---------|---------|
| Segment Sales | | | |
| Industrial | \$444.7 | \$416.5 | \$367.1 |
| Contractor | 306.7 | 320.5 | 305.3 |
| Lubrication | 89.9 | 79.5 | 59.3 |
| Consolidated | \$841.3 | \$816.5 | \$731.7 |
| Segment Operating Earnings | | | |
| Industrial | \$152.3 | \$128.5 | \$98.3 |
| Contractor | 81.5 | 89.1 | 77.6 |
| Lubrication | 9.3 | 18.7 | 15.6 |
| Unallocated corporate | (10.6) | (10.3) | (0.4) |
| Consolidated | \$232.5 | \$226.0 | \$191.1 |

Management looks at economic and financial indicators relevant to each segment and geography to gauge the business environment, as noted in the discussion below for each segment.

Industrial

The following table presents net sales, components of net sales change and operating earnings for the Industrial segment.

| (In millions) | 2007 | 2006 | 2005 |
|---------------------------------------|---------|---------|---------|
| Sales | | | |
| Americas | \$213.1 | \$221.4 | \$191.5 |
| Europe | 138.0 | 115.9 | 101.7 |
| Asia Pacific | 93.6 | 79.2 | 73.9 |
| Total | \$444.7 | \$416.5 | \$367.1 |
| Components of Net Sales Change | | | |
| Volume & Price | 4% | 12% | 8% |
| Acquisitions | 0% | 1% | 25% |
| Currency | 3% | 1% | 1% |
| Total | 7% | 14% | 34% |
| Operating Earnings | \$152.3 | \$128.5 | \$98.3 |

In 2007, sales in the Industrial segment increased by 7 percent, with sales growth in Europe and Asia offsetting sales declines in the Americas. Sales in Europe grew by 19 percent, including 9 percentage points related to favorable currency translation rates. The sales growth in Asia Pacific was 18 percent and the effect of currency translation rates was not significant.

In 2007, operating earnings in the Industrial segment were up 19 percent due to the increase in sales, improvements in gross profit margins and lower spending as percentage of sales. The lower spending is primarily the result of efficiencies obtained following the move of Gusmer operations into the Minneapolis, Sioux Falls and Ohio facilities and closure of the New Jersey facility in 2006.

In 2006, sales in the Industrial segment grew by 13 percent, with growth in all geographic regions. Growth in various product categories, such as high performance coatings and foam equipment, and full year impact of businesses acquired in 2005 contributed to the strong sales growth in the Industrial segment in 2006. Europe continued to experience strong sales growth in Eastern Europe and the Middle East.

In 2006, operating earnings in the Industrial segment were up 31 percent compared to 2005. Sales increased by 13 percent and gross profit margin as a percentage of sales increased by 2 percentage points. The increase in gross profit margin was primarily due to the higher cost of inventory of the acquired businesses in 2005.

In this segment, sales in each geographic region are significant and management looks at economic and financial indicators in each region, including gross domestic product, industrial production, capital investment rates and the level of the U.S. dollar versus the euro, Japanese yen, South Korean won and the Canadian dollar.

Contractor

The following table presents net sales, components of net sales change and operating earnings for the Contractor segment.

| (In millions) | 2007 | 2006 | 2005 |
|---------------------------------------|---------------|---------------|---------------|
| Sales | | | |
| Americas | \$210.9 | \$244.0 | \$242.2 |
| Europe | 71.0 | 55.3 | 46.2 |
| Asia Pacific | 24.8 | 21.2 | 16.9 |
| Total | \$306.7 | \$320.5 | \$305.3 |
| Components of Net Sales Change | | | |
| Volume & Price | (6%) | 4% | 9% |
| Acquisitions | 0% | 0% | 0% |
| Currency | 2% | 1% | 0% |
| Total | (4%) | 5% | 9% |
| Operating Earnings | \$81.5 | \$89.1 | \$77.6 |

In 2007, sales in the Contractor segment decreased by 4%. Although sales in the Americas decreased by 14 percent, sales in Europe and Asia Pacific grew by 28 percent and 17 percent, respectively. Sales in the Americas were lower due to declines in both the home center and professional paint store channels. Sales growth in both Europe and Asia Pacific is attributed to continued focus on converting professional contractors from manual to spray applications and new distribution.

In 2007, operating earnings in the Contractor segment decreased by 9 percent. Operating earnings include approximately \$1 million of incremental expense related to the launch and production of a new paint sprayer line for the home center channel. Gross profit margins and spending levels were otherwise consistent with the prior year.

In 2006, sales in the Contractor segment increased by 5 percent. Sales in the Americas were \$244 million or 76 percent of total segment sales, an increase of 1 percent from 2005. The lower rate of growth as compared to 2005 reflected the slowing housing market in the United States. Sales in Europe and Asia Pacific increased by 20 percent and 25 percent respectively due to new product introductions and increased distribution throughout both regions.

In 2006, operating earnings in the Contractor segment increased 15 percent due to higher net sales, gross profit margin improvement and spending that was slightly lower than the prior year as a percentage of sales.

In this segment, sales in the Americas and Europe are significant and management reviews economic and financial indicators in each region, including levels of residential, commercial and institutional building, remodeling rates and interest rates. Management also reviews gross domestic product for the regions and the level of the U.S. dollar versus the euro.

Lubrication

The following table presents net sales, components of net sales change and operating earnings for the Lubrication segment.

| (In millions) | 2007 | 2006 | 2005 |
|---------------------------------------|--------|--------|--------|
| Sales | | | |
| Americas | \$76.4 | \$69.5 | \$52.6 |
| Europe | 6.6 | 4.5 | 3.1 |
| Asia Pacific | 6.9 | 5.5 | 3.6 |
| Total | \$89.9 | \$79.5 | \$59.3 |
| Components of Net Sales Change | | | |
| Volume & Price | (2%) | 8% | 13% |
| Acquisitions | 14% | 25% | 1% |
| Currency | 1% | 1% | 1% |
| Total | 13% | 34% | 15% |
| Operating Earnings | \$9.3 | \$18.7 | \$15.6 |

In 2007, sales in the Lubrication segment increased by 13 percent. Sales in the Americas increased by \$7 million, with full year effect of the Lubriquip acquisition of \$9 million for the region. Sales in Europe increased by 46 percent, including 7 percentage points related to favorable currency translation rates. Sales in Asia Pacific increased by 26 percent; the effect of currency translation was not significant.

In 2007, operating earnings decreased by \$9 million, including \$2.3 million of expenses related to the integration of the Lubriquip manufacturing operations, closure of the Lubriquip facilities in Madison, Wisconsin and Cleveland, Ohio and the transfer of Lubrication manufacturing from the facility in Minneapolis to the new facility in Anoka, Minnesota. The segment also had higher spending than the prior year in new product development, marketing and warranty expense, partially due to the full year impact of the Lubriquip acquisition.

In 2006, sales in the Lubrication segment increased by 34 percent, with the acquired Lubriquip business providing 19 percentage points of the overall sales growth and the full year impact of the 2005 PBL acquisition providing 6 percentage points of the sales growth.

In 2006, operating earnings in the Lubrication Equipment segment increased by 20 percent with an increase in segment sales of 34 percent. Lubriquip contributed approximately one half of the sales growth and \$4 million of incremental operating expenses in 2006.

The Americas represent the vast majority of sales for the Lubrication Equipment segment and indicators in that region are the most important. The indicators used by management include levels of capital investment, industrial production and gross domestic product.

Unallocated corporate

| (In millions) | 2007 | 2006 | 2005 |
|----------------------------------|-----------|-----------|----------|
| Unallocated corporate (expenses) | \$ (10.6) | \$ (10.3) | \$ (0.4) |

Unallocated corporate includes items such as stock compensation, bad debt expense, contributions to the Company's charitable foundation and certain other charges or credits driven by corporate decisions. In 2007, unallocated corporate was \$11 million, and included \$9 million of stock compensation and \$1 million of contributions to the Company's charitable foundation.

In 2006, unallocated corporate increased \$10 million and included \$8 million of stock compensation, an increase from the prior year due to the adoption of SFAS No. 123 (R). Contributions to the Company's charitable foundation were \$2 million, an increase of \$1 million as compared to 2005.

Financial Condition

Working Capital. The following table highlights several key measures of asset performance.

| (Dollars in millions) | 2007 | 2006 |
|--|---------|---------|
| Working capital | \$123.0 | \$110.1 |
| Current ratio | 2.0 | 1.9 |
| Days of sales in receivables outstanding | 61 | 60 |
| Inventory turnover (LIFO) | 5.0 | 5.6 |

The Company's financial condition and cash flows from operations remain strong.

In 2007, the Company obtained a 5 year credit facility that provides \$250 million of unsecured committed credit with an option for an additional \$150 million. The facility is available for general corporate purposes, working capital needs, share repurchases and acquisitions. During the year, the Company used cash and long-term borrowings for share repurchases of \$230 million and dividend payments of \$43 million. Accounts receivable increased by \$6 million to \$140 million. The 5 percent increase was primarily due to higher sales (increase of 3 percent) compared to the prior year. Inventories decreased \$2 million in 2007 to \$75 million.

In 2006, the Company used cash for share repurchases of \$88 million and dividends of \$39 million. Cash and short-term borrowings were used to fund payments of \$31 million to acquire Lubriquip. Accounts receivable increased by \$11 million to \$134 million. The 9 percent increase was primarily due to higher sales (increase of 12 percent) compared to the prior year. Inventories increased \$20 million in 2006 to \$76 million due to additions associated with the Lubriquip business, start-up of the new factory in Suzhou, China and inventory related to new product introductions.

Capital Structure. At December 28, 2007, the Company's capital structure included current debt of \$19 million, long-term debt of \$107 million and shareholders' equity of \$245 million.

Shareholders' equity decreased \$86 million in 2007 to \$245 million. The key components of changes in shareholders' equity include current year earnings of \$153 million, common stock issued of \$25 million, reduced by \$44 million of dividends declared and \$232 million of shares repurchased.

Liquidity and Capital Resources. At December 28, 2007, the Company had various lines of credit totaling \$293 million, of which \$172 million was unused. The Company's primary credit facility provides \$250 million of unsecured committed credit with an option for an additional \$150 million. Internally generated funds and unused financing sources provide the Company with the flexibility to meet its liquidity needs in 2008, including its capital expenditure plan of approximately \$35 million, planned dividends of an estimated \$46 million and acquisitions.

In December 2007, the Company's Board of Directors increased the Company's regular common dividend from an annual rate of \$0.66 to \$0.74 per share, a 12 percent increase.

Cash Flow

A summary of cash flow follows:

| (In millions) | 2007 | 2006 | 2005 |
|---------------------------------------|--------|---------|---------|
| Operating Activities | \$ 177 | \$ 156 | \$ 153 |
| Investing Activities | (38) | (65) | (131) |
| Financing Activities | (138) | (103) | (65) |
| Effect of exchange rates on cash | (2) | (1) | 1 |
| Net cash (used) provided | \$ (1) | \$ (13) | \$ (42) |
| Cash and cash equivalents at year-end | \$ 5 | \$ 6 | \$ 19 |

Cash Flows Provided by Operating Activities. During 2007, \$177 million was generated from operating cash flows, compared to \$156 million in 2006 and \$153 million in 2005. The higher cash flows from operating activities in 2007 were primarily due to changes in inventories (decreased \$2 million in 2007 and increased \$16 million in 2006) and the \$3 million increase in net earnings. The increase in operating cash flows in 2006 was primarily due to higher net earnings.

Cash Flows Used in Investing Activities. During 2007, cash was used to fund \$37 million of additions to property, plant and equipment including expansion of manufacturing facilities in North Canton, Ohio, and Sioux Falls, South Dakota. In 2006, cash was used to fund \$34 million of capital expenditures and \$31 million for a business acquisition. 2006 capital expenditures increased \$14 million from the prior year, and included purchase of a new manufacturing/office facility in Anoka, Minnesota, construction of a new manufacturing facility in Suzhou, China, and manufacturing equipment additions.

Cash Flows Used in Financing Activities. During 2007, \$138 million was used in financing activities compared to \$103 million in 2006. Net borrowings on the long-term line of credit totaled \$107 million. Cash was used for share repurchases totaling \$230 million, an increase of \$143 million from the prior year. Cash dividends paid totaled \$43 million, an increase of \$4 million from the prior year.

In February 2006, the Board of Directors authorized the Company to repurchase up to 7 million shares of its outstanding common stock, primarily through open-market transactions. At December 28, 2007, there were no remaining shares to be purchased under this authorization. In September 2007, the Board of Directors authorized the Company to purchase up to a total of an additional 7 million shares. This authorization will expire on September 30, 2009 and approximately 6 million shares could yet be purchased under this plan at December 28, 2007.

Off-Balance Sheet Arrangements and Contractual Obligations. As of December 28, 2007, the Company is obligated to make cash payments in connection with its long-term debt, capital leases, operating leases and purchase obligations in the amounts listed below. The current portion of uncertain tax positions under FIN 48 is also noted. The Company has no significant off-balance sheet debt or other unrecorded obligations other than the items noted in the following table. In addition to the commitments noted in the following table, the Company could be obligated to perform under standby letters of credit totaling \$2 million at December 28, 2007. The Company has also guaranteed the debt of its subsidiaries for up to \$9 million. All debt of subsidiaries is reflected in the consolidated balance sheets.

| (In millions) | Payments due by period | | | | |
|---|------------------------|---------------------|--------------|---------------|----------------------|
| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| Long-term debt | \$ 107 | \$ — | \$ — | \$ 107 | \$ — |
| Capital lease obligations | — | — | — | — | — |
| Operating leases | 6 | 3 | 2 | — | 1 |
| Purchase obligations ¹ | 49 | 49 | — | — | — |
| Fixed rate payments on interest swap | 11 | 4 | 7 | — | — |
| Unfunded pension and postretirement medical benefits | 29 | 3 | 6 | 6 | 14 |
| Uncertain tax positions ² | | | | | |
| Total | \$ 202 | \$ 59 | \$ 15 | \$ 113 | \$ 15 |

¹ The Company is committed to pay suppliers under the terms of open purchase orders issued in the normal course of business. The Company has also committed up to \$5 million under capital expenditure plans for facility construction and improvements. In addition, the Company has commitments with certain suppliers to purchase minimum quantities, and under the terms of certain agreements, the Company is committed for certain portions of the supplier's inventory. The Company does not purchase, or commit to purchase, quantities in excess of normal usage or amounts that cannot be used within one year.

² The total liability for uncertain tax positions under FIN 48 at December 28, 2007 was approximately \$5.4 million. The Company is not able to reasonably estimate the timing of future payments relating to non-current unrecognized tax benefits.

Critical Accounting Estimates

The Company prepares its consolidated financial statements in conformity with generally accepted accounting principles in the United States of America ("U.S. GAAP"). The Company's most significant accounting policies are disclosed in Note A to the consolidated financial statements. The preparation of the consolidated financial statements, in conformity with U.S. GAAP, requires management to make estimates and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual amounts will differ from those estimates. The Company considers the following policies to involve the most judgment in the preparation of the Company's consolidated financial statements.

Sales Returns. An allowance is established for possible return of products. The amount of the allowance is an estimate, which is based on historical ratios of returns to sales, the historical average length of time between the sale and the return and other factors. Also, the Company's written agreements with distributors typically limit the amount that may be returned. From time to time, the Company may choose to terminate a distributor relationship and may take back inventory. These are considered period events and not included in the allowance for returns. Although management considers these balances adequate, changes in customers' behavior versus historical experience or changes in the Company's return policies are among the factors that would result in materially different amounts for this item.

Excess and Discontinued Inventory. The Company's inventories are valued at the lower of cost or market. Reserves for excess and discontinued product are estimated. The amount of the reserve is determined based on projected sales information, plans for discontinued products and other factors. Though management considers these balances adequate, changes in sales volumes due to unanticipated economic or competitive conditions are among the factors that would result in materially different amounts for this item.

Product Warranty. A liability is established for estimated warranty claims to be paid in the future that relate to current and prior period sales. The Company estimates these costs based on historical claim experience, changes in warranty programs and other factors, including evaluating specific product warranty issues. The establishment of reserves requires the use of judgment and assumptions regarding the potential for losses relating to warranty issues. Though management considers these balances adequate, changes in the Company's warranty policy or a significant change in product defects versus historical averages are among the factors that would result in materially different amounts for this item.

Goodwill and Other Intangible Assets. The Company performs impairment testing for goodwill and other intangible assets annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. For goodwill, the Company performs impairment reviews for the Company's reporting units, which have been determined to be the Company's divisions using a fair-value method based on management's judgments and assumptions. The Company estimates the fair value of the reporting units by an allocation of market capitalization value, cross-checked by a present value of future cash

flows calculation. The estimated fair value is then compared with the carrying amount of the reporting unit, including recorded goodwill. The Company also performs a separate impairment test for each other intangible asset with indefinite life, based on estimated future use and discounting estimated future cash flows. A considerable amount of management judgment and assumptions are required in performing the impairment tests. Though management considers its judgments and assumptions to be reasonable, changes in product offerings or marketing strategies could change the estimated fair values and result in impairment charges.

Self-Insured Retentions. The Company purchases insurance for products liability, workers compensation and employee medical benefits with high deductibles. Third party insurance is carried for what is believed to be the major portion of potential exposures that would exceed the Company's self-insured retentions. The Company has established liabilities for potential uninsured claims, including estimated costs and legal fees. The Company employs actuaries to assist in evaluating its potential ultimate exposure for uninsured claims and then considers factors such as known outstanding claims, historical experience, sales trends and other relevant factors in setting the liabilities. Though management considers these balances adequate, a substantial change in the number and /or severity of claims would result in materially different amounts for this item.

Income Taxes. In the preparation of the Company's consolidated financial statements, management calculates income taxes. This includes estimating current tax liability as well as assessing temporary differences resulting from different treatment of items for tax and financial statement purposes. These differences result in deferred tax assets and liabilities, which are recorded on the balance sheet using statutory rates in effect for the year in which the differences are expected to reverse. These assets and liabilities are analyzed regularly and management assesses the likelihood that deferred tax assets will be recoverable from future taxable income. A valuation allowance is established to the extent that management believes that recovery is not likely. Liabilities for uncertain tax positions are also established for potential and ongoing audits of federal, state and international issues. The Company routinely monitors the potential impact of such situations and believes that liabilities are properly stated. Valuations related to amounts owed and tax rates could be impacted by changes to tax codes, changes in statutory tax rates, the Company's future taxable income levels and the results of tax audits.

Retirement Obligations. The measurements of the Company's pension and postretirement medical obligations are dependent on a number of assumptions including estimates of the present value of projected future payments, taking into consideration future events such as salary increases and demographic experience. These assumptions may have an impact on the expense and timing of future contributions.

The assumptions used in developing the required estimates for pension obligations include discount rates, inflation, salary increases, retirement rates, expected return on plan assets and mortality rates. The assumptions used in developing the required estimates for postretirement medical obligations include discount rates, rate of future increase in medical costs and participation rates.

For U.S. plans, the Company establishes its discount rate assumption by reference to the "Citigroup Pension Liability Index," a published index commonly used as a benchmark. For plans outside of the U.S., the Company establishes a rate by country by reference to highly rated corporate bonds. These reference points have been determined to adequately match expected plan cash flows. The Company bases its inflation assumption on an evaluation of external market indicators. The salary assumptions are based on actual historical experience, the near-term outlook and assumed inflation. Retirement rates are based on experience. The investment return assumption is based on the expected long-term performance of plan assets. In setting this number, the Company considers the input of actuaries and investment advisors, its long-term historical returns, the allocation of plan assets, and projected returns on plan assets. Mortality rates are based on a common group mortality table for males and females.

Net pension credit in 2007 was \$0.7 million and was allocated to cost of products sold and operating expenses based on salaries and wages. At December 28, 2007, a one-half percentage point decrease in the indicated assumptions would have the following effects (in millions):

| Assumption | Funded Status | Expense |
|---------------------------|---------------|---------|
| Discount rate | \$ (13.9) | \$ 0.4 |
| Expected return on assets | \$ — | \$ 1.0 |

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, "Fair Value Measurements." This statement establishes a consistent framework for measuring fair value and expands disclosures on fair market value measurements. The Company will adopt the provisions of SFAS No. 157 for financial assets and liabilities in 2008. With respect to non-financial assets and liabilities, the statement is effective for the Company starting in fiscal 2009. The impact of the initial adoption of SFAS No. 157 is not expected to have a significant impact on the consolidated financial statements. The Company has not determined the impact, if any, the adoption of this statement as it pertains to non-financial assets and liabilities will have on its consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The Company sells and purchases products and services in currencies other than the U.S. dollar and pays variable interest rates on borrowings under its primary credit facility. Consequently, the Company is subject to profitability risk arising from exchange and interest rate movements. The Company may use a variety of financial and derivative instruments to manage foreign currency and interest rate risks. The Company does not enter into any of these instruments for trading purposes to generate revenue. Rather, the Company's objective in managing these risks is to reduce fluctuations in earnings and cash flows associated with changes in foreign currency exchange and interest rates.

The Company may use forward exchange contracts, options and other hedging activities to hedge the U.S. dollar value resulting from anticipated currency transactions and net monetary asset and liability positions. At December 28, 2007, the currencies to which the company had the most significant balance sheet exchange rate exposure were the euro, Canadian dollar, Japanese yen, British pound and Korean won. It is not possible to determine the true impact of currency rate changes; however, the direct translation effect on net sales and net earnings can be estimated. When compared to 2006 results, the weaker U.S. dollar versus other currencies helped to increase sales and net earnings. For the year ended December 28, 2007 the impact of currency translation resulted in a calculated increase in net sales and net earnings of approximately \$17 million and \$7 million, respectively. For the year ended December 29, 2006, the calculated impact of currency translation resulted in an increase in net sales and net earnings of approximately \$5 million and \$2 million, respectively.

In 2007 the Company entered into interest rate swap contracts that effectively fix the rates paid on a total of \$80 million of variable rate borrowings under the Company's primary credit facility. The contracts fix the rates at approximately 4.7 percent through 2010.

2008 Outlook

The Company is expecting higher net sales and net earnings in 2008. Management believes that economic conditions in the U.S. will remain challenging in 2008, particularly in markets related to the housing industry. However, the Company anticipates that sales activity outside of the Americas will continue to be solid and that most of the Company's major markets will continue to experience favorable economic conditions. The Company's backlog is typically small compared to annual sales and is not a good indicator of future business levels. In addition to economic growth, the improved sales outlook is dependent upon many factors, including the successful launch of new products, expanding distribution coverage, realization of price increases and stable foreign currency exchange rates. The earnings outlook assumes higher sales, continued improvements in manufacturing (which help offset cost increases including higher material prices), the continued disciplined management of operating expenses and the successful management and integration of acquisitions. The Company expects its effective tax rate will be approximately 34 percent. The tax rate in any quarter can be affected positively or negatively by developments in the specific quarter.

Forward-Looking Statements

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, or in press or earnings releases, analyst briefings, conference calls and the Company's Annual Report to shareholders which reflects the Company's current thinking on market trends and the Company's future financial performance at the time they are made. All forecasts and projections are forward-looking statements.

The Company 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 Item 1A of,

and Exhibit 99 to, the Company's Annual Report on Form 10-K for fiscal year 2007 for a more comprehensive discussion of these and other risk factors.

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

Item 8. Financial Statements and Supplementary Data

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Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. The internal control system was designed to provide reasonable assurance to management and the board of directors regarding the reliability of financial reporting and preparation of financial statements in accordance with generally accepted accounting principles.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 28, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*.

Based on our assessment and those criteria, management believes the Company's internal control over financial reporting is effective as of December 28, 2007.

The Company's independent auditors have issued an attestation report on management's assessment of the Company's internal control over financial reporting. That report appears in this Form 10-K.

REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Internal Control Over Financial Reporting

To the Shareholders and Board of Directors of
Graco Inc.
Minneapolis, Minnesota

We have audited the internal control over financial reporting of Graco Inc. and Subsidiaries (the "Company") as of December 28, 2007, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 28, 2007, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 28, 2007, of the Company and our report dated February 18, 2008 expressed an unqualified opinion on those financial statements and financial statement schedule and included an explanatory paragraph regarding the Company's change in the method of accounting for share-based compensation in 2006 described in Note A.

DELOITTE & TOUCHE LLP

Minneapolis, Minnesota
February 18, 2008

Consolidated Financial Statements

To the Shareholders and Board of Directors of
Graco Inc.
Minneapolis, Minnesota

We have audited the accompanying consolidated balance sheets of Graco Inc. and Subsidiaries (the "Company") as of December 28, 2007 and December 29, 2006, and the related consolidated statements of earnings, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 28, 2007. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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 28, 2007 and December 29, 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 28, 2007, 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.

As discussed in Note A to the consolidated financial statements, the Company changed its method of accounting for share-based compensation in 2006.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 28, 2007, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 18, 2008 expressed an unqualified opinion on the Company's internal control over financial reporting.

DELOITTE & TOUCHE LLP

Minneapolis, Minnesota
February 18, 2008

CONSOLIDATED STATEMENTS OF EARNINGS
Graco Inc. and Subsidiaries

| (In thousands, except per share amounts) | Years Ended | | |
|--|-------------------|-------------------|-------------------|
| | December 28, 2007 | December 29, 2006 | December 30, 2005 |
| Net Sales | \$841,339 | \$816,468 | \$731,702 |
| Cost of products sold | 393,913 | 382,511 | 352,352 |
| Gross Profit | 447,426 | 433,957 | 379,350 |
| Product development | 30,277 | 29,970 | 26,970 |
| Selling, marketing and distribution | 124,508 | 119,122 | 110,135 |
| General and administrative | 60,161 | 58,866 | 51,175 |
| Operating Earnings | 232,480 | 225,999 | 191,070 |
| Interest expense | 3,433 | 946 | 1,374 |
| Other expense, net | 211 | 687 | 342 |
| Earnings before Income Taxes | 228,836 | 224,366 | 189,354 |
| Income taxes | 76,000 | 74,600 | 63,500 |
| Net Earnings | \$152,836 | \$149,766 | \$125,854 |
| Basic Net Earnings per Common Share | \$ 2.35 | \$ 2.21 | \$ 1.83 |
| Diluted Net Earnings per Common Share | \$ 2.32 | \$ 2.17 | \$ 1.80 |
| Dividends Declared per Common Share | \$.68 | \$.60 | \$.54 |

See Notes to Consolidated Financial Statements.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Graco Inc. and Subsidiaries

| (In thousands) | Years Ended | | |
|---|-------------------|-------------------|-------------------|
| | December 28, 2007 | December 29, 2006 | December 30, 2005 |
| Net Earnings | \$152,836 | \$149,766 | \$125,854 |
| Other comprehensive income (loss) | | | |
| Cumulative translation adjustment | 108 | 2,693 | (2,390) |
| Pension and postretirement medical liability adjustment | (875) | 115 | (1,050) |
| Gain (loss) on interest rate hedge contracts | (1,700) | — | — |
| Income taxes | 895 | (3) | 368 |
| Other comprehensive income (loss) | (1,572) | 2,805 | (3,072) |
| Comprehensive Income | \$151,264 | \$152,571 | \$122,782 |

See Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

Graco Inc. and Subsidiaries

(In thousands, except share and per share amounts)

December 28, 2007 December 29, 2006

| ASSETS | | |
|---|------------------|------------------|
| Current Assets | | |
| Cash and cash equivalents | \$ 4,922 | \$ 5,871 |
| Accounts receivable, less allowances of \$6,500 and \$5,800 | 140,489 | 134,105 |
| Inventories | 74,737 | 76,311 |
| Deferred income taxes | 21,650 | 20,682 |
| Other current assets | 7,034 | 2,014 |
| Total current assets | 248,832 | 238,983 |
| Property, Plant and Equipment, net | 140,594 | 124,524 |
| Prepaid Pension | 31,823 | 26,903 |
| Goodwill | 67,204 | 67,174 |
| Other Intangible Assets, net | 41,889 | 50,325 |
| Other Assets | 6,382 | 3,694 |
| Total Assets | \$536,724 | \$511,603 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Notes payable to banks | \$ 18,991 | \$ 18,363 |
| Trade accounts payable | 27,379 | 27,442 |
| Salaries, wages and commissions | 20,470 | 26,303 |
| Dividends payable | 11,476 | 11,055 |
| Other current liabilities | 47,561 | 45,766 |
| Total current liabilities | 125,877 | 128,929 |
| Long-Term Debt | 107,060 | — |
| Retirement Benefits and Deferred Compensation | 40,639 | 36,946 |
| Uncertain Tax Positions | 5,400 | — |
| Deferred Income Taxes | 13,074 | 14,724 |
| Commitments and Contingencies (Note K) | | |
| Shareholders' Equity | | |
| Common stock, \$1 par value; 97,000,000 shares authorized; 61,963,962 and 66,804,781 shares outstanding in 2007 and 2006 | 61,964 | 66,805 |
| Additional paid-in capital | 156,420 | 130,621 |
| Retained earnings | 32,986 | 138,702 |
| Accumulated other comprehensive income (loss) | (6,696) | (5,124) |
| Total shareholders' equity | 244,674 | 331,004 |
| Total Liabilities and Shareholders' Equity | \$536,724 | \$511,603 |

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
Graco Inc. and Subsidiaries

| (In thousands) | Years Ended | | |
|--|-------------------|-------------------|-------------------|
| | December 28, 2007 | December 29, 2006 | December 30, 2005 |
| Cash Flows from Operating Activities | | | |
| Net earnings | \$152,836 | \$149,766 | \$125,854 |
| Adjustments to reconcile net earnings to net cash provided by operating activities | | | |
| Depreciation and amortization | 28,665 | 26,046 | 23,496 |
| Deferred income taxes | (1,590) | (6,597) | 1,260 |
| Share-based compensation | 8,583 | 8,392 | — |
| Excess tax benefit related to share-based payment arrangements | (4,508) | (2,857) | — |
| Change in | | | |
| Accounts receivable | (1,844) | (3,584) | (9,101) |
| Inventories | 2,045 | (15,587) | 4,524 |
| Trade accounts payable | (2,314) | (74) | 701 |
| Salaries, wages and commissions | (6,527) | 1,917 | 2,239 |
| Retirement benefits and deferred compensation | (2,290) | (12) | 396 |
| Other accrued liabilities | 4,666 | (2,302) | 1,189 |
| Other | (625) | 521 | 2,666 |
| Net cash provided by operating activities | 177,097 | 155,629 | 153,224 |
| Cash Flows from Investing Activities | | | |
| Property, plant and equipment additions | (36,869) | (33,652) | (19,904) |
| Proceeds from sale of property, plant and equipment | 296 | 128 | 239 |
| Investment in life insurance | (1,499) | — | — |
| Capitalized software and other intangible asset additions | (85) | (202) | (802) |
| Acquisitions of businesses, net of cash acquired | — | (30,676) | (111,005) |
| Net cash used in investing activities | (38,157) | (64,402) | (131,472) |
| Cash Flows from Financing Activities | | | |
| Net borrowings (payments) on short-term lines of credit | (312) | 9,593 | 2,498 |
| Borrowings on long-term line of credit | 158,351 | — | — |
| Payments on long-term line of credit | (51,295) | — | — |
| Excess tax benefit related to share-based payment arrangements | 4,508 | 2,857 | — |
| Common stock issued | 24,055 | 12,008 | 10,481 |
| Common stock retired | (230,412) | (87,570) | (42,297) |
| Cash dividends paid | (43,188) | (39,429) | (35,805) |
| Net cash used in financing activities | (138,293) | (102,541) | (65,123) |
| Effect of exchange rate changes on cash | (1,596) | (1,479) | 1,481 |
| Net increase (decrease) in cash and cash equivalents | (949) | (12,793) | (41,890) |
| Cash and cash equivalents | | | |
| Beginning of year | 5,871 | 18,664 | 60,554 |
| End of year | \$ 4,922 | \$ 5,871 | \$ 18,664 |

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
Graco Inc. and Subsidiaries

| (In thousands) | Years Ended | | |
|--|-------------------|-------------------|-------------------|
| | December 28, 2007 | December 29, 2006 | December 30, 2005 |
| Common Stock | | | |
| Balance, beginning of year | \$ 66,805 | \$ 68,387 | \$ 68,979 |
| Shares issued | 1,077 | 539 | 599 |
| Shares repurchased | (5,918) | (2,121) | (1,191) |
| Balance, end of year | 61,964 | 66,805 | 68,387 |
| Additional Paid-In Capital | | | |
| Balance, beginning of year | 130,621 | 110,842 | 100,180 |
| Shares issued | 24,093 | 11,469 | 9,882 |
| Stock compensation cost | 8,583 | 8,392 | — |
| Tax benefit related to stock options exercised | 5,808 | 3,357 | 2,510 |
| Restricted Stock Issued | (1,115) | — | — |
| Shares repurchased | (11,570) | (3,439) | (1,730) |
| Balance, end of year | 156,420 | 130,621 | 110,842 |
| Retained Earnings | | | |
| Balance, beginning of year | 138,702 | 112,506 | 62,773 |
| Net income | 152,836 | 149,766 | 125,854 |
| Dividends declared | (43,609) | (40,554) | (36,745) |
| Shares repurchased | (214,943) | (83,016) | (39,376) |
| Balance, end of year | 32,986 | 138,702 | 112,506 |
| Accumulated Other Comprehensive Income (Loss) | | | |
| Balance, beginning of year | (5,124) | (4,051) | (979) |
| Other comprehensive income (loss) | (1,572) | 2,805 | (3,072) |
| Adjustments to initially apply new accounting standard, net of tax | — | (3,878) | — |
| Balance, end of year | (6,696) | (5,124) | (4,051) |
| Total Shareholders' Equity | \$244,674 | \$331,004 | \$287,684 |

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Graco Inc. and Subsidiaries

Years Ended December 28, 2007, December 29, 2006 and December 30, 2005

A. Summary of Significant Accounting Policies

Fiscal Year. The fiscal year of Graco Inc. and Subsidiaries (the Company) is 52 or 53 weeks, ending on the last Friday in December. The years ended December 28, 2007, December 29, 2006 and December 30, 2005, 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 28, 2007, all subsidiaries are 100 percent owned.

Foreign Currency Translation. The functional currency of one subsidiary in Great Britain is local currency. Accordingly, adjustments resulting from the translation of that subsidiary's financial statements into U.S. dollars are charged or credited to accumulated other comprehensive income. The U.S. dollar is the functional currency for all other foreign subsidiaries, including one subsidiary in Spain whose functional currency changed to the U.S. dollar from the euro effective at the beginning of 2007. Accordingly, gains and losses from the translation of foreign currency balances and transactions of those subsidiaries are included in other expense, net.

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. Such estimates and assumptions also affect 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 most U.S. inventories. Inventories of foreign subsidiaries are valued using the first-in, first-out (FIFO) cost method.

Other Current Assets. Amounts included in other current assets were:

| (In thousands) | 2007 | 2006 |
|----------------------------|---------|---------|
| Prepaid income taxes | \$4,936 | \$ — |
| Prepaid expenses and other | 2,098 | 2,014 |
| Total | \$7,034 | \$2,014 |

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 | lesser of 5 to 10 years or life of lease |
| Manufacturing equipment | 5 to 10 years |
| Office, warehouse and automotive equipment | 3 to 10 years |

Intangible Assets. Goodwill has been assigned to reporting units, which are the Company's divisions. The amounts of goodwill for each reportable segment were:

| (In thousands) | 2007 | 2006 |
|----------------|----------|----------|
| Industrial | \$42,221 | \$42,191 |
| Contractor | 7,939 | 7,939 |
| Lubrication | 17,044 | 17,044 |
| Total | \$67,204 | \$67,174 |

Components of other intangible assets were:

| (Dollars in thousands) | Estimated Life (Years) | Original Cost | Amortization | Foreign Currency Translation and Other | Book Value |
|---|---------------------------|-----------------|-------------------|---|-----------------|
| December 28, 2007 | | | | | |
| Customer relationships and distribution network | 4 – 8 | \$26,102 | \$(11,092) | \$ 29 | \$15,039 |
| Patents, proprietary technology and product documentation | 5 – 15 | 22,243 | (7,720) | 16 | 14,539 |
| Trademarks, trade names and other | 3 – 10 | 4,684 | (2,555) | 22 | 2,151 |
| | | 53,029 | (21,367) | 67 | 31,729 |
| Not Subject to Amortization | | | | | |
| Brand names | | 10,260 | — | (100) | 10,160 |
| Total | | \$63,289 | \$(21,367) | \$(33) | \$41,889 |
| December 29, 2006 | | | | | |
| Customer relationships and distribution network | 4 – 8 | \$26,102 | \$ (7,335) | \$ 6 | \$18,773 |
| Patents, proprietary technology and product documentation | 5 – 15 | 22,243 | (4,443) | 5 | 17,805 |
| Trademarks, trade names and other | 3 – 10 | 5,114 | (1,641) | 14 | 3,487 |
| | | 53,459 | (13,419) | 25 | 40,065 |
| Not Subject to Amortization | | | | | |
| Brand names | | 10,260 | — | — | 10,260 |
| Total | | \$63,719 | \$(13,419) | \$25 | \$50,325 |

Amortization of intangibles was \$8.5 million in 2007 and \$6.9 million in 2006. Estimated future annual amortization is as follows: \$7.7 million in 2008, \$6.9 million in 2009, \$5.8 million in 2010, \$4.9 million in 2011 and \$6.4 million thereafter.

Other Assets. Components of other assets were:

| (In thousands) | 2007 | 2006 |
|--|----------------|----------------|
| Cash surrender value of life insurance | \$1,450 | \$ — |
| Assets held for sale | 1,138 | — |
| Capitalized software | 1,019 | 1,614 |
| Deposits and other | 2,775 | 2,080 |
| Total | \$6,382 | \$3,694 |

In June 2007, the Company paid \$1.5 million for contracts insuring the lives of certain employees who are eligible to participate in certain non-qualified pension and deferred compensation plans. These insurance contracts will be used to fund the non-qualified pension and deferred compensation arrangements. The insurance contracts are held in a trust and are available to general creditors in the event of the Company's insolvency. Changes in cash surrender value are recorded in operating expense and were not significant in 2007.

Operations in Cleveland, Ohio were moved to new facilities in Anoka, Minnesota in 2007. The property that formerly housed those operations is listed for sale and was reclassified to other assets from property, plant and equipment at estimated market value.

Capitalized software is amortized over its estimated useful life (generally 2 to 5 years) beginning at date of implementation.

Impairment of Long-Lived Assets. In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Company evaluates long-lived assets (including property and equipment, goodwill and other intangible assets) for impairment whenever events or changes in business circumstances indicate the carrying value of the assets may not be recoverable. Goodwill and other intangible assets not subject to amortization are also reviewed for impairment annually in the fourth quarter. There have been no significant write-downs of any long-lived assets in the periods presented.

Other Current Liabilities. Components of other current liabilities were:

| (In thousands) | 2007 | 2006 |
|--|-----------------|-----------------|
| Accrued self-insured retentions | \$ 7,842 | \$ 7,833 |
| Accrued warranty and service liabilities | 7,084 | 6,675 |
| Accrued trade promotions | 6,480 | 7,265 |
| Payable for employee stock purchases | 5,829 | 5,846 |
| Income taxes payable | 678 | 3,920 |
| Other | 19,648 | 14,227 |
| Total | \$47,561 | \$45,766 |

Self-Insurance. The Company is self-insured for certain losses and costs 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 self-insured retentions are based on claims filed and estimates of claims incurred but not reported.

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

| (In thousands) | 2007 | 2006 |
|--------------------------------|-----------------|-----------------|
| Balance, beginning of year | \$ 6,675 | \$ 7,649 |
| Charged to expense | 6,053 | 4,442 |
| Margin on parts sales reversed | 3,186 | 1,944 |
| Reductions for claims settled | (8,830) | (7,360) |
| Balance, end of year | \$ 7,084 | \$ 6,675 |

Revenue Recognition. Sales are recognized when revenue is realized or realizable and has been earned. The Company's policy is to recognize revenue when risk and title passes to the customer. This is generally on the date of shipment, however certain sales are shipped FOB destination and revenue is recognized when received by the customer. In cases where there are specific customer acceptance provisions, revenue is recognized at the later of customer acceptance or shipment (subject to FOB terms.) Payment terms are established based on the type of product, distributor capabilities and competitive market conditions. Rights of return are typically contractually limited, amounts are estimable, and the Company records provisions for anticipated returns and warranty claims at the time revenue is recognized. Historically, sales returns have been approximately 2 percent of sales. 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.

Trade promotions are offered to distributors and end users through various programs, generally with terms of one year or less. Such promotions include cooperative advertising arrangements, rebates based on annual purchases, and coupons. Payment of incentives may take the form of cash, trade credit, promotional merchandise or free product. Under cooperative advertising arrangements, the Company reimburses the distributor for a portion of its advertising costs related to the Company's products; estimated costs are accrued at the time of sale and classified as selling, marketing and distribution expense. Rebates are accrued based on the program rates and progress toward the estimated annual sales amount, and are recorded as a reduction of sales (cash, trade credit) or cost of products sold (free goods). The estimated costs related to coupon programs are accrued at the time of sale and classified as selling, marketing and distribution expense or cost of products sold, depending on the type of incentive offered.

Share-based Compensation. SFAS No. 123(R), "Share-Based Payment," became effective for the Company at the beginning of 2006. This standard requires compensation costs related to share-based payment transactions to be recognized in the financial statements. The Company adopted the standard using the modified prospective transition method, whereby compensation cost related to unvested awards as of the effective date are recognized as calculated for pro forma disclosures under SFAS No. 123, and cost related to new awards are recognized in accordance with SFAS No. 123(R). The Company continues to use the Black-Scholes option-pricing model to value option grants.

The Company recognized share-based compensation cost of \$8.6 million in 2007 and \$8.4 million in 2006, which reduced net income by \$6.4 million, or \$0.10 per weighted common share in 2007 and \$6.1 million, or \$0.09 per weighted common share in 2006. As of December 28, 2007, there was \$11.5 million of unrecognized compensation cost related to unvested options, expected to be recognized over a weighted average period of approximately two years.

Had share-based compensation cost for the Employee Stock Purchase Plan and stock options granted under various stock incentive plans been recognized prior to 2006, the Company's net earnings and earnings per share would have been reduced as follows:

| (In thousands, except per share amounts) | 2005 |
|--|-----------|
| Net earnings | |
| As reported | \$125,854 |
| Stock compensation, net of related tax effects | (4,636) |
| Pro forma | \$121,218 |
| Net earnings per common share | |
| Basic as reported | \$ 1.83 |
| Diluted as reported | 1.80 |
| Pro forma basic | 1.76 |
| Pro forma diluted | 1.74 |

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

| | 2007 | 2006 | 2005 |
|---------------------------------------|---------|---------|--------|
| Expected life in years | 5.6 | 6.3 | 6.3 |
| Interest rate | 4.2% | 4.6% | 4.2% |
| Volatility | 25.1% | 27.8% | 18.7% |
| Dividend yield | 1.7% | 1.4% | 1.4% |
| Weighted average fair value per share | \$10.55 | \$12.97 | \$8.24 |

Expected life is estimated based on vesting terms and exercise and termination history. Interest rate is based on the U.S Treasury rate on zero-coupon issues with a remaining term equal to the expected life of the option. For 2007 and 2006, expected volatility is based on historical volatility over a period commensurate with the expected life of options. Prior to 2006, volatility was based on historical volatility over a three-year period.

The fair value of employees' purchase rights under the Employee Stock Purchase Plan was estimated on the date of grant. The benefit of the 15 percent discount from the lesser of the fair market value per common share on the first day and the last day of the plan year was added to the fair value of the employees' purchase rights determined using the Black-Scholes option-pricing model with the following assumptions and results:

| | 2007 | 2006 | 2005 |
|---------------------------------------|--------|---------|--------|
| Expected life in years | 1.0 | 1.0 | 1.0 |
| Interest rate | 4.9% | 4.6% | 4.4% |
| Volatility | 24.4% | 24.0% | 18.9% |
| Dividend yield | 1.6% | 1.4% | 1.4% |
| Weighted average fair value per share | \$9.79 | \$10.18 | \$8.26 |

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

Comprehensive Income. Comprehensive income 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, changes in the value of qualifying hedges and pension liability adjustments.

Pension and Other Postretirement Plans. In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." SFAS No. 158 requires the recognition of the funded status of a defined benefit plan in the statement of financial position, requires that changes in the funded status be recognized through comprehensive income and expands disclosures. SFAS No. 158 was effective for the Company for year-end 2006 financial statements. The following table shows the incremental effect of SFAS No. 158 on the consolidated balance sheet as of December 29, 2006:

| (In thousands) | Before Application of SFAS No. 158 | Adjustments | After Application of SFAS No. 158 |
|---|--|-------------|---|
| Deferred income taxes, current | \$ 19,820 | \$ 862 | \$ 20,682 |
| Total current assets | 238,121 | 862 | 238,983 |
| Prepaid pension | 31,303 | (4,400) | 26,903 |
| Total assets | 515,141 | (3,538) | 511,603 |
| Other current liabilities | 43,435 | 2,331 | 45,766 |
| Total current liabilities | 126,598 | 2,331 | 128,929 |
| Retirement benefits and deferred compensation | 37,521 | (575) | 36,946 |
| Deferred income taxes, non-current | 16,140 | (1,416) | 14,724 |
| Accumulated other comprehensive income | (1,246) | (3,878) | (5,124) |
| Total shareholders' equity | 334,882 | (3,878) | 331,004 |
| Total liabilities and shareholders' equity | 515,141 | (3,538) | 511,603 |

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

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

In 2007, the Company entered into interest rate swap contracts that effectively fix the rates paid on a total of \$80 million of variable rate borrowings. One contract fixed the rate on \$40 million of borrowings at 4.7 percent plus the applicable spread (depending on cash flow leverage ratio) until December 2010. The second contract fixed an additional \$40 million of borrowings at 4.6 percent plus the applicable spread until January 2011. Both contracts have been designated as hedges against interest rate volatility. Consequently, changes in the fair market value are recorded in accumulated other comprehensive income (loss). As of December 28, 2007, the fair market value of the swap contracts totaled \$1.7 million and was included in other current liabilities.

The Company periodically evaluates its monetary asset and liability positions denominated in foreign currencies. The Company enters into forward contracts or options, or borrows in various currencies, in order to hedge its net monetary positions. These instruments are recorded at current market values and the gains and losses are included in other expense, net. The Company believes it uses strong financial counterparts in these transactions and that the resulting credit risk under these hedging strategies is not significant.

The Company may periodically hedge anticipated transactions, generally with forward exchange contracts, which are designated as cash flow hedges. Gains and losses representing effective hedges are initially recorded as a component of other comprehensive income and are subsequently reclassified into earnings when the hedged exposure affects earnings. There were no gains or losses on such transactions in 2007, 2006 and 2005, and there were no such transactions outstanding as of December 28, 2007, and December 29, 2006.

Recent Accounting Pronouncements. In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement establishes a consistent framework for measuring fair value and expands disclosures on fair value measurements. SFAS No. 157 is effective for the Company starting in fiscal 2008 with respect to financial assets and liabilities. With respect to non-financial assets and liabilities, the statement is effective for the Company starting in fiscal 2009. The impact of the initial adoption of SFAS No. 157 in 2008 is not expected to have a significant impact on the consolidated financial statements. The Company has not determined the impact, if any, the adoption of this statement as it pertains to non-financial assets and liabilities will have on its consolidated financial statements.

B. Segment Information

The Company has three reportable segments: Industrial, Contractor and Lubrication. The Industrial 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 based on activities performed, sales or space utilization. Assets of the Company are not tracked along reportable segment lines. Depreciation expense is charged to the manufacturing or operating cost center that utilizes the asset, and is then allocated to segments on the same basis as other expenses within that cost center.

Reportable segments are defined by product. 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 | 2007 | 2006 | 2005 |
|---------------------------------|-----------|-----------|-----------|
| Net sales | | | |
| Industrial | \$444,725 | \$416,498 | \$367,119 |
| Contractor | 306,703 | 320,476 | 305,298 |
| Lubrication | 89,911 | 79,494 | 59,285 |
| Total | \$841,339 | \$816,468 | \$731,702 |
| Operating earnings | | | |
| Industrial | \$152,278 | \$128,460 | \$ 98,330 |
| Contractor | 81,528 | 89,064 | 77,598 |
| Lubrication | 9,252 | 18,744 | 15,633 |
| Unallocated corporate (expense) | (10,578) | (10,269) | (491) |
| Total | \$232,480 | \$225,999 | \$191,070 |

Unallocated corporate is not included in management's measurement of segment performance and includes such items as stock compensation, bad debt expense, charitable contributions and certain other charges or credits driven by corporate decisions.

(In thousands)

| Geographic Information | 2007 | 2006 | 2005 |
|--|-----------|-----------|-----------|
| Net sales (based on customer location) | | | |
| United States | \$434,012 | \$474,366 | \$435,091 |
| Other countries | 407,327 | 342,102 | 296,611 |
| Total | \$841,339 | \$816,468 | \$731,702 |
| Long-lived assets | | | |
| United States | \$266,722 | \$240,341 | \$202,601 |
| Other countries | 21,170 | 32,279 | 29,131 |
| Total | \$287,892 | \$272,620 | \$231,732 |

Sales to Major Customers

There were no customers that accounted for 10 percent or more of consolidated sales in 2007. Sales to a paint retailer were 10 percent of consolidated sales in each of the years 2006 and 2005.

C. Inventories

Major components of inventories were as follows:

| (In thousands) | 2007 | 2006 |
|---|-----------|-----------|
| Finished products and components | \$ 46,677 | \$ 44,969 |
| Products and components in various stages of completion | 24,805 | 26,841 |
| Raw materials and purchased components | 37,311 | 35,258 |
| | 108,793 | 107,068 |
| Reduction to LIFO cost | (34,056) | (30,757) |
| Total | \$ 74,737 | \$ 76,311 |

Inventories valued under the LIFO method were \$46.6 million for 2007 and \$49.5 million for 2006. All other inventory was valued on the FIFO method.

In 2007, 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) | 2007 | 2006 |
|--|------------|------------|
| Land and improvements | \$ 10,066 | \$ 8,028 |
| Buildings and improvements | 92,145 | 76,485 |
| Manufacturing equipment | 166,869 | 149,603 |
| Office, warehouse and automotive equipment | 30,580 | 26,335 |
| Additions in progress | 6,413 | 17,867 |
| Total property, plant and equipment | 306,073 | 278,318 |
| Accumulated depreciation | (165,479) | (153,794) |
| Net property, plant and equipment | \$ 140,594 | \$ 124,524 |

Depreciation expense was \$19.5 million in 2007, \$18.2 million in 2006 and \$18.3 million in 2005.

E. Income Taxes

Earnings before income tax expense consist of:

| (In thousands) | 2007 | 2006 | 2005 |
|----------------|-----------|-----------|-----------|
| Domestic | \$203,795 | \$197,410 | \$172,164 |
| Foreign | 25,041 | 26,956 | 17,190 |
| Total | \$228,836 | \$224,366 | \$189,354 |

Income tax expense consists of:

| (In thousands) | 2007 | 2006 | 2005 |
|-----------------|----------|----------|----------|
| Current | | | |
| Domestic | | | |
| Federal | \$67,255 | \$65,652 | \$51,103 |
| State and local | 4,600 | 4,520 | 5,000 |
| Foreign | 6,023 | 7,206 | 5,958 |
| | 77,878 | 77,378 | 62,061 |
| Deferred | | | |
| Domestic | (1,874) | (2,611) | 973 |
| Foreign | (4) | (167) | 466 |
| | (1,878) | (2,778) | 1,439 |
| Total | \$76,000 | \$74,600 | \$63,500 |

Income taxes paid were \$74.6 million, \$77.6 million and \$57.0 million in 2007, 2006 and 2005.

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

| | 2007 | 2006 | 2005 |
|---|------|------|------|
| Statutory tax rate | 35% | 35% | 35% |
| Earnings from non-U.S. sales at lower tax rates | (1) | (2) | (2) |
| State taxes, net of federal effect | 2 | 2 | 2 |
| U.S. general business tax credits | (1) | (1) | (1) |
| Domestic production deduction | (2) | (1) | (1) |
| Effective tax rate | 33% | 33% | 33% |

Deferred income taxes are provided for 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) | 2007 | 2006 |
|--|----------|----------|
| Inventory valuations | \$ 8,986 | \$ 7,963 |
| Insurance accruals | 2,298 | 2,510 |
| Warranty reserves | 2,331 | 2,131 |
| Vacation accruals | 1,917 | 2,047 |
| Bad debt reserves | 1,888 | 1,715 |
| Stock compensation | 2,000 | 3,114 |
| Other | 2,230 | 1,202 |
| Current | 21,650 | 20,682 |
| Unremitted earnings of consolidated foreign subsidiaries | (1,800) | (2,400) |
| Excess of tax over book depreciation | (14,483) | (14,324) |
| Postretirement benefits | 7,462 | 7,372 |
| Stock, pension and deferred compensation | (4,531) | (5,816) |
| Other | 278 | 444 |
| Non-current | (13,074) | (14,724) |
| Net deferred tax assets | \$ 8,576 | \$ 5,958 |

Total deferred tax assets were \$36.8 million and \$32.6 million, and total deferred tax liabilities were \$28.2 million and \$26.6 million on December 28, 2007, and December 29, 2006.

Effective at the beginning of 2007, the Company adopted the provisions of FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes." The adoption of FIN 48 resulted in no adjustment to beginning retained earnings.

The Company files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2001. The Internal Revenue Service (IRS) commenced an examination of the Company's U.S. income tax returns for 2004 and 2005 in the first quarter of 2007, which is anticipated to be completed by the end of 2008. The Company does not anticipate that adjustments related to the resolution of the audit, if any, would result in a material change to its financial position.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

| (In thousands) | 2007 |
|--|----------|
| Unrecognized tax benefits balance at December 30, 2006 | \$ 4,900 |
| Gross increases – current period tax positions | 800 |
| Lapse of statute of limitations | (1,000) |
| Unrecognized tax benefits balance at December 28, 2007 | \$ 4,700 |

At the end of 2007, the Company's liability for uncertain tax positions was \$5.4 million, including \$ 0.7 million of interest and penalties. Unrecognized tax benefits of \$4.0 million would affect the Company's effective tax rate if recognized. The Company records penalties and accrued interest related to uncertain tax positions in income tax expense.

There is a reasonable possibility that unrecognized tax benefits will decrease by approximately \$3 to \$4 million in the next twelve months pursuant to the following events: expiring statute of limitations, the closure of the IRS audit, and the closure of other tax jurisdiction audits.

F. Debt

In July 2007, the Company entered into an agreement with a syndicate of lenders providing an unsecured credit facility for 5 years. This credit facility provides \$250 million of committed credit with an option for an additional \$150 million. The facility is available for general corporate purposes, working capital needs, share repurchases and acquisitions. Borrowings under the facility bear interest at either the bank's prime rate, the federal funds rate plus 0.5 percent or the London Interbank Offered Rate plus a spread of between 0.23 percent and 0.57 percent, depending on the Company's cash flow leverage ratio (debt to earnings before interest, taxes, depreciation and amortization). The Company is also required to pay a facility fee on the full amount of the loan commitment at an annual rate ranging from 0.07 percent to 0.15 percent, depending on the Company's cash flow leverage ratio. The agreement requires the Company to maintain certain financial ratios as to cash flow leverage and interest coverage.

On December 28, 2007, the Company had \$293 million in lines of credit, including the \$250 million in committed credit facilities described above and uncommitted lines of credit totaling \$20 million with U.S. banks and \$23 million with foreign banks. The unused portion of these credit lines was \$172 million at December 28, 2007. Borrowing rates under these credit lines vary with the prime rate, rates on domestic certificates of deposit and the London Interbank market. The weighted average short-term borrowing rates were 5.3 percent, 5.2 percent and 4.3 percent for the years ended December 28, 2007, December 29, 2006 and December 30, 2005. The Company pays facility fees of up to 0.15 percent per annum on certain of these lines. No compensating balances are required.

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

Interest paid on debt during 2007, 2006 and 2005 was \$2.6 million, \$0.9 million and \$1.3 million.

G. Shareholders' Equity

At December 28, 2007, the Company had 22,549 authorized, but not issued, cumulative preferred shares, \$100 par value. 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.

Components of accumulated other comprehensive income (loss) were:

| (In thousands) | 2007 | 2006 |
|-----------------------------------|-----------|-----------|
| Pension liability adjustment | \$(5,672) | \$(5,064) |
| Gain (loss) on hedge contracts | (1,072) | — |
| Cumulative translation adjustment | 48 | (60) |
| Total | \$(6,696) | \$(5,124) |

H. Share-Based Awards and Purchase Plans

Stock Option and Award Plan. The Company has a stock incentive plan under which it grants stock options and share awards to directors, officers and other employees. Option price is the market price on the date of grant. Options become exercisable at such time, generally over three or four years, and in such installments as set by the Company, and expire ten years from the date of grant.

Restricted share awards have been made to certain key employees under the plan. The market value of restricted stock at the date of grant is recorded as a reduction of additional paid-in capital and is charged to operations over the vesting period. Compensation cost charged to operations for restricted share awards was \$31,000 in 2007 and \$116,000 in 2005. There was no compensation cost related to restricted shares in 2006. Individual nonemployee directors of the Company may elect to receive, either currently or deferred, all or part of their 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. Under this arrangement, the Company issued 10,338 shares in 2007, 10,955 shares in 2006 and 12,933 shares in 2005. The expense related to this arrangement is not significant.

Options on common shares granted and outstanding, as well as the weighted average exercise price, are shown below (in thousands, except per share amounts):

| | Options | Weighted Average Exercise Price | Options Exercisable | Weighted Average Exercise Price |
|--------------------------------|---------|---------------------------------|---------------------|---------------------------------|
| Outstanding, December 31, 2004 | 3,622 | \$18.28 | 1,804 | \$11.87 |
| Granted | 389 | 37.95 | | |
| Exercised | (341) | 11.57 | | |
| Canceled | (55) | 29.93 | | |
| Outstanding, December 30, 2005 | 3,615 | \$20.85 | 2,017 | \$14.28 |
| Granted | 703 | 41.11 | | |
| Exercised | (324) | 15.11 | | |
| Canceled | (38) | 34.29 | | |
| Outstanding, December 29, 2006 | 3,956 | \$24.79 | 2,272 | \$16.94 |
| Granted | 1,037 | 40.08 | | |
| Exercised | (836) | 19.96 | | |
| Canceled | (378) | 38.98 | | |
| Outstanding, December 28, 2007 | 3,779 | \$28.63 | 2,228 | \$21.41 |

The following table summarizes information for options outstanding and exercisable at December 28, 2007 (in thousands, except per share and contractual term amounts):

| Range of Prices | Options Outstanding | Options Outstanding Weighted Avg. Contractual Term in Years | Options Outstanding Weighted Avg. Exercise Price | Options Exercisable | Options Exercisable Weighted Avg. Exercise Price |
|-----------------|---------------------|---|--|---------------------|--|
| \$ 6-13 | 772 | 2 | \$10.13 | 772 | \$10.13 |
| 17-29 | 1,041 | 5 | 22.77 | 906 | 21.99 |
| 32-39 | 929 | 8 | 36.53 | 415 | 34.61 |
| 40-49 | 1,037 | 9 | 41.22 | 135 | 41.40 |
| \$ 6-49 | 3,779 | 6 | \$28.63 | 2,228 | \$21.41 |

The aggregate intrinsic value of exercisable option shares was \$36.5 million as of December 28, 2007, with a weighted average contractual term of 4.5 years. There were approximately 3.7 million vested share options and share options expected to vest as of December 28, 2007, with an aggregate intrinsic value of \$37.8 million, a weighted average exercise price of \$28.30 and a weighted average contractual term of 6.1 years.

Information related to options exercised follows:

| (In thousands) | 2007 | 2006 | 2005 |
|---------------------------|----------|---------|---------|
| Cash received | \$16,688 | \$4,889 | \$3,945 |
| Aggregate intrinsic value | 17,465 | 8,851 | 8,574 |
| Tax benefit realized | 6,500 | 3,200 | 3,000 |

Stock Purchase Plan. Under the Company's Employee Stock Purchase Plan, the purchase price of the shares is the lesser of 85 percent of the fair market value on the first day or the last day of the plan year. The Company issued 202,096 shares under this Plan in 2007, 204,478 shares in 2006 and 245,303 shares in 2005.

Authorized Shares. Shares authorized for issuance under the stock option and purchase plans are shown below:

| (In thousands) | Total Shares Authorized | Available for Future Issuance as of December 28, 2007 |
|-------------------------------------|-------------------------|---|
| Stock Incentive Plan (2006) | 7,375 | 3,861 |
| Employee Stock Purchase Plan (2006) | 2,000 | 2,000 |
| Total | 9,375 | 5,861 |

Amounts available for future issuance exclude outstanding options. Options outstanding as of December 28, 2007, include options granted under three plans that were replaced by the Stock Incentive Plan in 2001 and 2006. No shares are available for future grants under those plans. At the annual meeting of shareholders in April 2006, shareholders approved the 2006 Employee Stock Purchase Plan, which authorized 2 million shares of common stock. The new plan became effective in March 2007, at which time shares remaining authorized and unissued by the old plan were cancelled.

I. Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share:

| (In thousands, except per share amounts) | 2007 | 2006 | 2005 |
|---|-----------|-----------|-----------|
| Numerator | | | |
| Net earnings available to common shareholders | \$152,836 | \$149,766 | \$125,854 |
| Denominators | | | |
| Weighted average shares outstanding for basic earnings per share | 65,043 | 67,807 | 68,766 |
| Dilutive effect of stock options computed based on the treasury stock method using the average market price | 941 | 1,170 | 1,096 |
| Denominator for diluted earnings per share | 65,984 | 68,977 | 69,862 |
| Basic earnings per share | \$ 2.35 | \$ 2.21 | \$ 1.83 |
| Diluted earnings per share | \$ 2.32 | \$ 2.17 | \$ 1.80 |

Stock options to purchase 1,142,000 and 615,000 common shares were not included in the 2007 and 2006 calculations of diluted earnings per share, respectively, because they would have been anti-dilutive.

J. Retirement Benefits

The Company has a defined contribution plan, under Section 401(k) of the Internal Revenue Code, which provides retirement benefits to most U.S. employees. For all employees who elect to participate, the Company matches employee contributions at a 100 percent rate, up to 3 percent of the employee's compensation. For employees not covered by a defined benefit plan, the Company contributes an amount equal to 1.5 percent of the employee's compensation. Employer contributions totaled \$3.0 million in 2007, \$2.6 million in 2006 and \$2.3 million in 2005.

The Company's postretirement medical plan provides certain medical benefits for retired U.S. employees. Employees hired before January 1, 2005, are eligible for these benefits upon retirement and fulfillment of other eligibility requirements as specified by the plan.

The Company has both funded and unfunded noncontributory defined benefit pension plans that together cover most U.S. employees hired before January 1, 2006, certain directors and some of the employees of the Company's non-U.S. subsidiaries. For U.S. plans, benefits are based on years of service and the highest five consecutive years' earnings in the ten years preceding retirement. The Company funds annually in amounts consistent with minimum funding requirements and maximum tax deduction limits.

Investment policies and strategies of the funded pension plan are based on a long-term view of economic growth and heavily weighted toward equity securities. The plan invests primarily in common stocks and bonds, including the Company's common stock. The market value of the plan's investment in the common stock of the Company was \$13.0 million at December 28, 2007, and \$13.8 million at December 29, 2006. For the funded pension plan, asset allocations at year-end were as follows:

| | 2007 | 2006 |
|-------------------------|-------------|-------------|
| Graco common stock | 6% | 7% |
| Other equity securities | 72% | 77% |
| Debt securities | 15% | 10% |
| Real estate | 6% | 5% |
| Cash | 1% | 1% |
| Total | 100% | 100% |

The Company uses a December 31 measurement date for all of its plans. The following provides a reconciliation of the changes in the plans' benefit obligations and fair value of assets over the periods ending December 28, 2007, and December 29, 2006, and a statement of the funded status as of the same dates.

| (In thousands) | Pension Benefits | | Postretirement Medical Benefits | |
|--|------------------|------------------|---------------------------------|-------------------|
| | 2007 | 2006 | 2007 | 2006 |
| Change in benefit obligation | | | | |
| Obligation, beginning of year | \$202,578 | \$191,261 | \$ 21,416 | \$ 30,555 |
| Pension obligation of acquired business | — | 4,531 | — | — |
| Service cost | 5,618 | 5,444 | 537 | 849 |
| Interest cost | 11,504 | 10,541 | 1,345 | 1,511 |
| Plan amendments | — | 211 | 873 | (8,164) |
| Actuarial loss (gain) | (10,615) | (3,265) | 1,772 | (1,254) |
| Exchange rate changes | 914 | 865 | — | — |
| Benefit payments | (7,817) | (7,010) | (2,347) | (2,081) |
| Obligation, end of year | \$202,182 | \$202,578 | \$ 23,596 | \$ 21,416 |
| Change in plan assets | | | | |
| Fair value, beginning of year | \$212,819 | \$185,330 | \$ — | \$ — |
| Pension assets of acquired business | — | 4,907 | — | — |
| Actual return on assets | 9,492 | 28,815 | — | — |
| Employer contributions | 884 | 777 | 2,347 | 2,081 |
| Benefit payments | (7,817) | (7,010) | (2,347) | (2,081) |
| Fair value, end of year | \$215,378 | \$212,819 | \$ — | \$ — |
| Funded status | \$ 13,196 | \$ 10,241 | \$(23,596) | \$(21,416) |
| Amounts recognized in consolidated balance sheets | | | | |
| Non-current assets | \$ 31,823 | \$ 26,903 | \$ — | \$ — |
| Current liabilities | 645 | 839 | 2,344 | 1,492 |
| Non-current liabilities | 17,982 | 15,823 | 21,252 | 19,924 |
| Net | \$ 13,196 | \$ 10,241 | \$(23,596) | \$(21,416) |

The accumulated benefit obligation for all defined benefit pension plans was \$182 million as of year-end for both 2007 and 2006. Information for plans with an accumulated benefit obligation in excess of plan assets follows:

| (In thousands) | 2007 | 2006 |
|--------------------------------|----------|----------|
| Projected benefit obligation | \$18,628 | \$16,662 |
| Accumulated benefit obligation | 15,806 | 14,530 |
| Fair value of plan assets | — | — |

The components of net periodic benefit cost for the plans for 2007, 2006 and 2005 were as follows:

| (In thousands) | Pension Benefits | | | Postretirement Medical Benefits | | |
|--|------------------|----------|----------|---------------------------------|---------|---------|
| | 2007 | 2006 | 2005 | 2007 | 2006 | 2005 |
| Service cost – benefits earned during the period | \$ 5,618 | \$ 5,444 | \$ 4,648 | \$ 537 | \$ 849 | \$ 841 |
| Interest cost on projected benefit obligation | 11,504 | 10,541 | 9,931 | 1,345 | 1,511 | 1,620 |
| Expected return on assets | (18,795) | (16,582) | (15,549) | — | — | — |
| Amortization of transition obligation (asset) | — | — | (11) | — | — | — |
| Amortization of prior service cost (credit) | 244 | 147 | 144 | (739) | (161) | — |
| Amortization of net loss (gain) | 236 | 535 | 92 | 811 | 595 | 526 |
| Cost of pension plans which are not significant and have not adopted SFAS No. 87 | 478 | 320 | 370 | N/A | N/A | N/A |
| Net periodic benefit cost (credit) | \$ (715) | \$ 405 | \$ (375) | \$1,954 | \$2,794 | \$2,987 |

Amounts recognized in other comprehensive (income) loss in 2007 were as follows:

| (In thousands) | Pension Benefits | Postretirement Medical Benefits |
|---|------------------|---------------------------------|
| Prior service cost (credit) arising during the period | \$ — | \$ 873 |
| Net loss (gain) arising during the period | (1,218) | 1,772 |
| Amortization of prior service credit (cost) | (244) | 739 |
| Amortization of net gain (loss) | (236) | (811) |
| Total | \$(1,698) | \$2,573 |

Amounts included in accumulated other comprehensive (income) loss as of December 28, 2007 and December 29, 2006, that had not yet been recognized as components of net periodic benefit cost, were as follows:

| (In thousands) | Pension Benefits | | Postretirement Medical Benefits | |
|-----------------------------|------------------|---------|---------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| Prior service cost (credit) | \$ 742 | \$ 996 | \$(6,390) | \$(8,002) |
| Net loss | 4,963 | 6,407 | 9,600 | 8,639 |
| Net before income taxes | 5,705 | 7,403 | 3,210 | 637 |
| Income taxes | (2,055) | (2,740) | (1,188) | (236) |
| Net | \$3,650 | \$4,663 | \$ 2,022 | \$ 401 |

Amounts included in accumulated other comprehensive (income) loss that are expected to be recognized as components of net periodic benefit cost in 2008 were as follows:

| (In thousands) | Pension Benefits | Postretirement Medical Benefits |
|-----------------------------|------------------|---------------------------------|
| Prior service cost (credit) | \$ 252 | \$(658) |
| Net loss (gain) | 144 | 638 |
| Net before income taxes | 396 | (20) |
| Income taxes | (146) | 7 |
| Net | \$ 250 | \$ (13) |

Assumptions used to determine the Company's benefit obligations are shown below:

| Weighted average assumptions | Pension Benefits | | Postretirement Medical Benefits | |
|-------------------------------|------------------|------|---------------------------------|------|
| | 2007 | 2006 | 2007 | 2006 |
| Discount rate | 6.2% | 5.7% | 6.3% | 5.8% |
| Rate of compensation increase | 3.8% | 3.8% | N/A | N/A |

Assumptions used to determine the Company's net periodic benefit cost are shown below:

| Weighted average assumptions | Pension Benefits | | | Postretirement Medical Benefits | | |
|-------------------------------|------------------|------|------|---------------------------------|------|------|
| | 2007 | 2006 | 2005 | 2007 | 2006 | 2005 |
| Discount rate | 5.7% | 5.5% | 5.9% | 5.8% | 5.5% | 6.0% |
| Expected return on assets | 9.0% | 9.0% | 9.0% | N/A | N/A | N/A |
| Rate of compensation increase | 3.8% | 3.8% | 3.8% | N/A | N/A | N/A |

Several sources of information are considered in determining the expected rate of return assumption, including the allocation of plan assets, the input of actuaries and professional investment advisors, and historical long-term returns. In setting the return assumption, the Company recognizes that historical returns are not always indicative of future returns and also considers the long-term nature of its pension obligations.

The Company's U.S. retirement medical plan limits the annual cost increase that will be paid by the Company. In 2006, the annual cost increase limitation was changed to 5 percent for 2007, 4 percent for 2008 and 3 percent thereafter. In 2007, the Company made changes in the administration of the plan to facilitate compliance with the cost limitation provisions. The Company also amended the plan to remove the 30-year service cap applied to the calculation of service-based credits provided to future retirees for postretirement health care costs. In measuring the accumulated postretirement benefit obligation (APBO), the annual trend rate for health care costs was assumed to be 9.0 percent for 2008, decreasing by one-half percentage point each year to a constant rate of 5 percent in 2016 and thereafter, subject to the plan's annual increase limitation.

At December 28, 2007, a one percent change in assumed health care cost trend rates would have no significant impact on the service and interest cost components of net periodic postretirement health care benefit cost or the APBO for health care benefits.

The Company expects to contribute \$0.6 million to its unfunded pension plans and \$2.3 million to the postretirement medical plan in 2008. No contribution to the funded pension plan is expected in 2008. Estimated future benefit payments are as follows:

| (In thousands) | Pension Benefits | Postretirement Medical Benefits |
|-------------------|------------------|---------------------------------|
| 2008 | \$ 8,400 | \$2,300 |
| 2009 | 9,000 | 2,200 |
| 2010 | 10,500 | 2,100 |
| 2011 | 10,800 | 2,000 |
| 2012 | 11,500 | 1,800 |
| Years 2013 – 2017 | 69,700 | 8,200 |

K. Commitments and Contingencies

Lease Commitments. Aggregate annual rental commitments under operating leases with noncancelable terms of more than one year were \$5.6 million at December 28, 2007, payable as follows:

| (In thousands) | Buildings | Vehicles & Equipment | Total |
|----------------|-----------|----------------------|---------|
| 2008 | \$ 629 | \$1,833 | \$2,462 |
| 2009 | 272 | 1,312 | 1,584 |
| 2010 | 30 | 529 | 559 |
| 2011 | 22 | 196 | 218 |
| 2012 | 22 | 78 | 100 |
| Thereafter | 679 | 6 | 685 |
| Total | \$1,654 | \$3,954 | \$5,608 |

Total rental expense was \$2.3 million for 2007, \$1.8 million for 2006 and \$1.7 million for 2005.

Other Commitments. The Company is committed to pay suppliers under the terms of open purchase orders issued in the normal course of business totaling approximately \$20 million at December 28, 2007. The Company also has commitments with certain suppliers to purchase minimum quantities, and under the terms of certain agreements, the Company is committed for certain portions of the supplier's inventory. The Company does not purchase, or commit to purchase quantities in excess of normal usage or amounts that cannot be used within one year. The Company estimates that the maximum commitment amount under such agreements does not exceed \$24 million. In addition, the Company could be obligated to perform under standby letters of credit totaling \$2 million at December 28, 2007. The Company has also guaranteed the debt of its subsidiaries for up to \$9 million.

Contingencies. The Company is party to various legal proceedings arising in the normal course of business. The Company is actively defending these matters and has recorded an estimate of the probable costs. Management does not expect that resolution of these matters will have a material adverse effect on the Company, although the ultimate outcome cannot be determined based on available information.

L. Acquisitions

Lubriquip. In July 2006, the Company purchased the stock of Lubriquip, Inc. for approximately \$31 million cash. Lubriquip, with sales of approximately \$30 million in 2005, is a manufacturer of centralized and automated oil and grease lubrication systems, force-feed lubricators, metering devices and related electronic controls and accessories. The products, brands and distribution channels of Lubriquip will expand and complement the Company's Lubrication Equipment business. Results of Lubriquip operations have been included in the Lubrication segment since the date of acquisition.

Lubriquip had manufacturing facilities in Warrensville Heights, Ohio and Madison, Wisconsin. In 2007, the Company combined those operations with the Company's existing lubrication businesses in a new facility in Anoka, Minnesota.

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

| | |
|--|-----------------|
| Accounts receivable and prepaid expenses | \$ 2,400 |
| Inventories | 3,700 |
| Deferred income taxes | 600 |
| Property, plant and equipment | 3,000 |
| Prepaid pension | 400 |
| Identifiable intangible assets | 17,000 |
| Goodwill | 14,000 |
| <hr/> | |
| Total purchase price | 41,100 |
| Current liabilities assumed | (3,600) |
| Deferred income taxes | (6,800) |
| <hr/> | |
| Net assets acquired | <u>\$30,700</u> |

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

| | |
|--------------------------------------|-----------------|
| Product documentation (8 years) | \$ 8,500 |
| Customer relationships (7 years) | 3,700 |
| Proprietary technology (5 years) | 1,600 |
| <hr/> | |
| Total (7 years) | 13,800 |
| Brand names (indefinite useful life) | 3,200 |
| <hr/> | |
| Total identifiable intangible assets | <u>\$17,000</u> |

None of the goodwill or identifiable intangible assets is expected to be deductible for tax purposes.

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

None.

Item 9A. Controls and Procedures

Evaluation of disclosure controls and procedures

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

Management's Annual Report on Internal Control Over Financial Reporting

The information under the heading "Management's Report on Internal Control Over Financial Reporting" in Part II, Item 8, of this 2007 Annual Report on Form 10-K is incorporated herein by reference.

Reports of Independent Registered Public Accounting Firm

The information under the heading "Reports of Independent Registered Public Accounting Firm: Internal Control Over Financial Reporting" in Part II, Item 8, of this 2007 Annual Report on Form 10-K is incorporated herein by reference.

Changes in Internal Control Over Financial Reporting

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

Item 9B. Other Information

Not applicable.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information under the heading “Executive Officers of the Company” in Part I of this 2007 Annual Report on Form 10-K and the information under the headings “Election of Directors-Nominees and Other Directors,” “Director Qualifications and Selection Process” and “Section 16(a) Beneficial Ownership Reporting Compliance” of our Company’s Proxy Statement for its 2008 Annual Meeting of Shareholders, to be held on April 25, 2008 (the “Proxy Statement”), are incorporated herein by reference.

New York Stock Exchange Rule 303A.12

Our Company’s Annual CEO Certification as required by NYSE Rule 303A.12(a) was filed with the New York Stock Exchange on or about May 10, 2007. The certifications of the President and Chief Executive Officer and Chief Financial Officer and Treasurer under Section 302 of the Sarbanes-Oxley Act of 2002, regarding the quality of our Company’s disclosure in this 2007 Annual Report on Form 10-K, have been filed as exhibits 31.1 and 31.2 hereto.

Audit Committee Members and Audit Committee Financial Expert

The information under the heading “Committees of the Board of Directors” of our Company’s Proxy Statement is incorporated herein by reference.

Corporate Governance Guidelines, Committee Charters and Code of Ethics

Our Company has adopted Corporate Governance Guidelines and Charters for the Audit, Governance, and Management Organization and Compensation Committees of the Board of Directors. We have also issued Conduct of Business Guidelines (Code of Ethics) that apply to our principal executive officer, principal financial officer, principal accounting officer, all officers, directors, and employees of Graco Inc. and all of its subsidiaries and branches worldwide. The Corporate Governance Guidelines, Committee Charters, and Conduct of Business Guidelines, with any amendments or waivers thereto, may be accessed free of charge by visiting the Graco website at www.graco.com. Copies of these documents are also available in print by written request directed to Secretary, Graco Inc., P.O. Box 1441, Minneapolis, MN 55440-1441.

Our Company intends to post on the Graco website any amendment to, or waiver from, a provision of the Conduct of Business Guidelines that applies to our principal executive officer, principal financial officer, principal accounting officer, controller and other persons performing similar functions within four business days following the date of such amendment or waiver.

Section 16(a) Reporting Compliance

The information under the heading “Section 16(a) Beneficial Ownership Reporting Compliance” of the Company’s Proxy Statement is incorporated herein by reference.

Item 11. Executive Compensation

The information contained under the headings “Executive Compensation,” “Compensation Committee Interlocks and Insider Participation” and “Report of the Management Organization and Compensation Committee” of the Proxy Statement is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information contained under the headings “Equity Compensation Plan Information” and “Beneficial Ownership of Shares” of the Proxy Statement is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions and Director Independence

The information under the headings “Certain Business Relationships,” “Related Person Transaction Approval Policy” and “Director Independence” of the Proxy Statement is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

The information under the headings “Independent Registered Public Accounting Firm Fees and Services” and “Pre-Approval Policies” of the Proxy Statement is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedule

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

- (1) Financial Statements
See Part II
- (2) Financial Statement Schedule
Schedule II – Valuation and Qualifying Accounts51

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)53
Those entries marked by an asterisk are Management Contracts, Compensatory Plans or Arrangements.

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 ¹ | Other add (deduct) ² | Balance at end of year |
|-----------------------------------|------------------------------|---|---------------------------------------|---------------------------------|------------------------|
| Year ended December 28, 2007 | | | | | |
| Allowance for doubtful accounts | \$2,600 | \$ 200 | \$ 400 | \$ 100 | \$2,500 |
| Allowance for returns and credits | 3,200 | 12,400 | 11,600 | — | 4,000 |
| | \$5,800 | \$12,600 | \$12,000 | \$ 100 | \$6,500 |
| Year ended December 29, 2006 | | | | | |
| Allowance for doubtful accounts | \$2,300 | \$ — | \$ — | \$ 300 | \$2,600 |
| Allowance for returns and credits | 3,600 | 10,400 | 10,900 | 100 | 3,200 |
| | \$5,900 | \$10,400 | \$10,900 | \$ 400 | \$5,800 |
| Year ended December 30, 2005 | | | | | |
| Allowance for doubtful accounts | \$2,300 | \$ 300 | \$ 200 | \$(100) | \$2,300 |
| Allowance for returns and credits | 3,300 | 8,100 | 7,700 | (100) | 3,600 |
| | \$5,600 | \$8,400 | \$ 7,900 | \$(200) | \$5,900 |

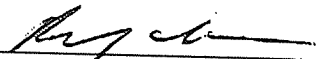
¹ For doubtful accounts, represents amounts determined to be uncollectible and charged against reserve, net of collections on accounts previously charged against reserves. For returns and credits, represents amounts of credits issued and returns processed.

² Includes amounts assumed or established in connection with acquisitions and effects of foreign currency translation.

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.

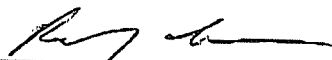
Graco Inc.



Patrick J. McHale
President and Chief Executive Officer

February 18, 2008

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.



Patrick J. McHale
President and Chief Executive Officer
(Principal Executive Officer)

February 18, 2008

James A. Graner
Chief Financial Officer and Treasurer
(Principal Financial Officer)

February 18, 2008

Caroline M. Chambers
Vice President and Controller
(Principal Accounting Officer)

February 18, 2008

- | | |
|---------------------|---------------------------------|
| Lee R. Mitau | Director, Chairman of the Board |
| William J. Carroll | Director |
| Jack W. Eugster | Director |
| J. Kevin Gilligan | Director |
| Patrick J. McHale | Director |
| Marti Morfitt | Director |
| Mark H. Rauenhorst | Director |
| William G. Van Dyke | Director |
| R. William Van Sant | Director |

Patrick J. McHale, 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.



Patrick J. McHale
(For himself and as attorney-in-fact)

February 18, 2008

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.

February 18, 2008

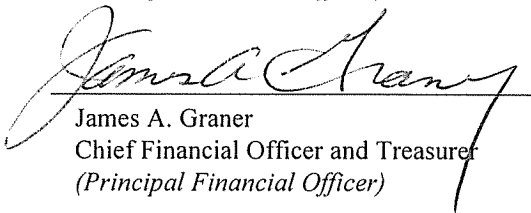
Patrick J. McHale
President and Chief Executive Officer

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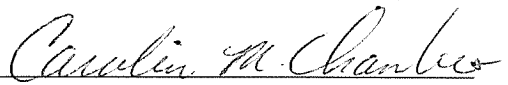
February 18, 2008

Patrick J. McHale
President and Chief Executive Officer
(Principal Executive Officer)

February 18, 2008


James A. Graner
Chief Financial Officer and Treasurer
(Principal Financial Officer)

February 18, 2008


Caroline M. Chambers
Vice President and Controller
(Principal Accounting Officer)

| | |
|---------------------|---------------------------------|
| Lee R. Mitau | Director, Chairman of the Board |
| William J. Carroll | Director |
| Jack W. Eugster | Director |
| J. Kevin Gilligan | Director |
| Patrick J. McHale | Director |
| Marti Morfitt | Director |
| Mark H. Rauenhorst | Director |
| William G. Van Dyke | Director |
| R. William Van Sant | Director |

Patrick J. McHale, 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.

February 18, 2008

Patrick J. McHale
(For himself and as attorney-in-fact)

Exhibit Index

| <u>Exhibit Number</u> | <u>Description</u> |
|-----------------------|---|
| 2.1 | Stock Purchase Agreement By and Among PMC Global, Inc. Gusmer Machinery Group, Inc. and Graco Inc., dated as of February 4, 2005 (Incorporated by reference to exhibit 2.1 to the Company's Report on Form 8-K dated February 10, 2005.) |
| 2.2 | Stock Purchase Agreement By and Among PMC Europe Investments, S.L. and Graco Inc. dated as of February 4, 2005 (Incorporated by reference to Exhibit 2.2 to the Company's Report on Form 8-K dated February 10, 2005.) |
| 3.1 | Restated Articles of Incorporation as amended June 14, 2007. (Incorporated by reference to Exhibit 3.1 to the Company's Report on Form 10-Q for the thirteen weeks ended June 29, 2007.) |
| 3.2 | Restated Bylaws as amended June 13, 2002. (Incorporated by reference to Exhibit 3 to the Company's Report on Form 10-Q for the thirteen weeks ended June 28, 2002.) |
| 4.1 | Share Rights Agreement dated as of February 25, 2000, between the Company and Wells Fargo, formerly known as Norwest Bank Minnesota, National Association, as Rights Agent. (Incorporated by reference to Exhibit 1 to the Company's Registration Statement on Form 8-A dated March 9, 2000.) |
| 4.2 | Credit Agreement dated July 12, 2007, between the Company and U.S. Bank National Association, JPMorgan Chase Bank, N.A., Wells Fargo Bank, National Association, and Bank of America, N.A. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K dated July 12, 2007.) |
| *10.1 | Executive Officer Bonus Plan. (Incorporated by reference to Exhibit 10.3 to the Company's Report on Form 8-K dated February 18, 2005.) |
| *10.2 | Executive Officer Annual Incentive Bonus Plan. (Incorporated by reference to the Company's Definitive Proxy Statement on Schedule 14A filed March 6, 2007.) |
| *10.3 | Graco Inc. Nonemployee Director Stock Option Plan, as amended and restated June 18, 2004. (Incorporated by reference to Exhibit 10.4 to the Company's Report on Form 10-Q for the thirteen weeks ended April 1, 2005.) |
| *10.4 | Long Term Stock Incentive Plan, as amended and restated June 18, 2004. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended April 1, 2005.) |
| *10.5 | Graco Inc. Amended and Restated Stock Incentive Plan (2006). (Incorporated by reference to the Company's Definitive Proxy Statement on Schedule 14A filed March 14, 2006.) |
| 10.6 | Employee Stock Incentive Plan, as amended and restated June 18, 2004. (Incorporated by reference to Exhibit 10.3 to the Company's Report on Form 10-Q for the thirteen weeks ended April 1, 2005.) |
| *10.7 | 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 Exhibit 10.2 to the Company's Report on Form 10-Q for the twenty-six weeks ended June 27, 1997.) Amendment 2 dated May 27, 2000. (Incorporated by reference to Exhibit 10.7 to the Company's 2005 Annual Report on Form 10-K.) Amendment 3 adopted on December 19, 2002. (Incorporated by reference to Exhibit 10.7 to the Company's 2005 Annual Report on Form 10-K.) Amendment 4 adopted June 14, 2007. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirteen weeks ended June 29, 2007.) |
| *10.8 | Deferred Compensation Plan (2005 Statement) as amended and restated on April 4, 2005. (Incorporated by reference to Exhibit 10.1 of the Company's Report on Form 10-Q for the thirteen weeks ended July 1, 2005.) Amendment 2 dated November 1, 2005. (Incorporated by reference to Exhibit 10.8 to the Company's 2005 Annual Report on Form 10-K.) |
| 10.9 | CEO Award Program. (Incorporated by reference to Exhibit 10.9 to the Company's 2005 Annual Report on Form 10-K.) |

- *10.10 Retirement Plan for Nonemployee 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.)
- *10.11 Graco Restoration Plan (2005 Statement.) (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended September 29, 2006.) First Amendment adopted December 8, 2006. (Incorporated by reference to Exhibit 10.12 to the Company's 2006 Annual Report on Form 10-K.) Second Amendment adopted August 15, 2007. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended September 28, 2007.)
- *10.12 Stock Option Agreement. Form of agreement used for award of nonstatutory stock options to nonemployee directors under the Nonemployee Director Stock Option Plan. (Incorporated by reference to Exhibit 10.11 to the Company's 2001 Annual Report on Form 10-K.)
- *10.13 Stock Option Agreement. Form of agreement used for award of nonstatutory stock options to nonemployee directors under the Graco Inc. Stock Incentive Plan. (Incorporated by reference to Exhibit 10.22 to the Company's 2002 Annual Report on Form 10-K.) Amended form of agreement for awards made to nonemployee directors. (Incorporated by reference to Exhibit 10.3 to the Company's Report on Form 10-Q for the thirteen weeks ended March 26, 2004.)
- *10.14 Stock Option Agreement. Form of agreement used for award of nonstatutory stock options to nonemployee directors under the Graco Inc. Amended and Restated Stock Incentive Plan (2006). (Incorporated by reference to Exhibit 10.3 to the Company's Report on Form 10-Q for the thirteen weeks ended June 29, 2007.)
- *10.15 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to executive officers under the Long Term Stock Incentive Plan. (Incorporated by reference to Exhibit 10.12 to the Company's 2001 Annual Report on Form 10-K.)
- *10.16 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to executive officers under the Graco Inc. Stock Incentive Plan. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirteen weeks ended March 29, 2002.) Amended form of agreement for awards made to Chief Executive Officer in 2001 and 2002. Amended form of agreement for awards made to executive officers in 2003. (Incorporated by reference to Exhibit 10.15 of the Company's 2003 Annual Report on Form 10-K.) Amended form of agreement for awards made to executive officers in 2004. Amended form of agreement for awards made to Chief Executive Officer in 2004. (Incorporated by reference to Exhibit 10.2 and 10.4 to the Company's Report on Form 10-Q for the thirteen weeks ended March 26, 2004.)
- *10.17 Stock Option Agreement. Form of agreement used for award in 2007 of non-incentive stock options to executive officers under the Graco Inc. Amended and Restated Stock Incentive Plan (2006). (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended March 30, 2007.)
- *10.18 Stock Option Agreement. Form of agreement used for award in 2007 of non-incentive stock options to chief executive officer under the Graco Inc. Amended and Restated Stock Incentive Plan (2006). (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended March 30, 2007.)
- *10.19 Executive Deferred Compensation Agreement. Form of supplementary agreement entered into by the Company which provides a retirement benefit to one executive officer, 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.)
- *10.20 Executive Officer Restricted Stock Agreement. Form of agreement used to award restricted stock to selected executive officers.
- *10.21 Election Form. Form of agreement used for the issuance of stock or deferred stock in lieu of cash payment of retainer and/or meeting fees to nonemployee directors under the Graco Inc. Stock Incentive Plan. (Incorporated by reference to Exhibit 10.17 to the Company's 2004 Annual Report on Form 10-K.) Amended form of agreement used for the 2006 plan year. (Incorporated by reference to Exhibit 10.4 to the Company's Report on Form 10-Q for the thirteen weeks ended June 29, 2007.)
- *10.22 Election Form. Form of agreement used for the 2007 plan year for the issuance of stock or deferred stock in lieu of cash payment of retainer and/or meeting fees to nonemployee directors under the Graco Inc. Amended and Restated

Stock Incentive Plan (2006). (Incorporated by reference to Exhibit 10.5 to the Company's Report on Form 10-Q for the thirteen weeks ended June 29, 2007.) Amended form of agreement used for the 2008 plan year.

- *10.23 Key Employee Agreement. Form of agreement with officers and other key employees relating to change of control. (Incorporated by reference to Exhibit 10.15 to the Company's 2001 Annual Report on Form 10-K.)
- *10.24 Key Employee Agreement. Form of agreement used with chief executive officer.
- *10.25 Key Employee Agreement. Form of agreement used with executive officers reporting to the chief executive officer.
- *10.26 Key Employee Agreement. Form of agreement used with executive officer reporting to an executive officer other than the chief executive officer.
- *10.27 Letter Agreement with President and Chief Executive Officer, dated June 5, 2001. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirteen weeks ended June 29, 2001.)
- *10.28 Executive Group Long-Term Disability Policy as revised in 1995. (Incorporated by reference to Exhibit 10.23 to the Company's 2004 Annual Report on Form 10-K.) As enhanced by Supplemental Income Protection Plan in 2004.
- 11 Statement of Computation of Earnings per share included in Note I on page 42.
- 21 Subsidiaries of the Registrant included herein on page 56.
- 23 Independent Registered Public Accounting Firm's Consent included herein on page 57.
- 24 Power of Attorney included herein on page 58.
- 31.1 Certification of President and Chief Executive Officer pursuant to Rule 13a-14(a) included herein on page 59.
- 31.2 Certification of Chief Financial Officer and Treasurer pursuant to Rule 13a-14(a) included herein on page 60.
- 32 Certification of President and Chief Executive Officer and Chief Financial Officer and Treasurer pursuant to Section 1350 of Title 18, U.S.C. included herein on page 61.
- 99 Cautionary Statement Regarding Forward-Looking Statements included herein on page 62.

Except as otherwise noted, all documents incorporated by reference above relate to File No. 001-09249.

*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 as of December 28, 2007

| Subsidiary | Jurisdiction of Organization | Percentage of Voting Securities Owned by the Company |
|--|------------------------------|--|
| Graco Australia Pty Ltd. | Australia | 100% ³ |
| Graco Canada Inc. | Canada | 100% |
| Graco do Brasil Limitada | Brazil | 100% ¹ |
| Graco Fluid Equipment (Shanghai) Co., Ltd. | China (PRC) | 100% |
| Graco Fluid Equipment (Suzhou) Co., Ltd. | China (PRC) | 100% ⁶ |
| Graco GmbH | Germany | 100% |
| Graco Hong Kong Ltd. | Hong Kong | 100% |
| Graco Indiana Inc. | United States | 100% |
| Graco K.K. | Japan | 100% |
| Graco Korea Inc. | Korea | 100% |
| Graco Ltd. | England | 100% |
| Graco Minnesota Inc. | United States | 100% |
| Graco N.V. | Belgium | 100% ¹ |
| Graco Ohio Inc. | United States | 100% |
| Graco S.A.S. | France | 100% |
| Gusmer Corporation | United States | 100% |
| Gusmer Canada Ltd. | Canada | 100% ⁴ |
| Gusmer Europe, S.L. | Spain | 100% ⁴ |
| Gusmer Sudamerica S.A. | Argentina | 100% ⁵ |
| Liquid Control Ltd. | England | 100% ² |
| Lubriquip, Inc. | United States | 100% |

¹ Includes shares held by executive officer of the Company or the relevant subsidiary to satisfy the requirements of local law.

² Shares 100% held by Graco Ohio Inc.

³ Shares 100% held by Graco Hong Kong Ltd.

⁴ Shares 100% held by Gusmer Corporation.

⁵ Shares held by Gusmer Corporation and by executive officer of the Company to satisfy the requirements of local law.

⁶ Shares 100% owned by Graco Minnesota Inc.

Exhibit 23

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in Registration Statements No. 333-17691, No. 333-03459, No. 333-75307, No. 333-63128, No. 333-123813, No. 333-134162, and No. 333-140848 on Form S-8 of our reports dated February 18, 2008, relating to the financial statements and financial statement schedule of Graco Inc. and Subsidiaries (the "Company") (which report expresses an unqualified opinion and includes an explanatory paragraph related to the Company's change in the method of accounting for share-based compensation in 2006 described in Note A), and the effectiveness of the Company's internal control over financial reporting, appearing in this Annual Report on Form 10-K of Graco Inc. and Subsidiaries for the year ended December 28, 2007.

DELOITTE & TOUCHE LLP

Minneapolis, Minnesota
February 18, 2008

Exhibit 24

Power of Attorney

Know all by these presents, that each person whose signature appears below hereby constitutes and appoints Patrick J. McHale or James A. Graner, that person's true and lawful attorney-in-fact and agent, with full power of substitution and re-substitution 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 28, 2007, 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, the following persons have signed this Power of Attorney on the date indicated.

| | <u>Date</u> |
|--|--------------------------|
| <u>/s/WILLIAM J. CARROLL</u> William J. Carroll | <u>February 15, 2008</u> |
| <u>/s/JACK W. EUGSTER</u> Jack W. Eugster | <u>February 15, 2008</u> |
| <u>/s/J. KEVIN GILLIGAN</u> J. Kevin Gilligan | <u>February 15, 2008</u> |
| <u>/s/PATRICK J. MCHALE</u> Patrick J. McHale | <u>February 15, 2008</u> |
| <u>/s/LEE R. MITAU</u> Lee R. Mitau | <u>February 15, 2008</u> |
| <u>/s/MARTI MORFITT</u> Marti Morfitt | <u>February 15, 2008</u> |
| <u>/s/MARK H. RAUENHORST</u> Mark H. Rauenhorst | <u>February 15, 2008</u> |
| <u>/s/WILLIAM G. VAN DYKE</u> William G. Van Dyke | <u>February 15, 2008</u> |
| <u>/s/R. WILLIAM VAN SANT</u> R. William Van Sant | <u>February 15, 2008</u> |

Exhibit 10.20

**GRACO INC.
AMENDED AND RESTATED STOCK INCENTIVE PLAN (2006)**

**EXECUTIVE OFFICER
RESTRICTED STOCK AGREEMENT**

This Restricted Stock Agreement ("Agreement") is made as of the 7th day of December 2007, between Graco Inc., a Minnesota corporation (the "Company"), and «Name» (the "Employee") pursuant to the Graco Inc. Amended and Restated Stock Incentive Plan (2006) (the "Plan"). All capitalized terms have the meanings set forth in the Plan, as it may be amended from time to time, unless otherwise specifically provided. All references to specified sections pertain to sections in this Restricted Stock Agreement, unless otherwise specifically provided.

WHEREAS, the Management Organization and Compensation Committee (the "Committee") has been designated by the Board of Directors (the "Board") to administer the Plan and in this capacity is authorized to award to executive officers and key employees stock-based awards, including options and restricted stock;

WHEREAS, the Committee has determined that the Employee is eligible to receive an award under the Plan; and

WHEREAS, the Committee has determined that it would be in the best interest of the Company to make an award of restricted stock to the Employee to provide further incentive to the Employee to continue his service to the Company and to more closely align his interests with those of the shareholders.

NOW THEREFORE, the Company makes an award of restricted stock to Employee under the terms, conditions and restrictions set forth in this Agreement and the Plan.

1. Award.

- a. The Company hereby grants to Employee, effective the date of this Agreement (the "Date of Grant") an award (the "Award") of «Shares» Common Shares, \$1.00 par value, of the Company ("Shares"). These Shares are subject to the restrictions, terms and conditions set forth in this Agreement, and while subject to the restrictions and risk of forfeiture hereunder are referred to collectively as the "Restricted Shares," and each Share individually as a "Restricted Share."

- b. Certificates representing the Restricted Shares and bearing the legend specified in Section 1d shall be issued in the name of the Employee and held by the Secretary of the Company until such Restricted Shares vest as provided herein. The Secretary will issue a receipt to Employee evidencing the certificates held by him/her. While the certificates representing the Restricted Shares are held by the Company, Employee will provide to the Company assignments separate from such certificates, in blank, signed by Employee to be held by the Company during the Period of Restriction, as defined in Section 2a below.
- c. Except as otherwise provided in this Agreement, Employee shall be entitled to exercise all rights of a shareholder of the Company with respect to the Restricted Shares, including the right to vote the Restricted Shares and the right to receive cash dividends thereon (subject to applicable tax withholding).
- d. Each stock certificate evidencing Restricted Shares shall bear the following legend:

This Certificate and the shares of stock represented hereby are subject to the terms and conditions (including forfeiture, restrictions against transfer and rights of repurchase, if applicable) contained in the Restricted Stock Award Agreement (the "Agreement") between the registered owner of the shares and the Company. Release from such terms and conditions shall be made only in accordance with the provisions of the Agreement, a copy of which is on file in the office of the Company's secretary.

- e. As soon as practicable following the expiration of the Period of Restriction applicable to each Restricted Share, the Company shall cause a book entry to be made in the records of the Company's transfer agent to reflect the issuance of the Share to the Employee without any restriction. The Company shall provide notice to Employee that the applicable book entry adjustment has been made.

2. Vesting.

- a. Subject to the forfeiture provisions of Sections 3 and 4 of this Agreement, any restrictions on the Restricted Shares shall lapse and the Restricted Shares granted shall vest in the percentages and on the dates specified in the Vesting Schedule below. The

period from the Date of Grant until the vesting of each Share shall be known as the Period of Restriction. Notwithstanding this Section 2, any restrictions on the Restricted Shares shall lapse and all Restricted Shares granted herein shall vest immediately upon the occurrence of a Change in Control of the Company, as defined in Appendix A to this Agreement.

b. Vesting Schedule:

| <u>Vesting Date</u> | <u>Portion of Award Vested</u> |
|------------------------------------|--------------------------------|
| Third Anniversary of Date of Grant | 100% |

Provided that no part of the Award has been forfeited, 100% of the Award shall be vested on the third anniversary of the Date of Grant.

- c. All restrictions set forth in this Agreement shall apply to each Restricted Share and to any other securities distributed with respect to that Restricted Share. Unless otherwise permitted by the Committee in accordance with the terms of the Plan, the Restricted Shares may not be assigned or transferred other than by will or the laws of descent and distribution and shall not be subject to pledge, hypothecation, execution, attachment or similar process. Each Restricted Share will remain restricted and subject to forfeiture to the Company, unless and until the Restricted Share has vested in Employee in accordance with all of the terms and conditions of this Agreement.
- d. The Committee may, in its sole discretion, declare at any time that the Restricted Shares are fully vested and free of all restrictions.

3. Effect of Termination of Employment.

- a. If Employee's employment terminates for any reason other than Employee's gross and willful misconduct (as defined in Section 3b), death, or disability (as defined in Section 3d), then, subject to Section 3c, any Restricted Shares remaining unvested shall be forfeited.
- b. If Employee's employment terminates by reason of Employee's gross and willful misconduct during employment, including, but not limited to, wrongful appropriation of Company funds, serious violations of Company policy, breach of fiduciary duty or the conviction of a felony, all Restricted Shares remaining unvested as of the time of the misconduct shall be forfeited. If between the time

of the misconduct and such termination the Company's transfer agent has made a book entry reflecting the issuance without restriction of any Restricted Shares that are to be forfeited pursuant to this Section 3b, Employee shall either pay the Company in cash an amount equal to the Fair Market Value of such Restricted Shares as of the time of the misconduct or cause such Shares to be reconveyed to the Company.

- c. If Employee shall die while employed by the Company or an Affiliate, all unvested Restricted Shares will vest immediately.
- d. If Employee's termination of employment is due to disability, then all unvested Restricted Shares will vest immediately. Employee shall be deemed to be disabled if the termination of employment occurs because Employee is unable to work due to an impairment which would qualify as a disability under the Company's long term disability program.

4. Forfeiture.

- a. If Employee attempts to pledge, encumber, assign, transfer or otherwise dispose of any of the Restricted Shares, or the Restricted Shares become subject to attachment or similar involuntary process in violation of this Agreement, any Restricted Shares that have not previously vested shall be forfeited by Employee to the Company.
- b. If the employment of Employee terminates under one or more of the circumstances described in Section 3, or if any of the events described in Section 4a occurs and forfeiture results as provided in such sections, the forfeiture shall have the following effects:
 - i. Upon forfeiture, Employee shall have no right, title or interest whatsoever in the Restricted Shares that have been forfeited.
 - ii. If the Company does not have custody of all certificates representing the Restricted Shares so forfeited, Employee shall immediately return the certificates representing such Restricted Shares to the Company.
 - iii. To the extent not already provided as set forth in Section 1b, Employee shall provide Company with an assignment applicable to certificates representing the Restricted Shares, and the Company will cancel the certificates representing the Restricted Shares so forfeited.

5. No Rights To Employment.

This Agreement shall not create an employment relationship between Employee and the Company and shall not confer on Employee any right with respect to continuance of employment by the Company or any of its affiliates or subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time.

6. Tax Consequences and Withholding.

- a. Employee acknowledges and agrees that:
- i. Employee and not the Company shall be responsible for any tax liability that may arise as a result of the transactions contemplated by this Agreement.
 - i. Employee will not make an election pursuant to Section 83(b) of the Internal Revenue Code of 1986, as amended from time to time, with respect to the Award.
 - ii. Employee will pay, or make arrangements reasonably satisfactory to the Company to pay, any taxes that the Company is required by law to withhold with respect to the Award. The payment will be due on the date upon which the Company is obligated to withhold such taxes. If Employee does not make such tax payment when due, the Company shall have the right to do one or more of the following in order to have sufficient funds to satisfy the amount required to be withheld:
 - (a) retain, or sell within ten (10) days of written notice to Employee or such longer period as may be required by applicable law, a number of the Shares sufficient to cover all or part of the amount required to be withheld; or
 - (b) deduct, to the extent permitted by law, from any payment of any kind otherwise due Employee 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.

- iii. On or before the date upon which any tax attributable to the Award is required to be withheld, Employee may satisfy his/her tax obligation, in whole or in part, by electing to:
 - (a) have the Company withhold the number of Shares otherwise to be delivered to Employee upon vesting with a then current Fair Market Value equal to the amount of such tax obligation; or
 - (b) surrender to the Company shares of Graco common stock currently owned by Employee with a then current Fair Market Value equal to the amount required to satisfy such tax obligation.

7. Adjustments

Unless the Committee otherwise determines, any securities or other property (except regular quarterly cash dividends) received by Employee as a result of an adjustment described in Section 4(c) of the Plan or otherwise as a result of a Restricted Share prior to the date upon which the Restricted Share vests shall be promptly deposited with the Secretary of the Company or his/her designee to be held in custody in accordance with Section 1b as though such security and other property were part of such Restricted Share.

8. Notices.

Any notice that either party or the Committee may be required or permitted to give to the others with respect to the Plan or this Agreement shall be in writing and may be delivered personally or by mail, postage prepaid, to the addresses set forth below or such other address as the person to whom the notice is directed shall have designated in writing to the others.

- (a) To the Company:

| <u>By Mail</u> | <u>Personal or Courier</u> |
|------------------------------------|------------------------------------|
| Graco Inc. | Graco Inc. |
| P.O. Box 1441 | 88 11th Avenue N.E. |
| Minneapolis, MN 55440-1441 | Minneapolis, MN 55413 |
| Attn: Chief Administrative Officer | Attn: Chief Administrative Officer |

- (b) To the Committee:

| <u>By Mail</u> | <u>Personal or Courier</u> |
|---|---|
| Mgt Org & Comp Committee c/o Chief Administrative Officer | Mgt Org & Comp Committee c/o Chief Administrative Officer |
| Graco Inc. | Graco Inc. |
| P.O. Box 1441 | 88 11th Avenue N.E. |
| Minneapolis, MN 55440-1441 | Minneapolis, MN 55413 |

(c) To Employee:

| <u>By Mail</u> | <u>Personal or Courier</u> |
|----------------------------|-----------------------------------|
| Mr/Ms «Name» | Mr/Ms «Name» |
| Graco Inc. | Graco Inc. |
| P.O. Box 1441 | 88 11th Avenue N.E. |
| Minneapolis, MN 55440-1441 | Minneapolis, MN 55413 |

9. Governing Law.

This Agreement is entered into under the laws of the State of Minnesota and shall be construed and interpreted under such laws without regard to its conflict of laws provisions.

10. Binding Effect.

This Agreement shall be binding in all respects on the heirs, representatives, successors and assigns of Employee.

11. Miscellaneous.

- a. This Award is issued pursuant to the Plan and is subject to its terms. The terms of the Plan are available for inspection during business hours at the principal offices of the Company.
- b. This Award has been granted to Employee as a purely discretionary benefit and shall not form part of Employee's salary or entitle Employee to receive similar Awards in the future. Benefits received under the Plan shall not be used in calculating severance payments, if any.
- c. The authority to interpret this Agreement is vested in the Committee, and the Committee's conclusions with respect to any

questions arising under this Agreement are binding on the Company and the Employee.

- d. Employee hereby consents to the transfer by his/her employer or the Company of information relating to his/her participation in the Plan, including the personal data set forth in this Agreement, between them or to other related parties in the United States or elsewhere, or to any financial institution or other third party engaged by the Company, but solely for the purpose of administering the Plan and this Award. Employee also consents to the storage and processing of such data by such persons for this purpose.

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: _____
Patrick J. McHale
President and CEO

«Name»

Appendix A

Change of Control

A. A "Change of Control" means:

- (1) An acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "1934 Act")), (a "Person"), of beneficial ownership (within the meaning of Rule of the 1934 Act) which, together with other acquisitions by such Person, results in the aggregate beneficial ownership by such Person of 30% or more of either
 - (a) the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or
 - (b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

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

- (i) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
 - (ii) an acquisition by the Employee or any group that includes the Employee, or
 - (iii) an acquisition by any entity pursuant to a transaction that complies with clauses (a), (b) and (c) of Section (3) below; or
- (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies by or on behalf of a Person other than the Board; or

- (3) Consummation of a reorganization, merger or consolidation of the Company with or into another entity or a statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination"); excluding, however, such a Business Combination pursuant to which
- (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, a majority of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors (or comparable equity interests), as the case may be, of the surviving or acquiring entity resulting from such Business Combination (including, without limitation, an entity that as a result of such transaction beneficially owns 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly) in substantially the same proportions (as compared to the other holders of the Company's common stock and voting securities prior to the Business Combination) as their respective ownership, immediately prior to such Business Combination, of the Outstanding Company Common Stock and Outstanding Company Voting Securities,
- (b) no Person (excluding (i) any employee benefit plan (or related trust) sponsored or maintained by the Company or such entity resulting from such Business Combination or any entity controlled by the Company or the entity resulting from such Business Combination, (ii) any entity beneficially owning 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly and (iii) the Employee and any group that includes the Employee) beneficially owns, directly or indirectly, 30% or more of the then outstanding shares of common stock (or comparable equity interests) of the entity resulting from such Business Combination or the combined voting power of the then outstanding voting securities (or comparable equity interests) of such entity, and

- (c) immediately after the Business Combination, a majority of the members of the board of directors (or comparable governors) of the entity resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or
- (4) Approval by the shareholders of the Company of a complete liquidation or dissolution of the Company.

GRACO INC.

NONEMPLOYEE DIRECTOR RETAINER/MEETING FEES
CASH/STOCK/DEFERRED STOCK

ELECTION/CHANGE IN ELECTION FORM

| | |
|-------------------|--|
| SUBMIT TO: | Secretary to the Board, Legal Department, Graco Inc., P.O. Box 1441, Mpls, MN. 55440-1441 |
| NAME: | <hr/> Stock may be registered in director's name and name of one other person. Print name(s) exactly as you wish them to appear in stock register. |

EFFECTIVE DATE: This Form must be completed and delivered to the Secretary to the Board before the beginning of the taxable year in which the services are to be performed. Your election will remain in effect for, and may not be changed during, the entire taxable year. In the event that a Change in Election Form is not received prior to the beginning of any taxable year, the election currently in effect will remain in effect for the next taxable year. An individual who becomes a nonemployee director during a taxable year may participate in this Program only if the individual has not previously been eligible to participate in any deferred compensation plan required to be aggregated with this Program pursuant to regulations issued under Section 409A of the Internal Revenue Code. If eligible, the individual must complete and deliver his Initial Election Form to the Secretary no later than 30 days after the date that the individual first becomes a nonemployee director and the election will be applicable only to services performed after receipt of the Form by the Secretary.

Check One:

- Initial Election.** Allocate my annual retainer and meeting fees according to the percentages indicated below.
- Change in Election.** I elect to change my election for the taxable year following the current taxable year and all taxable years subsequent thereto, unless I submit a Change in Election Form prior to the commencement of the applicable taxable year. Allocate my annual retainer and meeting fees according to the percentages indicated below.

Fill in Blanks:

Retainer: [Select one: 0%, 25%, 50%, 75%, 100%]

Percentage of Retainer paid in cash: _____%

Percentage of Retainer paid in Graco stock: _____%

Percentage of Retainer credited to Deferred Stock Account: _____%

TOTAL ** _____%

Meeting Fees (Board and Committee): [Select one: 0%, 25%, 50%, 75%, 100%]

Percentage of Meeting Fees paid in cash: _____%

Percentage of Meeting Fees paid in Graco stock: _____%

Percentage of Meeting Fees credited to Deferred Stock Account: _____%

TOTAL ** _____%

** Total cannot exceed 100%

PAYMENT ELECTION:

If you have made a Deferred Stock Account Election, select one of the payment options below. **NOTE: If you are changing your payment election from a payment election previously made, the new payment election will apply only to deferrals made with respect to services performed in taxable years subsequent to the current taxable year. Previous payment elections are irrevocable with respect to services performed in the taxable years to which they apply.**

I elect to receive payment from my Deferred Stock Account by the method checked below.

- Lump sum.** Credits to a Deferred Stock Account will be paid in full by the issuance of shares of Graco Common Stock plus cash in lieu of any fractional share on January 10, or the first business day after January 10, of the year following my separation from service, as defined by regulations and rulings issued under Section 409A of the Internal Revenue Code, as amended (the "IRC"), or such other date as elected by me. Alternative date: _____.(month/date/year)
- Installments.** Number of installments elected (from 2 to 15): _____. Credits to a Deferred Stock Account will be paid in annual installments by the issuance of shares of Graco Common Stock, plus cash in lieu of any fractional share, on January 10, or the first business day after January 10, of each year following my separation from service on the Board as defined by regulations and rulings issued under Section 409A of the IRC,. The number of annual installments may range from 2 to 15. The amount of each payment will be computed by multiplying the number of shares credited to my Deferred Stock Account as of January 10 of each year by a fraction, the numerator of which is one and the denominator of which is the total number of installments elected (not to exceed fifteen) minus the number of installments previously paid. Amounts paid prior to the final installment payment will be rounded to the nearest whole number of shares. The final installment payment will be for the whole number of shares remaining credited to my Deferred Stock Account, plus cash in lieu of any fractional share.

BENEFICIARY

In order to permit the payment of your Deferred Stock Account to a beneficiary in the event of your death prior to the complete payout of your Deferred Stock Account, provide the information indicated below:

Primary Beneficiary(ies)*

Name _____

Address _____

Name _____

Address _____

*Your Primary Beneficiaries will share equally unless any beneficiary dies before you or unless you specify otherwise above.

Secondary Beneficiary(ies)*

(If no primary beneficiary survives you)

Name _____

Address _____

Name _____

Address _____

*Your Secondary Beneficiaries will share equally unless any beneficiary dies before you or unless you specify otherwise above.

I have made the elections indicated above and on the reverse side and have received and read the Terms applicable to this Stock/Deferred Stock Program which are set forth in the document attached hereto entitled Graco Inc. Nonemployee Director Stock and Deferred Stock Program Terms and hereby agree to such Terms..

Date

Signature

**GRACO INC.
NONEMPLOYEE DIRECTOR
STOCK AND DEFERRED STOCK PROGRAM**

TERMS

1. Purpose of the Stock and Deferred Stock Program. The purpose of the Graco Inc. Nonemployee Director Stock and Deferred Stock Program (the “Program”) is to provide an opportunity for nonemployee members of the Board of Directors (the “Board”) of Graco Inc. (“Graco” or the “Company”) to increase their ownership of Graco Common Stock (“Common Stock”) and thereby align their interest in the long-term success of the Company with that of the other shareholders. Each nonemployee director may elect to receive all or a portion of his or her retainer and/or any fees payable for attendance at Board or Committee meetings in the form of shares of Common Stock or defer the receipt of such shares until a later date pursuant to an election made under the Program.

2. Eligibility. Directors of the Company who are not also officers or other employees of the Company or its subsidiaries are eligible to participate in the Program (“Eligible Directors”).

3. Administration. The Program will be administered by the Secretary of the Company (the “Administrator”). Since the issuance or crediting of shares of Common Stock pursuant to the Program is based on elections made by Eligible Directors, the Administrator’s duties under the Program will be limited to matters of interpretation and administrative oversight. All questions of interpretation of the Program will be determined by the Administrator, and each determination, interpretation or other action that the Administrator makes or takes pursuant to the provisions of the Program will be conclusive and binding for all purposes and on all persons. The Administrator will not be liable for any action or determination made in good faith with respect to the Program.

4. Election to Receive Stock and Stock Issuance.

4.1. Election to Receive Stock/Credit in Lieu of Cash. On forms provided by the Company, each Eligible Director may irrevocably elect (“Stock Election”) in lieu of cash, (i) to be issued shares of Common Stock or (ii) to have credited to an account (“Deferred Stock Account”) the number of shares of Common Stock having a Fair Market Value, as defined in Section 4.3, equal to 25%, 50%, 75% or 100% of the annual cash retainer (the “Retainer”) and/or 25%, 50%, 75% or 100% of any fees payable for attendance at Board or Committee meetings (the “Meeting Fees”) payable to that director for services rendered as a director (“Participating Director”). Eligible Directors are customarily paid the Retainer and the Meeting Fees in quarterly installments in arrears at the end of each calendar quarter. Any Stock Election must be received by the Company before the commencement of the first full taxable year with respect to which such election is made. Any Stock Election may only be

amended or revoked (“Amended Stock Election”) in accordance with the procedure set forth in Section 4.4.

4.1.1. Initial Election. An individual who first becomes an Eligible Director during a taxable year may make a Stock Election by delivering an election form to the Secretary of the Company within thirty (30) calendar days of the date that the individual first becomes an Eligible Director, provided that the individual has not previously been eligible to participate in any deferred compensation plan required to be aggregated with this Program pursuant to regulations issued under Section 409A of the Internal Revenue Code. In the event that an individual is permitted to become a Participating Director under this subsection, the Stock Election will be applicable only to services performed after the election form is received by the Secretary.

4.2. Issuance of Stock/Application of Credit in Lieu of Cash. If the Stock Election is for the issuance of shares of Common Stock, shares of Common Stock having a Fair Market Value equal to the amount of the Retainer and/or Meeting Fees so elected shall be issued to each Participating Director when each quarterly installment of the Retainer and the Meeting Fees is customarily paid. The Company shall not issue fractional shares, but in lieu thereof shall pay cash of equivalent value using the same Fair Market Value used to determine the number of Shares to be issued on the relevant issue date. If the Stock Election is for a credit to a Deferred Stock Account, the number of shares of Common Stock (rounded to the nearest hundredth of a share) having a Fair Market Value equal to the amount of the Retainer and/or the Meeting Fees so elected shall be credited to the Participating Director’s Deferred Stock Account when each quarterly installment of the Retainer and Meeting Fees is customarily paid. In the event that a Participating Director elects to receive less than 100% of each quarterly installment of the Retainer and/or Meeting Fees in shares of Common Stock, either issued or credited, he or she shall receive the balance of the quarterly installment in cash.

4.3. Fair Market Value. For purposes of converting dollar amounts into shares of Common Stock, the Fair Market Value of each share of Common Stock shall be equal to the closing price of one share of the Company’s Common Stock on the New York Stock Exchange-Composite Transactions on the last business day of the calendar quarter for which such shares are issued or credited.

4.4. Change in Election. Each Participating Director may irrevocably elect in writing to change an earlier Stock Election, either to elect to be issued shares of Common Stock or to have credited to the Participating Director’s Deferred Stock Account, a number of shares of Common Stock having a Fair Market Value equal to a percentage of the Participating Director’s Retainer and/or Meeting Fees different from the percentages previously elected or to receive the entire Retainer and/or Meeting Fees in cash (an “Amended Stock Election”). An Amended Stock Election shall not become effective until the commencement of the first full taxable year after the date of receipt of such Amended Stock Election by the Company.

4.5. Termination of Service as a Director. If a Participating Director leaves the Board before the conclusion of any calendar quarter, he or she will be paid the quarterly installment of the Retainer and Meeting Fees entirely in cash, notwithstanding that a Stock Election or Amended Stock Election is on file with the Company. The date of termination of a Participating Director's service as a director of the Company will be deemed to be the date of termination recorded on the personnel or other records of the Company.

4.6. Dividend Credit. Each time a dividend is paid on the Common Stock, each Participating Director who has a Deferred Stock Account shall receive a credit to his or her Deferred Stock Account equal to that number of shares of Common Stock (rounded to the nearest one-hundredth of a share) having a Fair Market Value on the dividend payment date equal to the amount of the dividend payable on the number of shares of Common Stock credited to the Participating Director's Deferred Stock Account on the dividend record date.

5. Payment of Deferred Stock Account. Subject to the regulations and rulings issued under Section 409A of the Internal Revenue Code, as amended (the "IRC"), the following rules apply.

5.1. Payment Election. At the time of making the Stock Election in which the Participating Director elects to have a Deferred Stock Account credited in accordance with the provisions of Section 4.1, the Participating Director will also elect the manner and timing for payment of the amounts credited to his or her Deferred Stock Account ("Payment Election") from the alternatives described in Section 5.2. The Participating Director may change the manner and timing for payment of amounts to be credited to his or her Deferred Stock Account by executing another Payment Election; provided, however, that the previously made Payment Election will be irrevocable as to all amounts credited to the Participating Director's Deferred Stock Account prior to the effective date of the new Payment Election. A new Payment Election shall not become effective until the commencement of the first full taxable year after the date of receipt of such new Payment Election by the Company.

5.2. Payment from Deferred Stock Accounts. A Participating Director may elect to receive payment from his or her Deferred Stock Account in a lump sum or installments. Payments, whether in a lump sum or by installments, shall be made in shares of Common Stock plus cash in lieu of any fractional share. Unless the Participating Director elects to receive payment in installments, credits to a Participating Director's Deferred Stock Account shall be payable in full on January 10 of the year following the Participating Director's termination from service as defined in regulations and rulings issued under Section 409A of the IRC, the first business day after January 10, or such other date as elected by the Participating Director pursuant to Section 5.1. If the Participating Director elects to receive payment from his or her Deferred Stock Account in installments, each installment payment will be made annually on January 10 of each year, or the first business day

after January 10, and the amount of each payment will be computed by multiplying the number of shares credited to the Deferred Stock Account as of January 10 of each year by a fraction, the numerator of which is one and the denominator of which is the total number of installments elected (not to exceed fifteen) minus the number of installments previously paid. Amounts paid prior to the final installment payment will be rounded to the nearest whole number of shares; the final installment payment shall be for the whole number of shares remaining credited to the Deferred Stock Account, plus cash in lieu of any fractional share.

5.3 Six-Month Delay in Commencement of Payment. If a Participating Director as of the date of payment is a “specified employee” as defined by the regulations issued under Section 409A, the payment (if lump sum) or the initial payment (if installments) to the Participating Director from his or her Deferred Stock Account shall be delayed until six (6) months following the date upon which the payment would have otherwise been made pursuant to Section 5.2 of these Terms.

6. Beneficiary.

6.1. Beneficiary Designation. A Participating Director may designate a beneficiary or beneficiaries who, upon his or her death, shall immediately receive the full payment of all unpaid credits to said Participating Director’s Deferred Stock Account, including payments for which the Participating Director has elected installment payments. All designations shall be in writing and shall be effective only if and when delivered to the Company during the lifetime of the Participating Director. Unless otherwise indicated by the Participating Director, no amounts shall be paid to the estate or heirs of beneficiaries who die before the Participating Director.

6.2. Change of Beneficiary. A Participating Director may from time to time during his or her lifetime change his or her beneficiary or beneficiaries by a written instrument delivered to the Company. In the event a Participating Director shall not designate a beneficiary or beneficiaries pursuant to this Section, or if for any reason such designation shall be ineffective, in whole or in part, the distribution that otherwise would have been paid to such Participating Director shall be paid to his or her estate and in such event, the term “beneficiary” shall include his or her estate.

7. Limitation on Rights of Eligible and Participating Directors.

7.1. Service as a Director. Nothing in the Program will interfere with or limit in any way the right of the Company’s Board or its shareholders to remove an Eligible or Participating Director from the Board. Neither the Program nor any action taken pursuant to it will constitute or be evidence of any agreement or understanding, express or implied, that the Company’s Board or its shareholders have retained or will retain an Eligible or Participating Director for any period of time or at any particular rate of compensation.

7.2. Nonexclusivity of the Program. Nothing contained in the Program is intended to effect, modify or rescind any of the Company's existing compensation programs or programs or to create any limitations on the Board's power or authority to modify or adopt compensation arrangements as the Board may from time to time deem necessary or desirable.

8. Program Amendment, Modification and Termination. The Board may suspend or terminate the Program at any time. The Board may amend the Program from time to time in such respects as the Board may deem advisable in order that the Program will conform to any change in applicable laws or regulations or in any other respect that the Board may deem to be in the Company's best interests.

9. Participants are General Creditors of the Company. The Participating Directors and beneficiaries thereof shall be general, unsecured creditors of the Company with respect to any payments to be made pursuant to the Program and shall not have any preferred interest by way of trust, escrow, lien or otherwise in any specific assets of the Company. If the Company shall, in fact, elect to set aside monies or other assets to meet its obligations hereunder (there being no obligation to do so), whether in a grantor's trust or otherwise, the same shall, nevertheless, be regarded as part of the general assets of the Company subject to the claims of its general creditors, and neither any Participating Director nor any beneficiary thereof shall have a legal, beneficial or security interest therein.

10. Miscellaneous.

10.1. Securities Law and Other Restrictions. Notwithstanding any other provision of the Program or any Stock Election or Amended Stock Election delivered pursuant to the Program, the Company will not be required to issue any shares of Common Stock under the Program and a Participating Director may not sell, assign, transfer or otherwise dispose of shares of Common Stock issued pursuant to the Program, unless:

(a) there is in effect with respect to such shares a registration statement under the Securities Act of 1933, as amended (the "Securities Act") and any applicable state securities laws or an exemption from such registration under the Securities Act and applicable state securities laws, and

(b) there has been obtained any other consent, approval or permit from any other regulatory body that the Administrator, in his or her sole discretion, deems necessary or advisable. The Company may condition such issuance, sale or transfer upon the receipt of any representations or agreements from the parties involved, and the placement of any legends on certificates representing shares of Common Stock, as may be deemed necessary or advisable by the Company, in order to comply with such securities law or other restriction.

10.2. Adjustment to Shares. In the event of any reorganization, merger,

consolidation, recapitalization, liquidation, reclassification, stock dividend, stock split, combination of shares, rights offering, divestiture or extraordinary dividend, an appropriate adjustment shall be made in the number and/or kind of securities available for issuance under the Plan to prevent the dilution or the enlargement of the rights of the Eligible and Participating Directors.

11. Governing Law. The validity, construction, interpretation, administration and effect of the Program and any rules, regulations and actions relating to the Program will be governed by and construed exclusively in accordance with the laws of the State of Minnesota, to the extent that federal laws and regulations do not apply.

KEY EMPLOYEE AGREEMENT

This Key Employee Agreement (“Agreement”) is entered into effective _____ (the “Effective Date”) by and between Graco Inc., a Minnesota corporation (the “Company”), and «Who», a resident of Minnesota (“Executive”).

BACKGROUND

- A. The Company desires to continue to employ Executive in accordance with the terms and conditions stated in this Agreement.
- B. The Company and Executive are parties to a key employee agreement dated «Date» (the “Prior Agreement”), which the parties desire to amend and restate in its entirety as set forth in this Agreement.
- C. Executive is a key member of the management of the Company and is expected to devote substantial skill and effort to the affairs of the Company, and the Company desires to recognize the significant personal contribution that Executive makes and is expected to continue to make to further the best interests of the Company and its shareholders.
- D. It is desirable and in the best interests of the Company and its shareholders to continue to obtain the benefits of Executive’s services and attention to the affairs of the Company. It is desirable and in the best interests of the Company and its shareholders to provide inducement for Executive (1) to remain in the service of the Company in the event of any proposed or anticipated change of control of the Company and (2) to remain in the service of the Company in order to facilitate an orderly transition in the event of a change of control of the Company.
- E. It is desirable and in the best interests of the Company and its shareholders that Executive be in a position to make judgments and advise the Company with respect to proposed changes of control of the Company without regard to the possibility that Executive’s employment may be terminated without compensation in the event of certain changes of control of the Company.
- F. Executive will continue to have access to confidential, proprietary and trade secret information of the Company. It is desirable and in the best interests of the Company and its shareholders to protect confidential, proprietary and trade secret information of the Company, to prevent unfair competition by former executives of the Company following separation of their employment with the Company and to secure cooperation from former executives with respect to matters related to their employment with the Company.
- G. It is desirable and in the best interests of the Company and its shareholders to obtain certain commitments from Executive with respect to Executive’s service with the

Company and compliance with Company policies, and to facilitate a smooth transition upon separation from service and to provide for releases of claims from former executives.

AGREEMENT

In consideration of the foregoing premises and the respective agreements of the Company and Executive set forth below, the Company and Executive, intending to be legally bound, agree as follows:

1. DEFINITIONS. The capitalized terms used in this Agreement shall have the following meanings:

(a) “Annual Compensation” means the sum of (i) Executive’s annual base salary in effect as of the Termination Date, plus (ii) Executive’s target bonus award that would have been payable to Executive under the Annual Bonus Plan described in Section 3(b) for the annual performance period in which the Termination Date occurs, as if all performance targets have been met.

(b) “Board” means the Board of Directors of the Company, or any authorized committee of the Board of Directors of the Company.

(c) “Cause” means:

(i) Executive’s conviction or guilty or no contest plea to any felony or other criminal act involving moral turpitude;

(ii) gross misconduct or any act of fraud, disloyalty or dishonesty by Executive related to or connected with Executive’s employment by the Company or otherwise likely to cause material harm to the Company or its reputation;

(iii) a willful and material violation by Executive of the Company’s written policies or codes of conduct;

(iv) wrongful appropriation by Executive of Company funds or property or other material breach of Executive’s fiduciary duties to the Company; or

(v) the willful and material breach of this Agreement by Executive.

(d) A “Change of Control” means:

(i) an acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934), (a “Person”), of beneficial ownership (within the meaning of Rule 13d-3 under the Securities Exchange Act of 1934) which, together with other acquisitions by such Person, results in the aggregate beneficial ownership by such Person of 30% or more of either

(A) the then outstanding shares of Common Stock of the Company (the “Outstanding Company Common Stock”) or

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

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

(1) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,

(2) an acquisition by the Executive or any group that includes the Executive, or

(3) an acquisition by any entity pursuant to a transaction that complies with clauses (A), (B) and (C) of Section 1(d)(iii) below; 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 by or on behalf of a Person other than the Board; or

(iii) Consummation of a reorganization, merger or consolidation of the Company with or into another entity or a statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company (“Business Combination”); excluding, however, such a Business Combination pursuant to which

(A) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, a majority of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors (or comparable equity interests), as the case may be, of the surviving or acquiring entity

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

(B) no Person (excluding (1) any employee benefit plan (or related trust) sponsored or maintained by the Company or such entity resulting from such Business Combination or any entity controlled by the Company or the entity resulting from such Business Combination, (2) any entity beneficially owning 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly and (3) the Executive and any group that includes the Executive) beneficially owns, directly or indirectly, 30% or more of the then outstanding shares of common stock (or comparable equity interests) of the entity resulting from such Business Combination or the combined voting power of the then outstanding voting securities (or comparable equity interests) of such entity, and

(C) immediately after the Business Combination, a majority of the members of the board of directors (or comparable governors) of the entity resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

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

(e) "Code" means the Internal Revenue Code of 1986, as amended, and any successor statute thereto.

(f) "Company" means the Company as defined in the first sentence of this Agreement and any successor to its business and/or assets which assumes or agrees to perform this Agreement by operation of law or otherwise.

(g) "Disability" means a continuing condition of Executive that has been determined to meet the criteria set forth in the Company's Long Term Disability Plan, or similar successor plan, to render Executive eligible for long-term disability benefits under said plan, whether or not Executive is in fact covered by such plan. The determination shall be made by the insurer of the plan or, if Executive is not covered by the plan, by the Company in its sole discretion.

(h) "Good Reason" means any of the following conditions arising during the Transition Period, without the consent of Executive:

(i) the assignment to Executive of any duties materially inconsistent in any respect with Executive's position (including offices and titles), duties or responsibilities, or any other action by the Company which results in a material diminution in such position, duties or responsibilities, as in effect immediately prior to the Transition Period, excluding for this purpose an isolated, insubstantial and inadvertent action not taken in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by Executive;

(ii) any material reduction, in the aggregate, to the compensation and benefit plans, programs and perquisites applicable to Executive as in effect immediately prior to the Transition Period, other than an isolated, insubstantial and inadvertent failure not occurring in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by Executive;

(iii) the Company requiring Executive to be based at any office or location more than 50 miles from the location at which Executive was based immediately prior to the Transition Period or the Company requiring Executive to travel on Company business to a substantially greater extent than required immediately prior to the Transition Period; or

(iv) any failure by the Company to comply with and satisfy Section 13(c) of this Agreement.

For purposes of this Section 1(h) any good faith determination of "Good Reason" made by Executive shall be conclusive.

(i) "Restricted Period" means the period commencing on the Effective Date and continuing during Executive's employment with the Company or any Subsidiary and for 24 months after the Termination Date, whether such termination is with or without Cause, is at the instance of Executive or the Company or occurs before or after expiration of the Term; provided, however, that in the event that Executive is entitled to payments under Section 10(a), then the Restricted Period shall end on the Termination Date.

(j) "Subsidiary" means, with respect to the Company, any corporation or other entity that is required to be combined with the Company as a single employer under Code § 414(b) or (c).

(k) "Term" means the period of Executive's employment under this Agreement, commencing on the Effective Date and ending on the third anniversary of the Effective Date, provided that such period shall be automatically extended for successive one-year periods unless either party gives written notice of non-renewal to the other party at least

six (6) months prior to the expiration of such third anniversary, or annual renewal, as the case may be, that such party elects not to extend the term of such employment under this Agreement; provided, further, that if a Change of Control occurs prior to the expiration of the Term specified in the preceding clause (including any extension year then in effect), then the Term shall end upon expiration of the Transition Period.

(l) “Termination Date” means the date of the Executive’s “separation from service” (within the meaning of Code § 409A(a)(2)(A)(i)) with the Company and its Subsidiaries, as determined by the Company.

(m) “Transition Period” means the period commencing at the time a Change of Control first occurs during the Term and ending on the date that is two years thereafter.

2. POSITION AND DUTIES. During Executive’s employment under this Agreement, Executive will perform such duties and responsibilities of an executive nature as the Company may assign from time to time. Executive will serve the Company faithfully and to the best of Executive’s ability and will devote Executive’s full working time, attention, and efforts to the business and affairs of the Company. Executive will report to the Board. Executive will follow and comply with applicable policies and procedures adopted by the Company from time to time, including without limitation policies relating to business ethics, conflict of interest, non-discrimination, confidentiality and protection of trade secrets, and insider trading. Executive will not engage in other employment or other material business activity, except as approved in writing by the Board. It shall not be a violation of this Agreement for Executive to (i) serve on corporate, civic or charitable boards or committees or (ii) manage personal investments, so long as such activities do not significantly interfere with the performance of Executive’s responsibilities in accordance with this Agreement. Executive hereby represents and confirms that Executive is under no contractual or legal commitments that would prevent Executive from fulfilling Executive’s duties and responsibilities as set forth in this Agreement.

3. COMPENSATION. During Executive’s employment under this Agreement, Executive will be provided with the following compensation and benefits:

(a) Base Salary. The Company will pay to Executive for services provided hereunder a base salary at a rate determined from time to time by the Board, which base salary will be paid in accordance with the Company’s normal payroll policies and procedures. The Board will review Executive’s performance on an annual basis and determine any adjustments to Executive’s base salary in its sole discretion.

(b) Incentive Compensation. Executive will be eligible to participate in an annual cash incentive plan of the Company as designated by the Board, in accordance with the terms and conditions of such plan as may be in effect from time to time (the “Annual Bonus Plan”).

(c) Employee Benefits. Executive will be entitled to participate in all employee benefit plans and programs generally available to executive employees of the Company, as determined by the Company and to the extent that Executive meets the eligibility requirements for each individual plan or program. Executive's participation in any plan or program will be subject to the provisions, rules, and regulations of, or applicable to, the plan or program. The Company provides no assurance as to the adoption or continuation of any particular employee benefit plan or program.

(d) Expenses. The Company will reimburse Executive for all reasonable and necessary out-of-pocket business, travel, and entertainment expenses incurred by Executive in the performance of his duties and responsibilities to the Company during the Term. Such reimbursement shall be subject to the Company's normal policies and procedures for expense verification, documentation, and reimbursement; provided, however, that Executive shall submit verification of expenses within 45 days after the date the expense was incurred, and the Company shall reimburse Executive for such expenses eligible for reimbursement within 30 days thereafter. The right to reimbursement hereunder is not subject to liquidation or exchange for any other benefit, and the amount of expenses eligible for reimbursement in a calendar year shall not affect the expenses eligible for reimbursement in any other calendar year.

4. CONFIDENTIAL INFORMATION. Except as authorized in writing by the Board or as necessary in carrying out Executive's responsibilities for the Company, Executive will not at any time during or following Executive's employment with the Company or any Subsidiary divulge, furnish, or make accessible to anyone or use in any way, any confidential, proprietary, or secret knowledge or information of the Company or any Subsidiary that Executive has acquired or will acquire about the Company or any Subsidiary, whether developed by Executive or by others, concerning (i) any trade secrets, (ii) any confidential, proprietary, or secret designs, inventions, discoveries, programs, processes, formulae, plans, devices, or material (whether or not patented or patentable) directly or indirectly useful in any aspect of the business of the Company or any Subsidiary, (iii) any customer or supplier lists, (iv) any confidential, proprietary, or secret development or research work, (v) any strategic or other business, marketing, or sales plans, systems or techniques, (vi) any financial data or plans, or (vii) any other confidential or proprietary information or secret aspects of the business of the Company or any Subsidiary. Executive acknowledges that the above-described knowledge and information constitute a unique and valuable asset of the Company and represent a substantial investment of time and expense by the Company, and that any disclosure or other use of such knowledge or information other than for the sole benefit of the Company would be wrongful and would cause irreparable harm to the Company. Executive will refrain from intentionally committing any acts that would materially reduce, and shall take reasonable steps to protect, the value of such knowledge or information to the Company. The foregoing obligations of confidentiality shall not apply to any knowledge or information that (i) is now or subsequently becomes generally publicly known, other than as a direct or indirect result of the breach by Executive of this Agreement, (ii) is independently made available to Executive in good faith by a third party who has not violated a confidential relationship with the Company or any Subsidiary,

or (iii) is required to be disclosed by law or legal process. Executive understands and agrees that Executive's obligations under this Agreement to maintain the confidentiality of the Company's confidential information are in addition to any obligations of Executive under applicable statutory or common law.

5. VENTURES. If, during Executive's employment with the Company, Executive participates in the planning or implementing of any project, program, or venture involving the Company, all rights in such project, program, or venture belong to the Company. Except as approved in writing by the Board, Executive will not be entitled to any interest in any such project, program, or venture or to any commission, finder's fee, or other compensation in connection therewith. Executive will have no interest, direct or indirect, in any customer or supplier that conducts business with the Company.

6. INTELLECTUAL PROPERTY.

(a) Disclosure and Assignment. As of the Effective Date, Executive hereby transfers and assigns to the Company (or its designee) all right, title, and interest of Executive in and to every idea, concept, invention, and improvement (whether patented, patentable or not) conceived or reduced to practice by Executive whether solely or in collaboration with others while Executive is employed by the Company, and all copyrighted or copyrightable matter created by Executive whether solely or in collaboration with others while Executive is employed by the Company, in each case, that relates to the Company's or any Subsidiary's business (collectively, "Creations"). Executive shall communicate promptly and disclose to the Company all information, details, and data pertaining to each Creation, whether or not specifically requested by the Company but in such form as the Company may request. Every copyrightable Creation, regardless of whether copyright protection is sought or preserved by the Company, shall be a "work made for hire" as defined in 17 U.S.C. § 101, and the Company shall own all rights in and to such matter throughout the world, without the payment of any royalty or other consideration to Executive or anyone claiming through Executive.

(b) Trademarks. All right, title, and interest in and to any and all trademarks, trade names, service marks, and logos adopted, used, or considered for use by the Company or any Subsidiary during Executive's employment (whether or not developed by Executive) to identify the Company's business or other goods or services (collectively, the "Marks"), together with the goodwill appurtenant thereto, and all other materials, ideas, or other property conceived, created, developed, adopted, or improved by Executive solely or jointly during Executive's employment by the Company and relating to its business shall be owned exclusively by the Company. Executive shall not have, and will not claim to have, any right, title, or interest of any kind in or to the Marks or such other property.

(c) Documentation. Executive shall execute and deliver to the Company such formal transfers and assignments and such other documents as the Company may request to permit the Company (or its designee) to file and prosecute such registration applications and other documents it deems useful to protect or enforce its rights hereunder.

Any idea, invention, copyrightable matter, or other property relating to the Company's or any Subsidiary's business and disclosed by Executive prior to the first anniversary of the effective date of Executive's termination of employment shall be deemed to be governed by the terms of this Section 6 unless proven by Executive to have been first conceived and made after such termination date.

(d) Non-Applicability. Executive is hereby notified that Section 6(a) does not apply to any invention for which no equipment, supplies, facility, confidential information, or other trade secret information of the Company was used and which was developed entirely on Executive's own time, unless (1) the invention relates (a) directly to the business of the Company or any Subsidiary or (b) to the Company's or any Subsidiary's actual or demonstrably anticipated research or development, or (2) the invention results from any work performed by Executive for the Company.

7. NONCOMPETITION AND NONSOLICITATION COVENANTS. In consideration of the benefits and promises contained in this Agreement, the compensation and benefits provided to Executive in connection with Executive's employment with the Company, the disclosure to Executive of confidential information, and training and development opportunities provided to Executive in connection with such employment, Executive agrees to the following restrictive covenants.

(a) Agreement Not to Compete. During the Restricted Period, except with the express written consent of the Board, Executive will not, directly or indirectly, in any manner or capacity, including without limitation as a proprietor, principal, agent, partner, officer, director, investor, stockholder, employee, member of any association, consultant, or otherwise, engage or participate in any Competitive Business. "Competitive Business" means any person, entity or business operation (other than the Company) engaged in, or making plans or actively preparing to engage in, a business (i) that competes with the business then conducted by, or proposed to be conducted by, the Company, including without limitation the design, development, manufacture, marketing or sale of fluid handling systems, products or technology similar to or competitive with the systems, products or technology of the Company, and (ii) that is conducted in the United States or in any other country where the Company is then doing business. Ownership by Executive, as a passive investment, of less than one percent of the outstanding shares of capital stock of any corporation listed on a national securities exchange or publicly traded in the over-the-counter market shall not constitute a breach of this Section 7(a).

(b) Agreement Not to Hire. During the Restricted Period, Executive will not, directly or indirectly, in any manner or capacity, including without limitation as a proprietor, principal, agent, partner, officer, director, investor, stockholder, employee, member of any association, consultant, or otherwise, hire, engage, or solicit any person who is then an employee of the Company or who was an employee of the Company at any time during the six month period immediately preceding Executive's termination of employment.

(c) Agreement Not to Solicit. During the Restricted Period, Executive will not, directly or indirectly, in any manner or capacity including without limitation as a proprietor, principal, agent, partner, officer, director, stockholder, employee, member of any association, consultant, or otherwise, solicit, request, advise, or induce any current or potential customer, supplier, vendor or other business contact of the Company to cancel, curtail, or otherwise change its relationship adversely to the Company, or interfere in any manner with the relationship between the Company and any of its customers, suppliers, vendors or other business contacts.

(d) Modification. If the duration of, the scope of, or any business activity covered by, any provision of this Section 7 exceeds that which is valid and enforceable under applicable law, such provision will be construed to cover only that duration, scope, or activity that is determined to be valid and enforceable. Executive hereby acknowledges that this Section 7 will be construed so that its provisions are valid and enforceable to the maximum extent, not exceeding its express terms, possible under applicable law.

(e) No Adequate Remedy at Law. Executive hereby acknowledges that the provisions of this Section 7 are reasonable and necessary to protect the legitimate interests of the Company and that any violation of this Section 7 by Executive will cause substantial and irreparable harm to the Company to such an extent that monetary damages alone would be an inadequate remedy therefor. Accordingly, in the event of any actual or threatened breach of any such provisions, the Company will, in addition to any other remedies it may have, be entitled to injunctive and other equitable relief to enforce such provisions, and such relief may be granted without the necessity of proving actual monetary damages.

8. TERMINATION OF EMPLOYMENT. Executive's employment with the Company under this Agreement is at will and may be terminated by either party for any or no reason, subject to the obligations of the parties provided for in this Agreement.

9. PAYMENTS UPON TERMINATION OF EMPLOYMENT PRIOR TO A CHANGE OF CONTROL.

(a) Involuntary Termination Without Cause Prior To a Change of Control. If Executive's Termination Date occurs during the Term and prior to any Change of Control, and if such termination is involuntary at the initiative of the Company without Cause, then, in addition to such base salary that has been earned but not paid to Executive as of the Termination Date, the Company shall provide to Executive the severance payments set forth in this Section 9(a), subject to the conditions in Section 12:

(i) Separation Pay. The Company shall pay to Executive an amount equal to one-half ($\frac{1}{2}$) times Executive's Annual Compensation, but in no event shall such amount paid under this Section 9(a)(i) exceed the lesser of:

(A) \$450,000.00; or

(B) two (2) times Executive's annualized compensation based upon the annual rate of pay for services to the Company for the calendar year prior to the calendar year in which the Termination Date occurs (adjusted for any increase during that year that was expected to continue indefinitely if the Executive had not separated from service).

Such separation pay shall be paid to Executive in six (6) equal monthly installments, commencing on the first regular payroll date of the Company that occurs following the Termination Date and continuing for six months, provided that Executive has satisfied the conditions set forth in Section 12. The Company and Executive intend the payments under this Section 9(a)(i) to be a "separation pay plan due to involuntary separation from service" under Treas. Reg. § 1.409A-1(b)(9)(iii).

(ii) Make-up Payment. In the event that Executive's separation pay under Section 9(a)(i) above is limited by application of clause (A) or (B) thereof, then the Company shall make an additional lump sum payment to Executive equal to the difference between (x) one-half times Executive's Annual Compensation and (y) the amount paid to Executive under Section 9(a)(i). Such payment shall be paid to Executive in a lump sum on the first regular payroll date of the Company to occur following the date that is six months after the Termination Date, provided that Executive has satisfied the conditions set forth in Section 12.

(iii) Supplemental Separation Pay. The Company shall pay to Executive an additional amount equal to one and one-half (1½) times Executive's Annual Compensation. Such supplemental separation pay shall be paid to Executive in eighteen (18) equal monthly installments, commencing on the first regular payroll date of the Company that occurs following the completion of all payments under Sections 9(a)(i) and 9(a)(ii) and continuing for eighteen (18) months, provided that Executive has satisfied the conditions set forth in Section 12.

(iv) Pro-Rated Bonus. If the Termination Date is any day other than the last day of a performance period under the Annual Bonus Plan, then the Company shall pay to Executive an amount equal to a pro rata portion of the award that would have been payable to Executive under the Annual Bonus Plan for such annual performance period had Executive remained employed by the Company until the end of the performance period, based on actual performance results. The pro rata portion shall be calculated based on the number of days during such annual performance period Executive was employed by the Company prior to the Termination Date divided by 365. Any separation pay that may become payable pursuant to this Section 9(a)(iv) shall be paid to Executive on the later of the date that awards for such annual performance period are paid to other participants in the Annual Bonus Plan and the first regular payroll date of the Company to occur following the date that is six months after the Termination Date, provided that Executive has satisfied the conditions set forth in Section 12.

(v) Continued Benefits. If Executive (and/or Executive's covered dependents) is eligible for and properly elects to continue group medical, dental and/or life insurance coverage, as in place immediately prior to the Termination Date, the Company shall continue to pay the Company's portion of any such premiums or costs of coverage (on a benefit by benefit basis) until the earlier of (A) twenty-four (24) months after the Termination Date, or (B) the date Executive (and Executive's covered dependents) is provided such form of coverage by a subsequent employer. In the event that Executive's participation in such plans is not possible under any of the applicable plans and laws as then in effect, the Company will purchase coverage reasonably comparable to the coverage provided under the plans provided by the Company, to the extent such coverage is reasonably available, and Executive will cooperate with the Company to obtain the most favorable rate for such coverage for Executive. All such Company-provided medical, dental and/or life insurance premiums, or costs of coverage, shall be paid directly to the insurance carrier or other provider by the Company and Executive shall make arrangements with the Company to pay the Executive's portion of such coverage.

(vi) Outplacement Services. The Company shall provide to Executive executive-level outplacement services from a provider selected by the Company, consistent with Company policy then in effect for executive officers, for up to one year following the Termination Date.

(vii) Legal Fees. The Company shall reimburse Executive for reasonable legal fees and expenses incurred by Executive in connection with seeking legal advice in seeking to obtain or enforce in good faith any right or benefit provided by this Agreement, to the extent such claims are timely commenced under applicable law; provided, however, that the Company may recover any such legal fees and expenses of Executive which the Company has paid, if it is finally judicially determined in such proceeding that Executive's claim or claims were frivolous or that Executive pursued such claim or claims in bad faith. Executive will submit to the Company verification of legal expenses eligible for reimbursement within 60 days from the date that the expense was incurred. The Company shall reimburse Executive for eligible expenses promptly thereafter, but in any event not earlier than the date that is six months following the Termination Date and not later than December 31 of the calendar year following the calendar year in which the expense was incurred. The amount of expenses eligible for reimbursement during any calendar year will not affect the expenses eligible for reimbursement in any other calendar year, and Executive's right to reimbursement of such expenses may not be exchanged for cash or any other benefit. Any amounts payable hereunder are intended to be payable in accordance with a reimbursement plan pursuant to Section 409A of the Code.

(b) Other Termination Prior to a Change of Control. If Executive's Termination Date occurs during the Term and prior to any Change of Control, and if such termination is:

(i) by reason of Executive's abandonment of or resignation from employment for any reason;

- (ii) by reason of termination of Executive's employment by the Company for Cause;
- (iii) because of Executive's death or Disability; or
- (iv) upon or following expiration of the Term,

then the Company will pay to Executive, or Executive's beneficiary or Executive's estate, as the case may be, such base salary that has been earned but not paid to Executive as of the Termination Date, payable pursuant to the Company's normal payroll practices and procedures, and such incentive compensation and benefits that have been earned as of the Termination Date, payable to the extent and in the manner provided in the applicable plans or programs, and Executive shall not be entitled to any additional compensation or benefits provided under Section 9 hereof.

10. PAYMENTS UPON TERMINATION OF EMPLOYMENT DURING THE TRANSITION PERIOD.

(a) Payments and Benefits Upon Involuntary Termination Without Cause or Resignation for Good Reason During The Transition Period. If Executive's Termination Date occurs during the Transition Period, and if such termination is involuntary at the initiative of the Company without Cause or at the initiative of Executive for Good Reason, then, in addition to such base salary and incentive compensation that has been earned but not paid to Executive as of the Termination Date, the Company shall provide to Executive the severance payments set forth in this Section 10(a), subject to the conditions in Section 12:

(i) Separation Pay. The Company shall pay to Executive an amount equal to three (3) times Executive's Annual Compensation.

(ii) Pro-Rated Bonus. If the Termination Date is any day other than the last day of a performance period under the Annual Bonus Plan, then the Company shall pay to Executive an amount equal to a pro rata portion of the target award that would have been payable to Executive under the Annual Bonus Plan for the annual performance period in which the Termination Date occurs, as if all performance targets been met. The pro rata portion shall be calculated based on the number of days during such annual performance period Executive was employed by the Company prior to the Termination Date divided by 365.

(iii) Continued Benefits. If Executive (and/or Executive's covered dependents) is eligible and properly elects to continue group medical, dental and/or life insurance coverage, as in place immediately prior to the Termination Date, the Company shall continue to pay the Company's portion of any such premiums or costs of coverage (on a benefit by benefit basis) until the earlier of (A) thirty-six (36) months after the Termination Date, or (B) the date Executive (and Executive's covered dependents) is provided such form

of coverage by a subsequent employer. In the event that Executive's participation in such plans is not possible under any of the applicable plans and laws as then in effect, the Company will purchase coverage reasonably comparable to the coverage provided under the plans provided by the Company, to the extent such coverage is reasonably available, and Executive will cooperate with the Company to obtain the most favorable rate for such coverage for Executive. All such Company-provided medical, dental and/or life insurance premiums, or costs of coverage, shall be paid directly to the insurance carrier or other provider by the Company and Executive shall make arrangements with the Company to pay the Executive's portion of such coverage.

(iv) Retirement/Restoration Benefits. If Executive is a participant in the Company's Restoration Plan, the Company shall credit Executive with additional years of service under such plan for purposes of calculating all benefits and rights under such plan, as if Executive had remained employed by the Company for an additional three (3) years following the Termination Date.

(v) Legal Fees. The Company shall reimburse Executive for reasonable legal fees and expenses incurred by Executive in connection with seeking legal advice in seeking to obtain or enforce in good faith any right or benefit provided by this Agreement, to the extent such claims are timely commenced under applicable law; provided, however, that the Company may recover any such legal fees and expenses of Executive which the Company has paid, if it is finally judicially determined in such proceeding that Executive's claim or claims were frivolous or that Executive pursued such claim or claims in bad faith. Executive will submit to the Company verification of legal expenses eligible for reimbursement within 60 days from the date that the expense was incurred. The Company shall reimburse Executive for eligible expenses promptly thereafter, but in any event not earlier than the date that is six months following the Termination Date and not later than December 31 of the calendar year following the calendar year in which the expense was incurred. The amount of expenses eligible for reimbursement during any calendar year will not affect the expenses eligible for reimbursement in any other calendar year, and Executive's right to reimbursement of such expenses may not be exchanged for cash or any other benefit. Any amounts payable hereunder are intended to be payable in accordance with a reimbursement plan pursuant to Section 409A of the Code.

(b) Timing and Form of Payments Following a Change of Control.

(i) Lump Sum Payment. Except as provided in Section 10(b)(ii) below, in the event that Executive is entitled to payments under Section 10(a) above, then any payments to which Executive is entitled under Sections 10(a)(i) or (ii) above shall be paid to Executive in a lump sum on the first regular payroll date of the Company to occur following the date that is six months after the Termination Date, provided that Executive has satisfied the conditions set forth in Section 12.

(ii) 409A Timing Exceptions. Notwithstanding the provisions of Section 10(b)(i) above, if, as of the Termination Date, the Change of Control does not

constitute a change “in the ownership or effective control” of the Company, or “in the ownership of a substantial portion of the assets” of the Company, as such phrases are defined in Section 409A(2)(a)(v) of the Code, then the payments under Section 10(a) shall be made as follows:

(A) A portion of the amount payable under Section 10(a)(i), such portion equal to the aggregate amounts that would have been payable to Executive pursuant to Sections 9(a)(i), (ii) and (iii) in the event of an involuntary termination prior to a Change of Control, shall be paid to Executive in the same manner and at the same time as if such payments were being made pursuant to Section 9(a)(i), (ii) and (iii) above.

(B) The remaining portion of the amount payable to Executive under Section 10(a)(i) shall be paid to Executive in twelve (12) equal monthly installments, commencing on the first regular payroll date of the Company that occurs following the completion of all payments under Section 10(b)(ii)(A) and continuing for twelve months.

(C) The amount payable under Section 10(a)(ii) shall be paid to Executive on the later of the date that awards for the annual performance period during which the Termination Date occurred are paid to other participants in the Annual Bonus Plan and the first regular payroll date of the Company to occur following the date that is six months after the Termination Date.

(c) Possible Payment Reduction. Notwithstanding any provision to the contrary contained in this Agreement, if the cash payments due and the other benefits to which Executive shall become entitled under Section 10(a), either alone or together with other payments in the nature of compensation to Executive which are contingent on a change in the ownership or effective control of the Company or in the ownership of a substantial portion of the assets of the Company or otherwise, would constitute a “parachute payment” (as defined in Section 280G of the Code or any successor provision thereto), such payments or benefits shall be reduced (but not below zero) to the largest aggregate amount as will result in no portion thereof being subject to the excise tax imposed under Section 4999 of the Code (or any successor provision thereto) or being non-deductible to the Company for Federal Income Tax purposes pursuant to Section 280G of the Code (or any successor provision thereto), provided, however, that no such reduction shall occur, and this Section 10(c) shall not apply, in the event that the amount of such reduction would be more than \$25,000. Executive in good faith shall determine the amount of any reduction to be made pursuant to this Section 10(c) and shall select from among the foregoing benefits and payments those which shall be reduced. No modification of, or successor provision to, Section 280G or Section 4999 subsequent to the date of this Agreement shall, however, reduce the benefits to which the Executive would be entitled under this Agreement in the absence of this Section 10(c) to a greater extent than they would have been reduced if Section 280G and Section 4999 had not been modified or superseded subsequent to the date

of this Agreement, notwithstanding anything to the contrary provided in the first sentence of this Section 10(c).

(d) Certain Additional Payments by the Company.

(i) Anything in this Agreement to the contrary notwithstanding, in the event it shall be determined that Section 10(c) above does not apply and any payment or distribution by the Company to or for the benefit of Executive (whether paid or payable or distributed or distributable pursuant to the terms of this Agreement, any stock option, restricted stock agreement or otherwise, but determined without regard to any additional payments required under this Section 10(d)) (a "Payment") would be subject to the excise tax imposed by Section 4999 of the Code or any interest or penalties are incurred by Executive with respect to such excise tax (such excise tax, together with any such interest and penalties, are hereinafter collectively referred to as the "Excise Tax"), then the Executive shall be entitled to receive an additional payment (a "Gross-Up Payment") in an amount such that after payment by Executive of all taxes (including any interest or penalties imposed with respect to such taxes), including, without limitation, any income taxes (and any interest and penalties imposed with respect thereto) and Excise Tax imposed upon the Gross-Up Payment, the Executive retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payments.

(ii) Subject to the provisions of Section 10(d)(iii) all determinations required to be made under this Section 10(d), including whether and when a Gross-Up Payment is required and the amount of such Gross-Up Payment and the assumptions to be utilized in arriving at such determination, shall be made by Deloitte and Touche LLP or such other certified public accounting firm as may be designated by Executive (the "Accounting Firm") which shall provide detailed supporting calculations both to the Company and Executive within 15 business days of the receipt of notice from Executive that there has been a Payment, or such earlier time as is requested by the Company. In the event that the Accounting Firm is serving as accountant or auditor for the individual, entity or group effecting the Change of Control, Executive shall appoint another nationally recognized accounting firm to make the determinations required hereunder (which accounting firm shall then be referred to as the Accounting Firm hereunder). All fees and expenses of the Accounting Firm shall be borne solely by the Company. Any Gross-Up Payment, as determined pursuant to this Section 10(d), shall be paid by the Company to Executive within five days of the receipt of the Accounting Firm's determination. If the Accounting Firm determines that no Excise Tax is payable by Executive, it shall furnish Executive with a written opinion that failure to report the Excise Tax on Executive's applicable federal income tax return would not result in the imposition of a negligence or similar penalty. Any determination by the Accounting Firm shall be binding upon the Company and Executive. As a result of the uncertainty in the application of Section 4999 of the Code at the time of the initial determination by the Accounting Firm hereunder, it is possible that Gross-Up Payments which will not have been made by the Company should have been made ("Underpayment"), consistent with the calculations required to be made hereunder. In the event that the Company exhausts its remedies pursuant to Section 10(d)(iii) and the

Executive thereafter is required to make a payment of any Excise Tax, the Accounting Firm shall determine the amount of the Underpayment that has occurred and any such Underpayment shall be promptly paid by the Company to or for the benefit of the Executive.

(iii) Executive shall notify the Company in writing of any claim by the Internal Revenue Service that, if successful, would require the payment by the Company of a Gross-Up Payment or an increase to a Gross-Up Payment previously made. Such notification shall be given as soon as practicable but no later than ten business days after Executive is informed in writing of such claim (provided that any delay in so informing the Company within such ten business day period shall not affect the obligations of the Company under this Section 10(d) except to the extent that such delay materially and adversely affects the Company) and shall apprise the Company of the nature of such claim and the date on which such claim is requested to be paid. Executive shall not pay such claim prior to the expiration of the 30-day period following the date on which it gives such notice to the Company (or such shorter period ending on the date that any payment of taxes with respect to such claim is due). If the Company notifies Executive in writing prior to the expiration of such period that it desires to contest such claim, Executive shall:

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

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

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

(D) permit the Company to participate in any proceedings relating to such claim; provided, however, that the Company shall bear and pay directly all costs and expenses (including additional interest and penalties) incurred in connection with such contest and shall indemnify and hold the Executive harmless, on an after-tax basis, for any Excise Tax or income tax (including interest and penalties with respect thereto) imposed as a result of such representation and payment of costs and expenses. Without limitation on the foregoing provisions of this Section 10(d)(iii), the Company shall control all proceedings taken in connection with such contest and, at its sole option, may pursue or forgo any and all administrative appeals, proceedings, hearings and conferences with the taxing authority in respect of such claim and may, at its sole option, either direct Executive to pay the tax claimed and sue for a refund or contest the claim in any permissible manner, and Executive agrees to prosecute such contest to a determination before any administrative tribunal, in a court of initial jurisdiction and in one or more appellate courts, as the Company shall determine; provided, however, that if the Company directs Executive to pay such claim and sue for a refund, the Company shall advance the amount of such payment

to Executive, on an interest-free basis, and shall indemnify and hold Executive harmless, on an after-tax basis, from any Excise Tax or income tax (including interest or penalties with respect thereto) imposed with respect to such advance or with respect to any imputed income with respect to such advance; and further provided that any extension of the statute of limitations relating to payment of taxes for the taxable year of Executive with respect to which such contested amount is claimed to be due is limited solely to such contested amount. Furthermore, the Company's control of the contest shall be limited to issues with respect to which a Gross-Up Payment would be payable hereunder and Executive shall be entitled to settle or contest, as the case may be, any other issue raised by the Internal Revenue Service or any other taxing authority.

(iv) If, after the receipt by Executive of an amount advanced by the Company pursuant to Section 10(d)(iii), Executive becomes entitled to receive any refund with respect to such claim, Executive shall (subject to the Company's complying with the requirements of Section 10(d)(iii)), promptly pay to the Company the amount of such refund (together with any interest paid or credited thereon after taxes applicable thereto). If, after the receipt by Executive of an amount advanced by the Company pursuant to Section 10(d)(iii), a determination is made that Executive shall not be entitled to any refund with respect to such claim and the Company does not notify Executive in writing of its intent to contest such denial of refund prior to the expiration of 30 days after such determination, then such advance shall be forgiven and shall not be required to be repaid and the amount of such advance shall offset, to the extent thereof, the amount of Gross-Up Payment required to be paid.

(v) Notwithstanding any provision above to the contrary, any Gross-Up Payment payable under this Section 10(d) shall be made by the end of the calendar year following the calendar year in which the Executive remits the taxes. Further, notwithstanding any provision above to the contrary, any right to reimbursement under this Section 10(d) of expenses incurred by Executive due to a tax audit or litigation addressing the existence or amount of a tax liability shall be made by the end of the calendar year following the calendar year in which the taxes that are the subject of the audit or litigation are remitted, or where as a result of the audit or litigation no taxes are remitted, the end of the calendar year following the calendar year in which the audit is completed or there is a final and non-appealable settlement or other resolution of the litigation. Any Gross-Up Payment and any reimbursement of expenses payable under this Section 10(d) shall not be made before the date that is six months after the Termination Date.

(e) Other Termination Following a Change of Control. If Executive's Termination Date occurs during the Transition Period or otherwise following a Change of Control, and such termination is:

(i) by reason of Executive's abandonment of or resignation from employment for any reason (other than, during the Transition Period, for Good Reason);

(ii) by reason of termination of Executive's employment by the Company for Cause;

(iii) because of Executive's death or Disability; or

(iv) upon or following expiration of the Term,

then the Company will pay to Executive, or Executive's beneficiary or Executive's estate, as the case may be, such base salary that has been earned but not paid to Executive as of the Termination Date, payable pursuant to the Company's normal payroll practices and procedures, and such incentive compensation and benefits that have been earned as of the Termination Date, payable to the extent and in the manner as provided in the applicable plans or programs, and Executive shall not be entitled to any additional compensation or benefits provided under Section 10 hereof.

11. OTHER POST-TERMINATION OBLIGATIONS.

(a) In the event of termination of Executive's employment, the sole obligation of the Company under this Agreement will be its obligation to make the payments called for by Sections 9 or 10 hereof, as the case may be, and the Company will have no other obligation to Executive or to his beneficiary or his estate, except as otherwise provided by law or by the terms of any employee benefit plans or programs, or of any incentive compensation or stock ownership plans, then maintained by the Company in which Executive participates. In no event shall Executive be eligible for payments under both Section 9 and Section 10.

(b) Immediately upon termination of Executive's employment with the Company for any reason, Executive will resign all positions then held as a director or officer of the Company and of any Subsidiary, parent or affiliated entity of the Company.

(c) Upon termination of Executive's employment with the Company, Executive shall promptly deliver to the Company any and all Company records and any and all Company property in his possession or under his control, including without limitation manuals, books, blank forms, documents, letters, memoranda, notes, notebooks, reports, printouts, computer disks, flash drives or other digital storage media, source codes, data, tables or calculations and all copies thereof, documents that in whole or in part contain any trade secrets or confidential, proprietary or other secret information of the Company and all copies thereof, and keys, access cards, access codes, passwords, credit cards, personal computers, handheld personal computers or other digital devices, telephones and other electronic equipment belonging to the Company.

(d) Following termination of Executive's employment with the Company for any reason, Executive will, upon reasonable request of the Company or its designee, cooperate with the Company in connection with the transition of his duties and responsibilities for the Company; consult with the Company regarding business matters that

he was directly and substantially involved with while employed by the Company; and be reasonably available, with or without subpoena, to be interviewed, review documents or things, give depositions, testify, or engage in other reasonable activities in connection with any litigation or investigation, with respect to matters that Executive then has or may have knowledge of by virtue of his employment by or service to the Company or any related entity.

(e) Executive will not malign, defame or disparage the reputation, character, image, products or services of the Company, or the reputation or character of the Company's directors, officers, employees or agents, provided that nothing in this Section 11(e) shall be construed to limit or restrict Executive from taking any action that he in good faith reasonably believes is necessary to fulfill his fiduciary obligations to the Company, or from providing truthful information in connection with any legal proceeding, government investigation or other legal matter.

(f) In the event any payments or benefits become payable to Executive pursuant to Sections 9(a) or 10(a), then such payments or benefits will supersede and replace any other payments or benefits applicable to Executive under this Agreement or any other agreement, plan or program applicable to Executive to the extent that such other agreement, plan or program provides payments or benefits to Executive in the event of involuntary termination at the initiative of the Company without Cause or voluntary termination on the initiative of Executive for Good Reason, and Employee shall be entitled to payments only pursuant to Sections 9(a) or 10(a), as applicable.

12. TERMINATION PAYMENT CONDITIONS. Notwithstanding anything above to the contrary, the Company will not be obligated to make any payments to Executive under Sections 9(a) or 10(a) – (d) hereof unless: (a) Executive has signed a release of claims in favor of the Company and its affiliates and related entities, and their directors, officers, insurers, employees and agents, in a form prescribed by the Company (which release shall not include any claims Executive may have to indemnification or advance of expenses with respect to Executive's actions as an officer or director of the Company); (b) all applicable rescission periods provided by law for releases of claims shall have expired and Executive has not rescinded the release of claims; and (c) Executive is in strict compliance with the terms of this Agreement as of the dates of such payments.

13. SUCCESSORS.

(a) This Agreement is personal to Executive and without the prior written consent of the Company shall not be assignable by Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by Executive's legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.

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

14. MISCELLANEOUS.

(a) Tax Withholding. The Company may withhold from any amounts payable under this Agreement such federal, state and local income and employment taxes as the Company shall determine are required to be withheld pursuant to any applicable law or regulation.

(b) Section 409A. This Agreement is intended to satisfy the requirements of Section 409A(a)(2), (3) and (4) of the Code, including current and future guidance and regulations interpreting such provisions, and should be interpreted accordingly.

(c) Governing Law. All matters relating to the interpretation, construction, application, validity, and enforcement of this Agreement will be governed by the laws of the State of Minnesota without giving effect to any choice or conflict of law provision or rule, whether of the State of Minnesota or any other jurisdiction, that would cause the application of laws of any jurisdiction other than the State of Minnesota.

(d) Jurisdiction and Venue. Executive and the Company consent to jurisdiction of the courts of the State of Minnesota and/or the United States District Court, District of Minnesota, for the purpose of resolving all issues of law, equity, or fact arising out of or in connection with this Agreement. Any action involving claims of a breach of this Agreement must be brought in such courts. Each party consents to personal jurisdiction over such party in the state and/or federal courts of Minnesota and hereby waives any defense of lack of personal jurisdiction. Venue, for the purpose of all such suits, will be in Hennepin County, State of Minnesota.

(e) Waiver of Jury Trial. To the extent permitted by law, Executive and the Company waive any and all rights to a jury trial with respect to any dispute arising out of or relating to this Agreement.

(f) Entire Agreement. This Agreement contains the entire agreement of the parties relating to Executive's employment with the Company and supersedes all prior agreements and understandings with respect to such subject matter, including without limitation the Prior Agreement. The parties hereto have made no agreements, representations, or warranties relating to the subject matter of this Agreement that are not set forth herein.

(g) No Violation of Other Agreements. Executive hereby represents and agrees that neither (i) Executive's entering into this Agreement nor (ii) Executive's carrying

out the provisions of this Agreement, will violate any other agreement (oral, written, or other) to which Executive is a party or by which Executive is bound.

(h) Amendments. No amendment or modification of this Agreement will be effective unless made in writing and signed by the parties hereto.

(i) Counterparts. This Agreement may be executed by facsimile signature and in any number of counterparts, and such counterparts executed and delivered, each as an original, will constitute but one and the same instrument.

(j) Severability. Subject to Section 7(d) hereof, to the extent that any portion of any provision of this Agreement is held invalid or unenforceable, it will be considered deleted herefrom and the remainder of such provision and of this Agreement will be unaffected and will continue in full force and effect.

(k) Survival. The provisions of this Agreement that by their terms or implication extend beyond the Term, including without limitation Sections 4, 5, 6 and 7 of this Agreement, shall survive the termination or expiration of the Term and termination of Executive's employment with the Company for any reason.

(l) Captions and Headings. The captions and paragraph headings used in this Agreement are for convenience of reference only and will not affect the construction or interpretation of this Agreement or any of the provisions hereof.

(m) Notices. Any notice required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been duly given when (i) delivered personally; (ii) sent by facsimile or other similar electronic device with confirmation; (iii) delivered by reliable overnight courier; or (iv) three business days after being sent by registered or certified mail, postage prepaid, and in the case of (iii) and (iv) addressed as follows, or to such other address as the party may designate by giving notice hereunder:

If to the Company: Graco Inc.
 88 Eleventh Avenue NE
 Minneapolis, MN 55413
 Attention: Chairman of the Board
 Attention: General Counsel

If to Executive: «Who»
 «HAddress»

Executive and the Company have executed this Agreement effective as of the date set forth in the first paragraph.

GRACO INC.

By: _____

«Chair»

Its: Chairman of the Board

«Who»

fb.us.2471653.01

KEY EMPLOYEE AGREEMENT

This Key Employee Agreement (“Agreement”) is entered into effective _____ (the “Effective Date”) by and between Graco Inc., a Minnesota corporation (the “Company”), and «Who», a resident of Minnesota (“Executive”).

BACKGROUND

- A. The Company desires to continue to employ Executive in accordance with the terms and conditions stated in this Agreement.
- B. The Company and Executive are parties to a key employee agreement dated «Date» (the “Prior Agreement”), which the parties desire to amend and restate in its entirety as set forth in this Agreement.
- C. Executive is a key member of the management of the Company and is expected to devote substantial skill and effort to the affairs of the Company, and the Company desires to recognize the significant personal contribution that Executive makes and is expected to continue to make to further the best interests of the Company and its shareholders.
- D. It is desirable and in the best interests of the Company and its shareholders to continue to obtain the benefits of Executive’s services and attention to the affairs of the Company. It is desirable and in the best interests of the Company and its shareholders to provide inducement for Executive (1) to remain in the service of the Company in the event of any proposed or anticipated change of control of the Company and (2) to remain in the service of the Company in order to facilitate an orderly transition in the event of a change of control of the Company.
- E. It is desirable and in the best interests of the Company and its shareholders that Executive be in a position to make judgments and advise the Company with respect to proposed changes of control of the Company without regard to the possibility that Executive’s employment may be terminated without compensation in the event of certain changes of control of the Company.
- F. Executive will continue to have access to confidential, proprietary and trade secret information of the Company. It is desirable and in the best interests of the Company and its shareholders to protect confidential, proprietary and trade secret information of the Company, to prevent unfair competition by former executives of the Company following separation of their employment with the Company and to secure cooperation from former executives with respect to matters related to their employment with the Company.
- G. It is desirable and in the best interests of the Company and its shareholders to obtain certain commitments from Executive with respect to Executive’s service with the

Company and compliance with Company policies, and to facilitate a smooth transition upon separation from service and to provide for releases of claims from former executives.

AGREEMENT

In consideration of the foregoing premises and the respective agreements of the Company and Executive set forth below, the Company and Executive, intending to be legally bound, agree as follows:

1. DEFINITIONS. The capitalized terms used in this Agreement shall have the following meanings:

(a) “Annual Compensation” means the sum of (i) Executive’s annual base salary in effect as of the Termination Date, plus (ii) Executive’s target bonus award that would have been payable to Executive under the Annual Bonus Plan described in Section 3(b) for the annual performance period in which the Termination Date occurs, as if all performance targets have been met.

(b) “Board” means the Board of Directors of the Company, or any authorized committee of the Board of Directors of the Company.

(c) “Cause” means:

(i) Executive’s conviction or guilty or no contest plea to any felony or other criminal act involving moral turpitude;

(ii) gross misconduct or any act of fraud, disloyalty or dishonesty by Executive related to or connected with Executive’s employment by the Company or otherwise likely to cause material harm to the Company or its reputation;

(iii) a willful and material violation by Executive of the Company’s written policies or codes of conduct;

(iv) wrongful appropriation by Executive of Company funds or property or other material breach of Executive’s fiduciary duties to the Company; or

(v) the willful and material breach of this Agreement by Executive.

(d) A “Change of Control” means:

(i) an acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934), (a “Person”), of beneficial ownership (within the meaning of Rule 13d-3 under the Securities Exchange Act of 1934) which, together with other acquisitions by such Person, results in the aggregate beneficial ownership by such Person of 30% or more of either

(A) the then outstanding shares of Common Stock of the Company (the “Outstanding Company Common Stock”) or

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

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

(1) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,

(2) an acquisition by the Executive or any group that includes the Executive, or

(3) an acquisition by any entity pursuant to a transaction that complies with clauses (A), (B) and (C) of Section 1(d)(iii) below; 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 by or on behalf of a Person other than the Board; or

(iii) Consummation of a reorganization, merger or consolidation of the Company with or into another entity or a statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company (“Business Combination”); excluding, however, such a Business Combination pursuant to which

(A) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, a majority of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors (or comparable equity interests), as the case may be, of the surviving or acquiring entity

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

(B) no Person (excluding (1) any employee benefit plan (or related trust) sponsored or maintained by the Company or such entity resulting from such Business Combination or any entity controlled by the Company or the entity resulting from such Business Combination, (2) any entity beneficially owning 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly and (3) the Executive and any group that includes the Executive) beneficially owns, directly or indirectly, 30% or more of the then outstanding shares of common stock (or comparable equity interests) of the entity resulting from such Business Combination or the combined voting power of the then outstanding voting securities (or comparable equity interests) of such entity, and

(C) immediately after the Business Combination, a majority of the members of the board of directors (or comparable governors) of the entity resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

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

(e) "Code" means the Internal Revenue Code of 1986, as amended, and any successor statute thereto.

(f) "Company" means the Company as defined in the first sentence of this Agreement and any successor to its business and/or assets which assumes or agrees to perform this Agreement by operation of law or otherwise.

(g) "Disability" means a continuing condition of Executive that has been determined to meet the criteria set forth in the Company's Long Term Disability Plan, or similar successor plan, to render Executive eligible for long-term disability benefits under said plan, whether or not Executive is in fact covered by such plan. The determination shall be made by the insurer of the plan or, if Executive is not covered by the plan, by the Company in its sole discretion.

(h) “Good Reason” means any of the following conditions arising during the Transition Period, without the consent of Executive:

(i) the assignment to Executive of any duties materially inconsistent in any respect with Executive’s position (including offices and titles), duties or responsibilities, or any other action by the Company which results in a material diminution in such position, duties or responsibilities, as in effect immediately prior to the Transition Period, excluding for this purpose an isolated, insubstantial and inadvertent action not taken in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by Executive;

(ii) any material reduction, in the aggregate, to the compensation and benefit plans, programs and perquisites applicable to Executive as in effect immediately prior to the Transition Period, other than an isolated, insubstantial and inadvertent failure not occurring in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by Executive;

(iii) the Company requiring Executive to be based at any office or location more than 50 miles from the location at which Executive was based immediately prior to the Transition Period or the Company requiring Executive to travel on Company business to a substantially greater extent than required immediately prior to the Transition Period; or

(iv) any failure by the Company to comply with and satisfy Section 13(c) of this Agreement.

For purposes of this Section 1(h) any good faith determination of “Good Reason” made by Executive shall be conclusive.

(i) “Restricted Period” means the period commencing on the Effective Date and continuing during Executive’s employment with the Company or any Subsidiary and for 24 months after the Termination Date, whether such termination is with or without Cause, is at the instance of Executive or the Company or occurs before or after expiration of the Term; provided, however, that (i) in the event that Executive is entitled to payments under Section 9(a) and has satisfied the conditions in Section 12, then (A) the Restricted Period for purposes of Section 7(a) shall continue during Executive’s employment with the Company or any Subsidiary and for twelve (12) months after the Termination Date plus each additional month thereafter that the Company in its sole discretion elects to pay Executive additional monthly installments of supplemental separation pay and to provide benefits (if applicable) in the same manner set forth in Sections 9(a)(iii) and 9(a)(v), but ending no later than 24 months after the Termination Date, and (B) the Restricted Period for purposes of Sections 7(b) and 7(c) shall continue during Executive’s employment with the Company or any Subsidiary and for 24 months after the Termination Date; and (ii) in the event that

Executive is entitled to payments under Section 10(a) and has satisfied the conditions in Section 12, then the Restricted Period for all purposes shall end on the Termination Date.

(j) “Subsidiary” means, with respect to the Company, any corporation or other entity that is required to be combined with the Company as a single employer under Code § 414(b) or (c).

(k) “Term” means the period of Executive’s employment under this Agreement, commencing on the Effective Date and ending on the third anniversary of the Effective Date, provided that such period shall be automatically extended for successive one-year periods unless either party gives written notice of non-renewal to the other party at least six (6) months prior to the expiration of such third anniversary, or annual renewal, as the case may be, that such party elects not to extend the term of such employment under this Agreement; provided, further, that if a Change of Control occurs prior to the expiration of the Term specified in the preceding clause (including any extension year then in effect), then the Term shall end upon expiration of the Transition Period.

(l) “Termination Date” means the date of the Executive’s “separation from service” (within the meaning of Code § 409A(a)(2)(A)(i)) with the Company and its Subsidiaries, as determined by the Company.

(m) “Transition Period” means the period commencing at the time a Change of Control first occurs during the Term and ending on the date that is two years thereafter.

2. POSITION AND DUTIES. During Executive’s employment under this Agreement, Executive will perform such duties and responsibilities of an executive nature as the Company may assign from time to time. Executive will serve the Company faithfully and to the best of Executive’s ability and will devote Executive’s full working time, attention, and efforts to the business and affairs of the Company. Executive will report to the President and Chief Executive Officer of the Company (the “CEO”). Executive will follow and comply with applicable policies and procedures adopted by the Company from time to time, including without limitation policies relating to business ethics, conflict of interest, non-discrimination, confidentiality and protection of trade secrets, and insider trading. Executive will not engage in other employment or other material business activity, except as approved in writing by the CEO. It shall not be a violation of this Agreement for Executive to (i) serve on corporate, civic or charitable boards or committees or (ii) manage personal investments, so long as such activities do not significantly interfere with the performance of Executive’s responsibilities in accordance with this Agreement. Executive hereby represents and confirms that Executive is under no contractual or legal commitments that would prevent Executive from fulfilling Executive’s duties and responsibilities as set forth in this Agreement.

3. COMPENSATION. During Executive’s employment under this Agreement, Executive will be provided with the following compensation and benefits:

(a) Base Salary. The Company will pay to Executive for services provided hereunder a base salary at a rate determined from time to time by the Board, which base salary will be paid in accordance with the Company's normal payroll policies and procedures. The Board will review Executive's performance on an annual basis and determine any adjustments to Executive's base salary in its sole discretion.

(b) Incentive Compensation. Executive will be eligible to participate in an annual cash incentive plan of the Company as designated by the Board, in accordance with the terms and conditions of such plan as may be in effect from time to time (the "Annual Bonus Plan").

(c) Employee Benefits. Executive will be entitled to participate in all employee benefit plans and programs generally available to executive employees of the Company, as determined by the Company and to the extent that Executive meets the eligibility requirements for each individual plan or program. Executive's participation in any plan or program will be subject to the provisions, rules, and regulations of, or applicable to, the plan or program. The Company provides no assurance as to the adoption or continuation of any particular employee benefit plan or program.

(d) Expenses. The Company will reimburse Executive for all reasonable and necessary out-of-pocket business, travel, and entertainment expenses incurred by Executive in the performance of his duties and responsibilities to the Company during the Term. Such reimbursement shall be subject to the Company's normal policies and procedures for expense verification, documentation, and reimbursement; provided, however, that Executive shall submit verification of expenses within 45 days after the date the expense was incurred, and the Company shall reimburse Executive for such expenses eligible for reimbursement within 30 days thereafter. The right to reimbursement hereunder is not subject to liquidation or exchange for any other benefit, and the amount of expenses eligible for reimbursement in a calendar year shall not affect the expenses eligible for reimbursement in any other calendar year.

4. CONFIDENTIAL INFORMATION. Except as authorized in writing by the Board or as necessary in carrying out Executive's responsibilities for the Company, Executive will not at any time during or following Executive's employment with the Company or any Subsidiary divulge, furnish, or make accessible to anyone or use in any way, any confidential, proprietary, or secret knowledge or information of the Company or any Subsidiary that Executive has acquired or will acquire about the Company or any Subsidiary, whether developed by Executive or by others, concerning (i) any trade secrets, (ii) any confidential, proprietary, or secret designs, inventions, discoveries, programs, processes, formulae, plans, devices, or material (whether or not patented or patentable) directly or indirectly useful in any aspect of the business of the Company or any Subsidiary, (iii) any customer or supplier lists, (iv) any confidential, proprietary, or secret development or research work, (v) any strategic or other business, marketing, or sales plans, systems or techniques, (vi) any financial data or plans, or (vii) any other confidential or proprietary

information or secret aspects of the business of the Company or any Subsidiary. Executive acknowledges that the above-described knowledge and information constitute a unique and valuable asset of the Company and represent a substantial investment of time and expense by the Company, and that any disclosure or other use of such knowledge or information other than for the sole benefit of the Company would be wrongful and would cause irreparable harm to the Company. Executive will refrain from intentionally committing any acts that would materially reduce, and shall take reasonable steps to protect, the value of such knowledge or information to the Company. The foregoing obligations of confidentiality shall not apply to any knowledge or information that (i) is now or subsequently becomes generally publicly known, other than as a direct or indirect result of the breach by Executive of this Agreement, (ii) is independently made available to Executive in good faith by a third party who has not violated a confidential relationship with the Company or any Subsidiary, or (iii) is required to be disclosed by law or legal process. Executive understands and agrees that Executive's obligations under this Agreement to maintain the confidentiality of the Company's confidential information are in addition to any obligations of Executive under applicable statutory or common law.

5. VENTURES. If, during Executive's employment with the Company, Executive participates in the planning or implementing of any project, program, or venture involving the Company, all rights in such project, program, or venture belong to the Company. Except as approved in writing by the Board, Executive will not be entitled to any interest in any such project, program, or venture or to any commission, finder's fee, or other compensation in connection therewith. Executive will have no interest, direct or indirect, in any customer or supplier that conducts business with the Company.

6. INTELLECTUAL PROPERTY.

(a) Disclosure and Assignment. As of the Effective Date, Executive hereby transfers and assigns to the Company (or its designee) all right, title, and interest of Executive in and to every idea, concept, invention, and improvement (whether patented, patentable or not) conceived or reduced to practice by Executive whether solely or in collaboration with others while Executive is employed by the Company, and all copyrighted or copyrightable matter created by Executive whether solely or in collaboration with others while Executive is employed by the Company, in each case, that relates to the Company's or any Subsidiary's business (collectively, "Creations"). Executive shall communicate promptly and disclose to the Company all information, details, and data pertaining to each Creation, whether or not specifically requested by the Company but in such form as the Company may request. Every copyrightable Creation, regardless of whether copyright protection is sought or preserved by the Company, shall be a "work made for hire" as defined in 17 U.S.C. § 101, and the Company shall own all rights in and to such matter throughout the world, without the payment of any royalty or other consideration to Executive or anyone claiming through Executive.

(b) Trademarks. All right, title, and interest in and to any and all trademarks, trade names, service marks, and logos adopted, used, or considered for use by

the Company or any Subsidiary during Executive's employment (whether or not developed by Executive) to identify the Company's business or other goods or services (collectively, the "Marks"), together with the goodwill appurtenant thereto, and all other materials, ideas, or other property conceived, created, developed, adopted, or improved by Executive solely or jointly during Executive's employment by the Company and relating to its business shall be owned exclusively by the Company. Executive shall not have, and will not claim to have, any right, title, or interest of any kind in or to the Marks or such other property.

(c) Documentation. Executive shall execute and deliver to the Company such formal transfers and assignments and such other documents as the Company may request to permit the Company (or its designee) to file and prosecute such registration applications and other documents it deems useful to protect or enforce its rights hereunder. Any idea, invention, copyrightable matter, or other property relating to the Company's or any Subsidiary's business and disclosed by Executive prior to the first anniversary of the effective date of Executive's termination of employment shall be deemed to be governed by the terms of this Section 6 unless proven by Executive to have been first conceived and made after such termination date.

(d) Non-Applicability. Executive is hereby notified that Section 6(a) does not apply to any invention for which no equipment, supplies, facility, confidential information, or other trade secret information of the Company was used and which was developed entirely on Executive's own time, unless (1) the invention relates (a) directly to the business of the Company or any Subsidiary or (b) to the Company's or any Subsidiary's actual or demonstrably anticipated research or development, or (2) the invention results from any work performed by Executive for the Company.

7. NONCOMPETITION AND NONSOLICITATION COVENANTS. In consideration of the benefits and promises contained in this Agreement, the compensation and benefits provided to Executive in connection with Executive's employment with the Company, the disclosure to Executive of confidential information, and training and development opportunities provided to Executive in connection with such employment, Executive agrees to the following restrictive covenants.

(a) Agreement Not to Compete. During the Restricted Period, except with the express written consent of the Board, Executive will not, directly or indirectly, in any manner or capacity, including without limitation as a proprietor, principal, agent, partner, officer, director, investor, stockholder, employee, member of any association, consultant, or otherwise, engage or participate in any Competitive Business. "Competitive Business" means any person, entity or business operation (other than the Company) engaged in, or making plans or actively preparing to engage in, a business (i) that competes with the business then conducted by, or proposed to be conducted by, the Company, including without limitation the design, development, manufacture, marketing or sale of fluid handling systems, products or technology similar to or competitive with the systems, products or technology of the Company, and (ii) that is conducted in the United States or in any other country where the Company is then doing business. Ownership by Executive, as a passive investment, of less

than one percent of the outstanding shares of capital stock of any corporation listed on a national securities exchange or publicly traded in the over-the-counter market shall not constitute a breach of this Section 7(a).

(b) Agreement Not to Hire. During the Restricted Period, Executive will not, directly or indirectly, in any manner or capacity, including without limitation as a proprietor, principal, agent, partner, officer, director, investor, stockholder, employee, member of any association, consultant, or otherwise, hire, engage, or solicit any person who is then an employee of the Company or who was an employee of the Company at any time during the six month period immediately preceding Executive's termination of employment.

(c) Agreement Not to Solicit. During the Restricted Period, Executive will not, directly or indirectly, in any manner or capacity including without limitation as a proprietor, principal, agent, partner, officer, director, stockholder, employee, member of any association, consultant, or otherwise, solicit, request, advise, or induce any current or potential customer, supplier, vendor or other business contact of the Company to cancel, curtail, or otherwise change its relationship adversely to the Company, or interfere in any manner with the relationship between the Company and any of its customers, suppliers, vendors or other business contacts.

(d) Modification. If the duration of, the scope of, or any business activity covered by, any provision of this Section 7 exceeds that which is valid and enforceable under applicable law, such provision will be construed to cover only that duration, scope, or activity that is determined to be valid and enforceable. Executive hereby acknowledges that this Section 7 will be construed so that its provisions are valid and enforceable to the maximum extent, not exceeding its express terms, possible under applicable law.

(e) No Adequate Remedy at Law. Executive hereby acknowledges that the provisions of this Section 7 are reasonable and necessary to protect the legitimate interests of the Company and that any violation of this Section 7 by Executive will cause substantial and irreparable harm to the Company to such an extent that monetary damages alone would be an inadequate remedy therefor. Accordingly, in the event of any actual or threatened breach of any such provisions, the Company will, in addition to any other remedies it may have, be entitled to injunctive and other equitable relief to enforce such provisions, and such relief may be granted without the necessity of proving actual monetary damages.

8. TERMINATION OF EMPLOYMENT. Executive's employment with the Company under this Agreement is at will and may be terminated by either party for any or no reason, subject to the obligations of the parties provided for in this Agreement.

9. PAYMENTS UPON TERMINATION OF EMPLOYMENT PRIOR TO A CHANGE OF CONTROL.

(a) Involuntary Termination Without Cause Prior To a Change of Control. If Executive's Termination Date occurs during the Term and prior to any Change of Control,

and if such termination is involuntary at the initiative of the Company without Cause, then, in addition to such base salary that has been earned but not paid to Executive as of the Termination Date, the Company shall provide to Executive the severance payments set forth in this Section 9(a), subject to the conditions in Section 12:

(i) Separation Pay. The Company shall pay to Executive an amount equal to one-half ($\frac{1}{2}$) times Executive's Annual Compensation, but in no event shall such amount paid under this Section 9(a)(i) exceed the lesser of:

(A) \$450,000.00; or

(B) two (2) times Executive's annualized compensation based upon the annual rate of pay for services to the Company for the calendar year prior to the calendar year in which the Termination Date occurs (adjusted for any increase during that year that was expected to continue indefinitely if the Executive had not separated from service).

Such separation pay shall be paid to Executive in six (6) equal monthly installments, commencing on the first regular payroll date of the Company that occurs following the Termination Date and continuing for six months, provided that Executive has satisfied the conditions set forth in Section 12. The Company and Executive intend the payments under this Section 9(a)(i) to be a "separation pay plan due to involuntary separation from service" under Treas. Reg. § 1.409A-1(b)(9)(iii).

(ii) Make-up Payment. In the event that Executive's separation pay under Section 9(a)(i) above is limited by application of clause (A) or (B) thereof, then the Company shall make an additional lump sum payment to Executive equal to the difference between (x) one-half times Executive's Annual Compensation and (y) the amount paid to Executive under Section 9(a)(i). Such payment shall be paid to Executive in a lump sum on the first regular payroll date of the Company to occur following the date that is six months after the Termination Date, provided that Executive has satisfied the conditions set forth in Section 12.

(iii) Supplemental Separation Pay. The Company shall pay to Executive an additional amount equal to one-half ($\frac{1}{2}$) times Executive's Annual Compensation. Such supplemental separation pay shall be paid to Executive in six (6) equal monthly installments, commencing on the first regular payroll date of the Company that occurs following the completion of all payments under Sections 9(a)(i) and 9(a)(ii) and continuing for six (6) months, provided that Executive has satisfied the conditions set forth in Section 12. Supplemental separation pay may be continued at the same monthly rate for such additional period elected by the Company in its sole discretion, as described in Section 1(i)(i)(A).

(iv) Pro-Rated Bonus. If the Termination Date is any day other than the last day of a performance period under the Annual Bonus Plan, then the Company shall

pay to Executive an amount equal to a pro rata portion of the award that would have been payable to Executive under the Annual Bonus Plan for such annual performance period had Executive remained employed by the Company until the end of the performance period, based on actual performance results. The pro rata portion shall be calculated based on the number of days during such annual performance period Executive was employed by the Company prior to the Termination Date divided by 365. Any separation pay that may become payable pursuant to this Section 9(a)(iv) shall be paid to Executive on the later of the date that awards for such annual performance period are paid to other participants in the Annual Bonus Plan and the first regular payroll date of the Company to occur following the date that is six months after the Termination Date, provided that Executive has satisfied the conditions set forth in Section 12.

(v) Continued Benefits. If Executive (and/or Executive's covered dependents) is eligible for and properly elects to continue group medical, dental and/or life insurance coverage, as in place immediately prior to the Termination Date, the Company shall continue to pay the Company's portion of any such premiums or costs of coverage (on a benefit by benefit basis) until the earlier of (A) twelve (12) months after the Termination Date (or for such additional period elected by the Company in its sole discretion, as described in Section 1(i)(i)(A)), or (B) the date Executive (and Executive's covered dependents) is provided such form of coverage by a subsequent employer. In the event that Executive's participation in such plans is not possible under any of the applicable plans and laws as then in effect, the Company will purchase coverage reasonably comparable to the coverage provided under the plans provided by the Company, to the extent such coverage is reasonably available, and Executive will cooperate with the Company to obtain the most favorable rate for such coverage for Executive. All such Company-provided medical, dental and/or life insurance premiums, or costs of coverage, shall be paid directly to the insurance carrier or other provider by the Company and Executive shall make arrangements with the Company to pay the Executive's portion of such coverage.

(vi) Outplacement Services. The Company shall provide to Executive executive-level outplacement services from a provider selected by the Company, consistent with Company policy then in effect for executive officers, for up to one year following the Termination Date.

(vii) Legal Fees. The Company shall reimburse Executive for reasonable legal fees and expenses incurred by Executive in connection with seeking legal advice in seeking to obtain or enforce in good faith any right or benefit provided by this Agreement, to the extent such claims are timely commenced under applicable law; provided, however, that the Company may recover any such legal fees and expenses of Executive which the Company has paid, if it is finally judicially determined in such proceeding that Executive's claim or claims were frivolous or that Executive pursued such claim or claims in bad faith. Executive will submit to the Company verification of legal expenses eligible for reimbursement within 60 days from the date that the expense was incurred. The Company shall reimburse Executive for eligible expenses promptly thereafter, but in any event not earlier than the date that is six months following the Termination Date and not later than

December 31 of the calendar year following the calendar year in which the expense was incurred. The amount of expenses eligible for reimbursement during any calendar year will not affect the expenses eligible for reimbursement in any other calendar year, and Executive's right to reimbursement of such expenses may not be exchanged for cash or any other benefit. Any amounts payable hereunder are intended to be payable in accordance with a reimbursement plan pursuant to Section 409A of the Code.

(b) Other Termination Prior to a Change of Control. If Executive's Termination Date occurs during the Term and prior to any Change of Control, and if such termination is:

- (i) by reason of Executive's abandonment of or resignation from employment for any reason;
- (ii) by reason of termination of Executive's employment by the Company for Cause;
- (iii) because of Executive's death or Disability; or
- (iv) upon or following expiration of the Term,

then the Company will pay to Executive, or Executive's beneficiary or Executive's estate, as the case may be, such base salary that has been earned but not paid to Executive as of the Termination Date, payable pursuant to the Company's normal payroll practices and procedures, and such incentive compensation and benefits that have been earned as of the Termination Date, payable to the extent and in the manner provided in the applicable plans or programs, and Executive shall not be entitled to any additional compensation or benefits provided under Section 9 hereof.

10. PAYMENTS UPON TERMINATION OF EMPLOYMENT DURING THE TRANSITION PERIOD.

(a) Payments and Benefits Upon Involuntary Termination Without Cause or Resignation for Good Reason During The Transition Period. If Executive's Termination Date occurs during the Transition Period, and if such termination is involuntary at the initiative of the Company without Cause or at the initiative of Executive for Good Reason, then, in addition to such base salary and incentive compensation that has been earned but not paid to Executive as of the Termination Date, the Company shall provide to Executive the severance payments set forth in this Section 10(a), subject to the conditions in Section 12:

(i) Separation Pay. The Company shall pay to Executive an amount equal to two (2) times Executive's Annual Compensation.

(ii) Pro-Rated Bonus. If the Termination Date is any day other than the last day of a performance period under the Annual Bonus Plan, then the Company shall

pay to Executive an amount equal to a pro rata portion of the target award that would have been payable to Executive under the Annual Bonus Plan for the annual performance period in which the Termination Date occurs, as if all performance targets been met. The pro rata portion shall be calculated based on the number of days during such annual performance period Executive was employed by the Company prior to the Termination Date divided by 365.

(iii) Continued Benefits. If Executive (and/or Executive's covered dependents) is eligible and properly elects to continue group medical, dental and/or life insurance coverage, as in place immediately prior to the Termination Date, the Company shall continue to pay the Company's portion of any such premiums or costs of coverage (on a benefit by benefit basis) until the earlier of (A) twenty-four (24) months after the Termination Date, or (B) the date Executive (and Executive's covered dependents) is provided such form of coverage by a subsequent employer. In the event that Executive's participation in such plans is not possible under any of the applicable plans and laws as then in effect, the Company will purchase coverage reasonably comparable to the coverage provided under the plans provided by the Company, to the extent such coverage is reasonably available, and Executive will cooperate with the Company to obtain the most favorable rate for such coverage for Executive. All such Company-provided medical, dental and/or life insurance premiums, or costs of coverage, shall be paid directly to the insurance carrier or other provider by the Company and Executive shall make arrangements with the Company to pay the Executive's portion of such coverage.

(iv) Retirement/Restoration Benefits. If Executive is a participant in the Company's Restoration Plan, the Company shall credit Executive with additional years of service under such plan for purposes of calculating all benefits and rights under such plan, as if Executive had remained employed by the Company for an additional two (2) years following the Termination Date.

(v) Legal Fees. The Company shall reimburse Executive for reasonable legal fees and expenses incurred by Executive in connection with seeking legal advice in seeking to obtain or enforce in good faith any right or benefit provided by this Agreement, to the extent such claims are timely commenced under applicable law; provided, however, that the Company may recover any such legal fees and expenses of Executive which the Company has paid, if it is finally judicially determined in such proceeding that Executive's claim or claims were frivolous or that Executive pursued such claim or claims in bad faith. Executive will submit to the Company verification of legal expenses eligible for reimbursement within 60 days from the date that the expense was incurred. The Company shall reimburse Executive for eligible expenses promptly thereafter, but in any event not earlier than the date that is six months following the Termination Date and not later than December 31 of the calendar year following the calendar year in which the expense was incurred. The amount of expenses eligible for reimbursement during any calendar year will not affect the expenses eligible for reimbursement in any other calendar year, and Executive's right to reimbursement of such expenses may not be exchanged for cash or any

other benefit. Any amounts payable hereunder are intended to be payable in accordance with a reimbursement plan pursuant to Section 409A of the Code.

(b) Timing and Form of Payments Following a Change of Control.

(i) Lump Sum Payment. Except as provided in Section 10(b)(ii) below, in the event that Executive is entitled to payments under Section 10(a) above, then any payments to which Executive is entitled under Sections 10(a)(i) or (ii) above shall be paid to Executive in a lump sum on the first regular payroll date of the Company to occur following the date that is six months after the Termination Date, provided that Executive has satisfied the conditions set forth in Section 12.

(ii) 409A Timing Exceptions. Notwithstanding the provisions of Section 10(b)(i) above, if, as of the Termination Date, the Change of Control does not constitute a change “in the ownership or effective control” of the Company, or “in the ownership of a substantial portion of the assets” of the Company, as such phrases are defined in Section 409A(2)(a)(v) of the Code, then the payments under Section 10(a) shall be made as follows:

(A) A portion of the amount payable under Section 10(a)(i), such portion equal to the aggregate amounts that would have been payable to Executive pursuant to Sections 9(a)(i), (ii) and (iii) in the event of an involuntary termination prior to a Change of Control, shall be paid to Executive in the same manner and at the same time as if such payments were being made pursuant to Section 9(a)(i), (ii) and (iii) above.

(B) The remaining portion of the amount payable to Executive under Section 10(a)(i) shall be paid to Executive in twelve (12) equal monthly installments, commencing on the first regular payroll date of the Company that occurs following the completion of all payments under Section 10(b)(ii)(A) and continuing for twelve months.

(C) The amount payable under Section 10(a)(ii) shall be paid to Executive on the later of the date that awards for the annual performance period during which the Termination Date occurred are paid to other participants in the Annual Bonus Plan and the first regular payroll date of the Company to occur following the date that is six months after the Termination Date.

(c) Possible Payment Reduction. Notwithstanding any provision to the contrary contained in this Agreement, if the cash payments due and the other benefits to which Executive shall become entitled under Section 10(a), either alone or together with other payments in the nature of compensation to Executive which are contingent on a change in the ownership or effective control of the Company or in the ownership of a substantial portion of the assets of the Company or otherwise, would constitute a “parachute payment” (as defined in Section 280G of the Code or any successor provision thereto), such payments

or benefits shall be reduced (but not below zero) to the largest aggregate amount as will result in no portion thereof being subject to the excise tax imposed under Section 4999 of the Code (or any successor provision thereto) or being non-deductible to the Company for Federal Income Tax purposes pursuant to Section 280G of the Code (or any successor provision thereto), provided, however, that no such reduction shall occur, and this Section 10(c) shall not apply, in the event that the amount of such reduction would be more than \$25,000. Executive in good faith shall determine the amount of any reduction to be made pursuant to this Section 10(c) and shall select from among the foregoing benefits and payments those which shall be reduced. No modification of, or successor provision to, Section 280G or Section 4999 subsequent to the date of this Agreement shall, however, reduce the benefits to which the Executive would be entitled under this Agreement in the absence of this Section 10(c) to a greater extent than they would have been reduced if Section 280G and Section 4999 had not been modified or superseded subsequent to the date of this Agreement, notwithstanding anything to the contrary provided in the first sentence of this Section 10(c).

(d) Certain Additional Payments by the Company.

(i) Anything in this Agreement to the contrary notwithstanding, in the event it shall be determined that Section 10(c) above does not apply and any payment or distribution by the Company to or for the benefit of Executive (whether paid or payable or distributed or distributable pursuant to the terms of this Agreement, any stock option, restricted stock agreement or otherwise, but determined without regard to any additional payments required under this Section 10(d)) (a "Payment") would be subject to the excise tax imposed by Section 4999 of the Code or any interest or penalties are incurred by Executive with respect to such excise tax (such excise tax, together with any such interest and penalties, are hereinafter collectively referred to as the "Excise Tax"), then the Executive shall be entitled to receive an additional payment (a "Gross-Up Payment") in an amount such that after payment by Executive of all taxes (including any interest or penalties imposed with respect to such taxes), including, without limitation, any income taxes (and any interest and penalties imposed with respect thereto) and Excise Tax imposed upon the Gross-Up Payment, the Executive retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payments.

(ii) Subject to the provisions of Section 10(d)(iii) all determinations required to be made under this Section 10(d), including whether and when a Gross-Up Payment is required and the amount of such Gross-Up Payment and the assumptions to be utilized in arriving at such determination, shall be made by Deloitte and Touche LLP or such other certified public accounting firm as may be designated by Executive (the "Accounting Firm") which shall provide detailed supporting calculations both to the Company and Executive within 15 business days of the receipt of notice from Executive that there has been a Payment, or such earlier time as is requested by the Company. In the event that the Accounting Firm is serving as accountant or auditor for the individual, entity or group effecting the Change of Control, Executive shall appoint another nationally recognized accounting firm to make the determinations required hereunder (which accounting firm shall

then be referred to as the Accounting Firm hereunder). All fees and expenses of the Accounting Firm shall be borne solely by the Company. Any Gross-Up Payment, as determined pursuant to this Section 10(d), shall be paid by the Company to Executive within five days of the receipt of the Accounting Firm's determination. If the Accounting Firm determines that no Excise Tax is payable by Executive, it shall furnish Executive with a written opinion that failure to report the Excise Tax on Executive's applicable federal income tax return would not result in the imposition of a negligence or similar penalty. Any determination by the Accounting Firm shall be binding upon the Company and Executive. As a result of the uncertainty in the application of Section 4999 of the Code at the time of the initial determination by the Accounting Firm hereunder, it is possible that Gross-Up Payments which will not have been made by the Company should have been made ("Underpayment"), consistent with the calculations required to be made hereunder. In the event that the Company exhausts its remedies pursuant to Section 10(d)(iii) and the Executive thereafter is required to make a payment of any Excise Tax, the Accounting Firm shall determine the amount of the Underpayment that has occurred and any such Underpayment shall be promptly paid by the Company to or for the benefit of the Executive.

(iii) Executive shall notify the Company in writing of any claim by the Internal Revenue Service that, if successful, would require the payment by the Company of a Gross-Up Payment or an increase to a Gross-Up Payment previously made. Such notification shall be given as soon as practicable but no later than ten business days after Executive is informed in writing of such claim (provided that any delay in so informing the Company within such ten business day period shall not affect the obligations of the Company under this Section 10(d) except to the extent that such delay materially and adversely affects the Company) and shall apprise the Company of the nature of such claim and the date on which such claim is requested to be paid. Executive shall not pay such claim prior to the expiration of the 30-day period following the date on which it gives such notice to the Company (or such shorter period ending on the date that any payment of taxes with respect to such claim is due). If the Company notifies Executive in writing prior to the expiration of such period that it desires to contest such claim, Executive shall:

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

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

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

(D) permit the Company to participate in any proceedings relating to such claim; provided, however, that the Company shall bear and pay directly all costs and expenses (including additional interest and penalties) incurred in

connection with such contest and shall indemnify and hold the Executive harmless, on an after-tax basis, for any Excise Tax or income tax (including interest and penalties with respect thereto) imposed as a result of such representation and payment of costs and expenses. Without limitation on the foregoing provisions of this Section 10(d)(iii), the Company shall control all proceedings taken in connection with such contest and, at its sole option, may pursue or forgo any and all administrative appeals, proceedings, hearings and conferences with the taxing authority in respect of such claim and may, at its sole option, either direct Executive to pay the tax claimed and sue for a refund or contest the claim in any permissible manner, and Executive agrees to prosecute such contest to a determination before any administrative tribunal, in a court of initial jurisdiction and in one or more appellate courts, as the Company shall determine; provided, however, that if the Company directs Executive to pay such claim and sue for a refund, the Company shall advance the amount of such payment to Executive, on an interest-free basis, and shall indemnify and hold Executive harmless, on an after-tax basis, from any Excise Tax or income tax (including interest or penalties with respect thereto) imposed with respect to such advance or with respect to any imputed income with respect to such advance; and further provided that any extension of the statute of limitations relating to payment of taxes for the taxable year of Executive with respect to which such contested amount is claimed to be due is limited solely to such contested amount. Furthermore, the Company's control of the contest shall be limited to issues with respect to which a Gross-Up Payment would be payable hereunder and Executive shall be entitled to settle or contest, as the case may be, any other issue raised by the Internal Revenue Service or any other taxing authority.

(iv) If, after the receipt by Executive of an amount advanced by the Company pursuant to Section 10(d)(iii), Executive becomes entitled to receive any refund with respect to such claim, Executive shall (subject to the Company's complying with the requirements of Section 10(d)(iii)), promptly pay to the Company the amount of such refund (together with any interest paid or credited thereon after taxes applicable thereto). If, after the receipt by Executive of an amount advanced by the Company pursuant to Section 10(d)(iii), a determination is made that Executive shall not be entitled to any refund with respect to such claim and the Company does not notify Executive in writing of its intent to contest such denial of refund prior to the expiration of 30 days after such determination, then such advance shall be forgiven and shall not be required to be repaid and the amount of such advance shall offset, to the extent thereof, the amount of Gross-Up Payment required to be paid.

(v) Notwithstanding any provision above to the contrary, any Gross-Up Payment payable under this Section 10(d) shall be made by the end of the calendar year following the calendar year in which the Executive remits the taxes. Further, notwithstanding any provision above to the contrary, any right to reimbursement under this Section 10(d) of expenses incurred by Executive due to a tax audit or litigation addressing the existence or amount of a tax liability shall be made by the end of the calendar year following the calendar year in which the taxes that are the subject of the audit or litigation

are remitted, or where as a result of the audit or litigation no taxes are remitted, the end of the calendar year following the calendar year in which the audit is completed or there is a final and non-appealable settlement or other resolution of the litigation. Any Gross-Up Payment and any reimbursement of expenses payable under this Section 10(d) shall not be made before the date that is six months after the Termination Date.

(e) Other Termination Following a Change of Control. If Executive's Termination Date occurs during the Transition Period or otherwise following a Change of Control, and such termination is:

- (i) by reason of Executive's abandonment of or resignation from employment for any reason (other than, during the Transition Period, for Good Reason);
- (ii) by reason of termination of Executive's employment by the Company for Cause;
- (iii) because of Executive's death or Disability; or
- (iv) upon or following expiration of the Term,

then the Company will pay to Executive, or Executive's beneficiary or Executive's estate, as the case may be, such base salary that has been earned but not paid to Executive as of the Termination Date, payable pursuant to the Company's normal payroll practices and procedures, and such incentive compensation and benefits that have been earned as of the Termination Date, payable to the extent and in the manner as provided in the applicable plans or programs, and Executive shall not be entitled to any additional compensation or benefits provided under Section 10 hereof.

11. OTHER POST-TERMINATION OBLIGATIONS.

(a) In the event of termination of Executive's employment, the sole obligation of the Company under this Agreement will be its obligation to make the payments called for by Sections 9 or 10 hereof, as the case may be, and the Company will have no other obligation to Executive or to his beneficiary or his estate, except as otherwise provided by law or by the terms of any employee benefit plans or programs, or of any incentive compensation or stock ownership plans, then maintained by the Company in which Executive participates. In no event shall Executive be eligible for payments under both Section 9 and Section 10.

(b) Immediately upon termination of Executive's employment with the Company for any reason, Executive will resign all positions then held as a director or officer of the Company and of any Subsidiary, parent or affiliated entity of the Company.

(c) Upon termination of Executive's employment with the Company, Executive shall promptly deliver to the Company any and all Company records and any and

all Company property in his possession or under his control, including without limitation manuals, books, blank forms, documents, letters, memoranda, notes, notebooks, reports, printouts, computer disks, flash drives or other digital storage media, source codes, data, tables or calculations and all copies thereof, documents that in whole or in part contain any trade secrets or confidential, proprietary or other secret information of the Company and all copies thereof, and keys, access cards, access codes, passwords, credit cards, personal computers, handheld personal computers or other digital devices, telephones and other electronic equipment belonging to the Company.

(d) Following termination of Executive's employment with the Company for any reason, Executive will, upon reasonable request of the Company or its designee, cooperate with the Company in connection with the transition of his duties and responsibilities for the Company; consult with the Company regarding business matters that he was directly and substantially involved with while employed by the Company; and be reasonably available, with or without subpoena, to be interviewed, review documents or things, give depositions, testify, or engage in other reasonable activities in connection with any litigation or investigation, with respect to matters that Executive then has or may have knowledge of by virtue of his employment by or service to the Company or any related entity.

(e) Executive will not malign, defame or disparage the reputation, character, image, products or services of the Company, or the reputation or character of the Company's directors, officers, employees or agents, provided that nothing in this Section 11(e) shall be construed to limit or restrict Executive from taking any action that he in good faith reasonably believes is necessary to fulfill his fiduciary obligations to the Company, or from providing truthful information in connection with any legal proceeding, government investigation or other legal matter.

(f) In the event any payments or benefits become payable to Executive pursuant to Sections 9(a) or 10(a), then such payments or benefits will supersede and replace any other payments or benefits applicable to Executive under this Agreement or any other agreement, plan or program applicable to Executive to the extent that such other agreement, plan or program provides payments or benefits to Executive in the event of involuntary termination at the initiative of the Company without Cause or voluntary termination on the initiative of Executive for Good Reason, and Employee shall be entitled to payments only pursuant to Sections 9(a) or 10(a), as applicable.

12. TERMINATION PAYMENT CONDITIONS. Notwithstanding anything above to the contrary, the Company will not be obligated to make any payments to Executive under Sections 9(a) or 10(a) – (d) hereof unless: (a) Executive has signed a release of claims in favor of the Company and its affiliates and related entities, and their directors, officers, insurers, employees and agents, in a form prescribed by the Company (which release shall not include any claims Executive may have to indemnification or advance of expenses with respect to Executive's actions as an officer or director of the Company); (b) all applicable rescission periods provided by law for releases of claims shall have expired and Executive

has not rescinded the release of claims; and (c) Executive is in strict compliance with the terms of this Agreement as of the dates of such payments.

13. SUCCESSORS.

(a) This Agreement is personal to Executive and without the prior written consent of the Company shall not be assignable by Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by Executive's legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.

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

14. MISCELLANEOUS.

(a) Tax Withholding. The Company may withhold from any amounts payable under this Agreement such federal, state and local income and employment taxes as the Company shall determine are required to be withheld pursuant to any applicable law or regulation.

(b) Section 409A. This Agreement is intended to satisfy the requirements of Section 409A(a)(2), (3) and (4) of the Code, including current and future guidance and regulations interpreting such provisions, and should be interpreted accordingly.

(c) Governing Law. All matters relating to the interpretation, construction, application, validity, and enforcement of this Agreement will be governed by the laws of the State of Minnesota without giving effect to any choice or conflict of law provision or rule, whether of the State of Minnesota or any other jurisdiction, that would cause the application of laws of any jurisdiction other than the State of Minnesota.

(d) Jurisdiction and Venue. Executive and the Company consent to jurisdiction of the courts of the State of Minnesota and/or the United States District Court, District of Minnesota, for the purpose of resolving all issues of law, equity, or fact arising out of or in connection with this Agreement. Any action involving claims of a breach of this Agreement must be brought in such courts. Each party consents to personal jurisdiction over such party in the state and/or federal courts of Minnesota and hereby waives any defense of lack of personal jurisdiction. Venue, for the purpose of all such suits, will be in Hennepin County, State of Minnesota.

(e) Waiver of Jury Trial. To the extent permitted by law, Executive and the Company waive any and all rights to a jury trial with respect to any dispute arising out of or relating to this Agreement.

(f) Entire Agreement. This Agreement contains the entire agreement of the parties relating to Executive's employment with the Company and supersedes all prior agreements and understandings with respect to such subject matter, including without limitation the Prior Agreement. The parties hereto have made no agreements, representations, or warranties relating to the subject matter of this Agreement that are not set forth herein.

(g) No Violation of Other Agreements. Executive hereby represents and agrees that neither (i) Executive's entering into this Agreement nor (ii) Executive's carrying out the provisions of this Agreement, will violate any other agreement (oral, written, or other) to which Executive is a party or by which Executive is bound.

(h) Amendments. No amendment or modification of this Agreement will be effective unless made in writing and signed by the parties hereto.

(i) Counterparts. This Agreement may be executed by facsimile signature and in any number of counterparts, and such counterparts executed and delivered, each as an original, will constitute but one and the same instrument.

(j) Severability. Subject to Section 7(d) hereof, to the extent that any portion of any provision of this Agreement is held invalid or unenforceable, it will be considered deleted herefrom and the remainder of such provision and of this Agreement will be unaffected and will continue in full force and effect.

(k) Survival. The provisions of this Agreement that by their terms or implication extend beyond the Term, including without limitation Sections 4, 5, 6 and 7 of this Agreement, shall survive the termination or expiration of the Term and termination of Executive's employment with the Company for any reason.

(l) Captions and Headings. The captions and paragraph headings used in this Agreement are for convenience of reference only and will not affect the construction or interpretation of this Agreement or any of the provisions hereof.

(m) Notices. Any notice required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been duly given when (i) delivered personally; (ii) sent by facsimile or other similar electronic device with confirmation; (iii) delivered by reliable overnight courier; or (iv) three business days after being sent by registered or certified mail, postage prepaid, and in the case of (iii) and (iv) addressed as follows, or to such other address as the party may designate by giving notice hereunder:

If to the Company: Graco Inc.

88 Eleventh Avenue NE
Minneapolis, MN 55413
Attention: Chairman of the Board
Attention: General Counsel

If to Executive:

<<Name>>
«Home Address»

Executive and the Company have executed this Agreement effective as of the date set forth in the first paragraph.

GRACO INC.

By: _____

<<CEO>>

Its: _____

«Who»

KEY EMPLOYEE AGREEMENT

This Key Employee Agreement (“Agreement”) is entered into effective _____ (the “Effective Date”) by and between Graco Inc., a Minnesota corporation (the “Company”), and «Who», a resident of Minnesota (“Executive”).

BACKGROUND

A. The Company desires to continue to employ Executive in accordance with the terms and conditions stated in this Agreement.

B. The Company and Executive are parties to a key employee agreement dated «Date» (the “Prior Agreement”), which the parties desire to amend and restate in its entirety as set forth in this Agreement.

C. Executive is a key member of the management of the Company and is expected to devote substantial skill and effort to the affairs of the Company, and the Company desires to recognize the significant personal contribution that Executive makes and is expected to continue to make to further the best interests of the Company and its shareholders.

D. It is desirable and in the best interests of the Company and its shareholders to continue to obtain the benefits of Executive’s services and attention to the affairs of the Company. It is desirable and in the best interests of the Company and its shareholders to provide inducement for Executive (1) to remain in the service of the Company in the event of any proposed or anticipated change of control of the Company and (2) to remain in the service of the Company in order to facilitate an orderly transition in the event of a change of control of the Company.

E. It is desirable and in the best interests of the Company and its shareholders that Executive be in a position to make judgments and advise the Company with respect to proposed changes of control of the Company without regard to the possibility that Executive’s employment may be terminated without compensation in the event of certain changes of control of the Company.

AGREEMENT

In consideration of the foregoing premises and the respective agreements of the Company and Executive set forth below, the Company and Executive, intending to be legally bound, agree as follows:

1. DEFINITIONS. The capitalized terms used in this Agreement shall have the following meanings:

(a) “Annual Compensation” means the sum of (i) Executive’s annual base salary in effect as of the Termination Date, plus (ii) Executive’s target bonus award that would have been payable to Executive under the Annual Bonus Plan described in Section 3(b) for the annual performance period in which the Termination Date occurs, as if all performance targets have been met.

(b) “Board” means the Board of Directors of the Company, or any authorized committee of the Board of Directors of the Company.

(c) “Cause” means:

(i) Executive’s conviction or guilty or no contest plea to any felony or other criminal act involving moral turpitude;

(ii) gross misconduct or any act of fraud, disloyalty or dishonesty by Executive related to or connected with Executive’s employment by the Company or otherwise likely to cause material harm to the Company or its reputation;

(iii) a willful and material violation by Executive of the Company’s written policies or codes of conduct;

(iv) wrongful appropriation by Executive of Company funds or property or other material breach of Executive’s fiduciary duties to the Company; or

(v) the willful and material breach of this Agreement by Executive.

(d) A “Change of Control” means:

(i) an acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934), (a “Person”), of beneficial ownership (within the meaning of Rule 13d-3 under the Securities Exchange Act of 1934) which, together with other acquisitions by such Person, results in the aggregate beneficial ownership by such Person of 30% or more of either

(A) the then outstanding shares of Common Stock of the Company (the “Outstanding Company Common Stock”) or

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

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

(1) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,

(2) an acquisition by the Executive or any group that includes the Executive, or

(3) an acquisition by any entity pursuant to a transaction that complies with clauses (A), (B) and (C) of Section 1(d)(iii) below; 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 by or on behalf of a Person other than the Board; or

(iii) Consummation of a reorganization, merger or consolidation of the Company with or into another entity or a statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination"); excluding, however, such a Business Combination pursuant to which

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

(B) no Person (excluding (1) any employee benefit plan (or related trust) sponsored or maintained by the Company or such entity resulting from such Business Combination or any entity controlled by the Company or the entity resulting from such Business Combination, (2) any entity beneficially owning 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly and (3) the Executive and any group that includes the Executive) beneficially owns, directly or indirectly, 30% or more of the then outstanding shares of common stock (or comparable equity interests) of the entity resulting from such Business Combination or the combined voting power of the then outstanding voting securities (or comparable equity interests) of such entity, and

(C) immediately after the Business Combination, a majority of the members of the board of directors (or comparable governors) of the entity resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

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

(e) "Code" means the Internal Revenue Code of 1986, as amended, and any successor statute thereto.

(f) "Company" means the Company as defined in the first sentence of this Agreement and any successor to its business and/or assets which assumes or agrees to perform this Agreement by operation of law or otherwise.

(g) "Disability" means a continuing condition of Executive that has been determined to meet the criteria set forth in the Company's Long Term Disability Plan, or similar successor plan, to render Executive eligible for long-term disability benefits under said plan, whether or not Executive is in fact covered by such plan. The determination shall be made by the insurer of the plan or, if Executive is not covered by the plan, by the Company in its sole discretion.

(h) "Good Reason" means any of the following conditions arising during the Transition Period, without the consent of Executive:

(i) the assignment to Executive of any duties materially inconsistent in any respect with Executive's position (including offices and titles), duties or responsibilities, or any other action by the Company which results in a material diminution in such position, duties or responsibilities, as in effect immediately prior to the Transition Period, excluding for this purpose an isolated, insubstantial and inadvertent action not taken

in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by Executive;

(ii) any material reduction, in the aggregate, to the compensation and benefit plans, programs and perquisites applicable to Executive as in effect immediately prior to the Transition Period, other than an isolated, insubstantial and inadvertent failure not occurring in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by Executive;

(iii) the Company requiring Executive to be based at any office or location more than 50 miles from the location at which Executive was based immediately prior to the Transition Period or the Company requiring Executive to travel on Company business to a substantially greater extent than required immediately prior to the Transition Period; or

(iv) any failure by the Company to comply with and satisfy Section 8(c) of this Agreement.

For purposes of this Section 1(h) any good faith determination of “Good Reason” made by Executive shall be conclusive.

(i) “Subsidiary” means, with respect to the Company, any corporation or other entity that is required to be combined with the Company as a single employer under Code § 414(b) or (c).

(j) “Term” means the period of Executive’s employment under this Agreement, commencing on the Effective Date and ending on the third anniversary of the Effective Date, provided that such period shall be automatically extended for successive one-year periods unless either party gives written notice of non-renewal to the other party at least six (6) months prior to the expiration of such third anniversary, or annual renewal, as the case may be, that such party elects not to extend the term of such employment under this Agreement; provided, further, that if a Change of Control occurs prior to the expiration of the Term specified in the preceding clause (including any extension year then in effect), then the Term shall end upon expiration of the Transition Period.

(k) “Termination Date” means the date of the Executive’s “separation from service” (within the meaning of Code § 409A(a)(2)(A)(i)) with the Company and its Subsidiaries, as determined by the Company.

(l) “Transition Period” means the period commencing at the time a Change of Control first occurs during the Term and ending on the date that is two years thereafter.

2. POSITION AND DUTIES. During Executive’s employment under this Agreement, Executive will perform such duties and responsibilities of an executive nature as the

Company may assign from time to time. Executive will serve the Company faithfully and to the best of Executive's ability and will devote Executive's full working time, attention, and efforts to the business and affairs of the Company. Executive will follow and comply with applicable policies and procedures adopted by the Company from time to time, including without limitation policies relating to business ethics, conflict of interest, non-discrimination, confidentiality and protection of trade secrets, and insider trading. Executive will not engage in other employment or other material business activity, except as approved in writing by the CEO. It shall not be a violation of this Agreement for Executive to (i) serve on corporate, civic or charitable boards or committees or (ii) manage personal investments, so long as such activities do not significantly interfere with the performance of Executive's responsibilities in accordance with this Agreement. Executive hereby represents and confirms that Executive is under no contractual or legal commitments that would prevent Executive from fulfilling Executive's duties and responsibilities as set forth in this Agreement.

3. COMPENSATION. During Executive's employment under this Agreement, Executive will be provided with the following compensation and benefits:

(a) Base Salary. The Company will pay to Executive for services provided hereunder a base salary at a rate determined from time to time by the Company, which base salary will be paid in accordance with the Company's normal payroll policies and procedures. The Company will review Executive's performance on an annual basis and determine any adjustments to Executive's base salary in its sole discretion.

(b) Incentive Compensation. Executive will be eligible to participate in an annual cash incentive plan of the Company as designated by the Company, in accordance with the terms and conditions of such plan as may be in effect from time to time (the "Annual Bonus Plan").

(c) Employee Benefits. Executive will be entitled to participate in all employee benefit plans and programs generally available to employees of the Company, as determined by the Company and to the extent that Executive meets the eligibility requirements for each individual plan or program. Executive's participation in any plan or program will be subject to the provisions, rules, and regulations of, or applicable to, the plan or program. The Company provides no assurance as to the adoption or continuation of any particular employee benefit plan or program.

(d) Expenses. The Company will reimburse Executive for all reasonable and necessary out-of-pocket business, travel, and entertainment expenses incurred by Executive in the performance of his duties and responsibilities to the Company during the Term. Such reimbursement shall be subject to the Company's normal policies and procedures for expense verification, documentation, and reimbursement; provided, however, that Executive shall submit verification of expenses within 45 days after the date the expense was incurred, and the Company shall reimburse Executive for such expenses eligible for reimbursement within 30 days thereafter. The right to reimbursement hereunder is not subject to liquidation or exchange for any other benefit, and the amount of expenses eligible

for reimbursement in a calendar year shall not affect the expenses eligible for reimbursement in any other calendar year.

4. TERMINATION OF EMPLOYMENT. Executive's employment with the Company under this Agreement is at will and may be terminated by either party for any or no reason, subject to the obligations of the parties provided for in this Agreement.

5. PAYMENTS UPON TERMINATION OF EMPLOYMENT FOLLOWING A CHANGE OF CONTROL. If a Change of Control occurs during the Term, and if Executive's employment terminates such that the Termination Date occurs during the Transition Period, then Executive shall be entitled to payments and benefits on the terms and conditions specified in this Section 5.

(a) Payments and Benefits Upon Involuntary Termination Without Cause or Resignation for Good Reason During the Transition Period. If Executive's Termination Date occurs during the Transition Period, and if such termination is involuntary at the initiative of the Company without Cause or at the initiative of Executive for Good Reason, then, in addition to such base salary and incentive compensation that has been earned but not paid to Executive as of the Termination Date, the Company shall provide to Executive the severance payments set forth in this Section 5(a), subject to the conditions in Section 7:

(i) Separation Pay. The Company shall pay to Executive an amount equal to two (2) times Executive's Annual Compensation.

(ii) Pro-Rated Bonus. If the Termination Date is any day other than the last day of a performance period under the Annual Bonus Plan, then the Company shall pay to Executive an amount equal to a pro rata portion of the target award that would have been payable to Executive under the Annual Bonus Plan for the annual performance period in which the Termination Date occurs, as if all performance targets been met. The pro rata portion shall be calculated based on the number of days during such annual performance period Executive was employed by the Company prior to the Termination Date divided by 365.

(iii) Continued Benefits. If Executive (and/or Executive's covered dependents) is eligible and properly elects to continue group medical, dental and/or life insurance coverage, as in place immediately prior to the Termination Date, the Company shall continue to pay the Company's portion of any such premiums or costs of coverage (on a benefit by benefit basis) until the earlier of (A) twenty-four (24) months after the Termination Date, or (B) the date Executive (and Executive's covered dependents) is provided such form of coverage by a subsequent employer. In the event that Executive's participation in such plans is not possible under any of the applicable plans and laws as then in effect, the Company will purchase coverage reasonably comparable to the coverage provided under the plans provided by the Company, to the extent such coverage is reasonably available, and Executive will cooperate with the Company to obtain the most favorable rate for such coverage for Executive. All such Company-provided medical, dental

and/or life insurance premiums, or costs of coverage, shall be paid directly to the insurance carrier or other provider by the Company and Executive shall make arrangements with the Company to pay the Executive's portion of such coverage.

(iv) Retirement/Restoration Benefits. If Executive is a participant in the Company's Restoration Plan, the Company shall credit Executive with additional years of service under such plan for purposes of calculating all benefits and rights under such plan, as if Executive had remained employed by the Company for an additional two (2) years following the Termination Date.

(v) Legal Fees. The Company shall reimburse Executive for reasonable legal fees and expenses incurred by Executive in connection with seeking legal advice in seeking to obtain or enforce in good faith any right or benefit provided by this Agreement, to the extent such claims are timely commenced under applicable law; provided, however, that the Company may recover any such legal fees and expenses of Executive which the Company has paid, if it is finally judicially determined in such proceeding that Executive's claim or claims were frivolous or that Executive pursued such claim or claims in bad faith. Executive will submit to the Company verification of legal expenses eligible for reimbursement within 60 days from the date that the expense was incurred. The Company shall reimburse Executive for eligible expenses promptly thereafter, but in any event not earlier than the date that is six months following the Termination Date and not later than December 31 of the calendar year following the calendar year in which the expense was incurred. The amount of expenses eligible for reimbursement during any calendar year will not affect the expenses eligible for reimbursement in any other calendar year, and Executive's right to reimbursement of such expenses may not be exchanged for cash or any other benefit. Any amounts payable hereunder are intended to be payable in accordance with a reimbursement plan pursuant to Section 409A of the Code.

(b) Timing and Form of Payments Following a Change of Control. In the event that Executive is entitled to payments under Section 5(a) above, then any payments to which Executive is entitled under Sections 5(a)(i) or (ii) above shall be paid to Executive in a lump sum on the first regular payroll date of the Company to occur following the date that is six months after the Termination Date, provided that Executive has satisfied the conditions set forth in Section 7.

(c) Possible Payment Reduction. Notwithstanding any provision to the contrary contained in this Agreement, if the cash payments due and the other benefits to which Executive shall become entitled under Section 5(a), either alone or together with other payments in the nature of compensation to Executive which are contingent on a change in the ownership or effective control of the Company or in the ownership of a substantial portion of the assets of the Company or otherwise, would constitute a "parachute payment" (as defined in Section 280G of the Code or any successor provision thereto), such payments or benefits shall be reduced (but not below zero) to the largest aggregate amount as will result in no portion thereof being subject to the excise tax imposed under Section 4999 of the Code (or any successor provision thereto) or being non-deductible to the Company for Federal Income

Tax purposes pursuant to Section 280G of the Code (or any successor provision thereto), provided, however, that no such reduction shall occur, and this Section 5(c) shall not apply, in the event that the amount of such reduction would be more than \$25,000. Executive in good faith shall determine the amount of any reduction to be made pursuant to this Section 5(c) and shall select from among the foregoing benefits and payments those which shall be reduced. No modification of, or successor provision to, Section 280G or Section 4999 subsequent to the date of this Agreement shall, however, reduce the benefits to which the Executive would be entitled under this Agreement in the absence of this Section 5(c) to a greater extent than they would have been reduced if Section 280G and Section 4999 had not been modified or superseded subsequent to the date of this Agreement, notwithstanding anything to the contrary provided in the first sentence of this Section 5(c).

(d) Certain Additional Payments by the Company.

(i) Anything in this Agreement to the contrary notwithstanding, in the event it shall be determined that Section 5(c) above does not apply and any payment or distribution by the Company to or for the benefit of Executive (whether paid or payable or distributed or distributable pursuant to the terms of this Agreement, any stock option, restricted stock agreement or otherwise, but determined without regard to any additional payments required under this Section 5(d)) (a "Payment") would be subject to the excise tax imposed by Section 4999 of the Code or any interest or penalties are incurred by Executive with respect to such excise tax (such excise tax, together with any such interest and penalties, are hereinafter collectively referred to as the "Excise Tax"), then the Executive shall be entitled to receive an additional payment (a "Gross-Up Payment") in an amount such that after payment by Executive of all taxes (including any interest or penalties imposed with respect to such taxes), including, without limitation, any income taxes (and any interest and penalties imposed with respect thereto) and Excise Tax imposed upon the Gross-Up Payment, the Executive retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payments.

(ii) Subject to the provisions of Section 5(d)(iii) all determinations required to be made under this Section 5(d), including whether and when a Gross-Up Payment is required and the amount of such Gross-Up Payment and the assumptions to be utilized in arriving at such determination, shall be made by Deloitte and Touche LLP or such other certified public accounting firm as may be designated by Executive (the "Accounting Firm") which shall provide detailed supporting calculations both to the Company and Executive within 15 business days of the receipt of notice from Executive that there has been a Payment, or such earlier time as is requested by the Company. In the event that the Accounting Firm is serving as accountant or auditor for the individual, entity or group effecting the Change of Control, Executive shall appoint another nationally recognized accounting firm to make the determinations required hereunder (which accounting firm shall then be referred to as the Accounting Firm hereunder). All fees and expenses of the Accounting Firm shall be borne solely by the Company. Any Gross-Up Payment, as determined pursuant to this Section 5(d), shall be paid by the Company to Executive within five days of the receipt of the Accounting Firm's determination. If the Accounting Firm

determines that no Excise Tax is payable by Executive, it shall furnish Executive with a written opinion that failure to report the Excise Tax on Executive's applicable federal income tax return would not result in the imposition of a negligence or similar penalty. Any determination by the Accounting Firm shall be binding upon the Company and Executive. As a result of the uncertainty in the application of Section 4999 of the Code at the time of the initial determination by the Accounting Firm hereunder, it is possible that Gross-Up Payments which will not have been made by the Company should have been made ("Underpayment"), consistent with the calculations required to be made hereunder. In the event that the Company exhausts its remedies pursuant to Section 5(d)(iii) and the Executive thereafter is required to make a payment of any Excise Tax, the Accounting Firm shall determine the amount of the Underpayment that has occurred and any such Underpayment shall be promptly paid by the Company to or for the benefit of the Executive.

(iii) Executive shall notify the Company in writing of any claim by the Internal Revenue Service that, if successful, would require the payment by the Company of a Gross-Up Payment or an increase to a Gross-Up Payment previously made. Such notification shall be given as soon as practicable but no later than ten business days after Executive is informed in writing of such claim (provided that any delay in so informing the Company within such ten business day period shall not affect the obligations of the Company under this Section 5(d) except to the extent that such delay materially and adversely affects the Company) and shall apprise the Company of the nature of such claim and the date on which such claim is requested to be paid. Executive shall not pay such claim prior to the expiration of the 30-day period following the date on which it gives such notice to the Company (or such shorter period ending on the date that any payment of taxes with respect to such claim is due). If the Company notifies Executive in writing prior to the expiration of such period that it desires to contest such claim, Executive shall:

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

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

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

(D) permit the Company to participate in any proceedings relating to such claim; provided, however, that the Company shall bear and pay directly all costs and expenses (including additional interest and penalties) incurred in connection with such contest and shall indemnify and hold the Executive harmless, on an after-tax basis, for any Excise Tax or income tax (including interest and penalties with respect thereto) imposed as a result of such representation and payment of costs and expenses. Without limitation on the foregoing provisions of this Section 5(d)(iii),

the Company shall control all proceedings taken in connection with such contest and, at its sole option, may pursue or forgo any and all administrative appeals, proceedings, hearings and conferences with the taxing authority in respect of such claim and may, at its sole option, either direct Executive to pay the tax claimed and sue for a refund or contest the claim in any permissible manner, and Executive agrees to prosecute such contest to a determination before any administrative tribunal, in a court of initial jurisdiction and in one or more appellate courts, as the Company shall determine; provided, however, that if the Company directs Executive to pay such claim and sue for a refund, the Company shall advance the amount of such payment to Executive, on an interest-free basis, and shall indemnify and hold Executive harmless, on an after-tax basis, from any Excise Tax or income tax (including interest or penalties with respect thereto) imposed with respect to such advance or with respect to any imputed income with respect to such advance; and further provided that any extension of the statute of limitations relating to payment of taxes for the taxable year of Executive with respect to which such contested amount is claimed to be due is limited solely to such contested amount. Furthermore, the Company's control of the contest shall be limited to issues with respect to which a Gross-Up Payment would be payable hereunder and Executive shall be entitled to settle or contest, as the case may be, any other issue raised by the Internal Revenue Service or any other taxing authority.

(iv) If, after the receipt by Executive of an amount advanced by the Company pursuant to Section 5(d)(iii), Executive becomes entitled to receive any refund with respect to such claim, Executive shall (subject to the Company's complying with the requirements of Section 5(d)(iii)), promptly pay to the Company the amount of such refund (together with any interest paid or credited thereon after taxes applicable thereto). If, after the receipt by Executive of an amount advanced by the Company pursuant to Section 5(d)(iii), a determination is made that Executive shall not be entitled to any refund with respect to such claim and the Company does not notify Executive in writing of its intent to contest such denial of refund prior to the expiration of 30 days after such determination, then such advance shall be forgiven and shall not be required to be repaid and the amount of such advance shall offset, to the extent thereof, the amount of Gross-Up Payment required to be paid.

(v) Notwithstanding any provision above to the contrary, any Gross-Up Payment payable under this Section 5(d) shall be made by the end of the calendar year following the calendar year in which the Executive remits the taxes. Further, notwithstanding any provision above to the contrary, any right to reimbursement under this Section 5(d) of expenses incurred by Executive due to a tax audit or litigation addressing the existence or amount of a tax liability shall be made by the end of the calendar year following the calendar year in which the taxes that are the subject of the audit or litigation are remitted, or where as a result of the audit or litigation no taxes are remitted, the end of the calendar year following the calendar year in which the audit is completed or there is a final and non-appealable settlement or other resolution of the litigation. Any Gross-Up Payment and any

reimbursement of expenses payable under this Section 5(d) shall not be made before the date that is six months after the Termination Date.

(e) Other Termination Following a Change of Control. If Executive's Termination Date occurs during the Transition Period or otherwise following a Change of Control, and such termination is:

(i) by reason of Executive's abandonment of or resignation from employment for any reason (other than, during the Transition Period, for Good Reason);

(ii) by reason of termination of Executive's employment by the Company for Cause;

(iii) because of Executive's death or Disability; or

(iv) upon or following expiration of the Term,

then the Company will pay to Executive, or Executive's beneficiary or Executive's estate, as the case may be, such base salary that has been earned but not paid to Executive as of the Termination Date, payable pursuant to the Company's normal payroll practices and procedures, and such incentive compensation and benefits that have been earned as of the Termination Date, payable to the extent and in the manner as provided in the applicable plans or programs, and Executive shall not be entitled to any additional compensation or benefits provided under Section 5 hereof.

6. OTHER POST-TERMINATION OBLIGATIONS.

(a) In the event of termination of Executive's employment during the Transition Period, the sole obligation of the Company under this Agreement will be its obligation to make the payments called for by Section 5 hereof, and the Company will have no other obligation to Executive or to his beneficiary or his estate, except as otherwise provided by law or by the terms of any employee benefit plans or programs, or of any incentive compensation or stock ownership plans, then maintained by the Company in which Executive participates. In no event shall Executive be eligible for payments under Section 5 upon any termination of employment prior to a Change of Control.

(b) Immediately upon termination of Executive's employment with the Company for any reason, Executive will resign all positions then held as a director or officer of the Company and of any Subsidiary, parent or affiliated entity of the Company.

(c) Upon termination of Executive's employment with the Company, Executive shall promptly deliver to the Company any and all Company records and any and all Company property in his possession or under his control, including without limitation manuals, books, blank forms, documents, letters, memoranda, notes, notebooks, reports, printouts, computer disks, flash drives or other digital storage media, source codes, data,

tables or calculations and all copies thereof, documents that in whole or in part contain any trade secrets or confidential, proprietary or other secret information of the Company and all copies thereof, and keys, access cards, access codes, passwords, credit cards, personal computers, handheld personal computers or other digital devices, telephones and other electronic equipment belonging to the Company.

(d) Following termination of Executive's employment with the Company for any reason, Executive will, upon reasonable request of the Company or its designee, cooperate with the Company in connection with the transition of his duties and responsibilities for the Company; consult with the Company regarding business matters that he was directly and substantially involved with while employed by the Company; and be reasonably available, with or without subpoena, to be interviewed, review documents or things, give depositions, testify, or engage in other reasonable activities in connection with any litigation or investigation, with respect to matters that Executive then has or may have knowledge of by virtue of his employment by or service to the Company or any related entity.

(e) Executive will not malign, defame or disparage the reputation, character, image, products or services of the Company, or the reputation or character of the Company's directors, officers, employees or agents, provided that nothing in this Section 6(e) shall be construed to limit or restrict Executive from taking any action that he in good faith reasonably believes is necessary to fulfill his fiduciary obligations to the Company, or from providing truthful information in connection with any legal proceeding, government investigation or other legal matter.

(f) In the event any payments or benefits become payable to Executive pursuant to Section 5(a), then such payments or benefits will supersede and replace any other payments or benefits applicable to Executive under this Agreement or any other agreement, plan or program applicable to Executive to the extent that such other agreement, plan or program provides payments or benefits to Executive in the event of involuntary termination at the initiative of the Company without Cause or voluntary termination on the initiative of Executive for Good Reason, and Executive shall be entitled to payments only pursuant to Section 5(a).

7. TERMINATION PAYMENT CONDITIONS. Notwithstanding anything above to the contrary, the Company will not be obligated to make any payments to Executive under Sections 5(a) – (d) hereof unless: (a) Executive has signed a release of claims in favor of the Company and its affiliates and related entities, and their directors, officers, insurers, employees and agents, in a form prescribed by the Company (which release shall not include any claims Executive may have to indemnification or advance of expenses with respect to Executive's actions as an officer or director of the Company); (b) all applicable rescission periods provided by law for releases of claims shall have expired and Executive has not rescinded the release of claims; and (c) Executive is in strict compliance with the terms of this Agreement as of the dates of such payments.

8. SUCCESSORS.

(a) This Agreement is personal to Executive and without the prior written consent of the Company shall not be assignable by Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by Executive's legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.

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

9. MISCELLANEOUS.

(a) Tax Withholding. The Company may withhold from any amounts payable under this Agreement such federal, state and local income and employment taxes as the Company shall determine are required to be withheld pursuant to any applicable law or regulation.

(b) Section 409A. This Agreement is intended to satisfy the requirements of Section 409A(a)(2), (3) and (4) of the Code, including current and future guidance and regulations interpreting such provisions, and should be interpreted accordingly.

(c) Governing Law. All matters relating to the interpretation, construction, application, validity, and enforcement of this Agreement will be governed by the laws of the State of Minnesota without giving effect to any choice or conflict of law provision or rule, whether of the State of Minnesota or any other jurisdiction, that would cause the application of laws of any jurisdiction other than the State of Minnesota.

(d) Jurisdiction and Venue. Executive and the Company consent to jurisdiction of the courts of the State of Minnesota and/or the United States District Court, District of Minnesota, for the purpose of resolving all issues of law, equity, or fact arising out of or in connection with this Agreement. Any action involving claims of a breach of this Agreement must be brought in such courts. Each party consents to personal jurisdiction over such party in the state and/or federal courts of Minnesota and hereby waives any defense of lack of personal jurisdiction. Venue, for the purpose of all such suits, will be in Hennepin County, State of Minnesota.

(e) Waiver of Jury Trial. To the extent permitted by law, Executive and the Company waive any and all rights to a jury trial with respect to any dispute arising out of or relating to this Agreement.

(f) Entire Agreement. This Agreement contains the entire agreement of the parties relating to the subject matter hereof and supersedes all prior agreements and understandings with respect to such subject matter, including without limitation the Prior Agreement. The parties hereto have made no agreements, representations, or warranties relating to the subject matter of this Agreement that are not set forth herein.

(g) No Violation of Other Agreements. Executive hereby represents and agrees that neither (i) Executive's entering into this Agreement nor (ii) Executive's carrying out the provisions of this Agreement, will violate any other agreement (oral, written, or other) to which Executive is a party or by which Executive is bound.

(h) Amendments. No amendment or modification of this Agreement will be effective unless made in writing and signed by the parties hereto.

(i) Counterparts. This Agreement may be executed by facsimile signature and in any number of counterparts, and such counterparts executed and delivered, each as an original, will constitute but one and the same instrument.

(j) Severability. To the extent that any portion of any provision of this Agreement is held invalid or unenforceable, it will be considered deleted herefrom and the remainder of such provision and of this Agreement will be unaffected and will continue in full force and effect.

(k) Survival. The provisions of this Agreement that by their terms or implication extend beyond the Term shall survive the termination or expiration of the Term and termination of Executive's employment with the Company for any reason.

(l) Captions and Headings. The captions and paragraph headings used in this Agreement are for convenience of reference only and will not affect the construction or interpretation of this Agreement or any of the provisions hereof.

(m) Notices. Any notice required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been duly given when (i) delivered personally; (ii) sent by facsimile or other similar electronic device with confirmation; (iii) delivered by reliable overnight courier; or (iv) three business days after being sent by registered or certified mail, postage prepaid, and in the case of (iii) and (iv) addressed as follows, or to such other address as the party may designate by giving notice hereunder:

If to the Company: Graco Inc.
88 Eleventh Avenue NE
Minneapolis, MN 55413
Attention: Chairman of the Board
Attention: General Counsel

If to Executive:

«Who»

«HAddress»

Executive and the Company have executed this Agreement effective as of the date set forth in the first paragraph.

GRACO INC.

By: _____
«CEO»
Its: President and Chief Executive Officer

«Who»



Supplemental Income Protection Plan

3/8/2004

Developed Specifically for: Graco, Inc

Risk # 137153

Presented by: Ramona McCree, Marsh USA Inc.

Plan Offering Approved by: Kathleen Filippone, CLU, ChFC

PLAN OFFERING

We recently completed a review of our in-force GSI Supplemental Income Protection offer and are pleased to enhance your plan to our new Income Series Contract. This change does not impact any existing coverage, but provides for any future benefits to be issued with the Income Series Contract. UnumProvident is pleased to partner with you to provide a Supplemental Income Protection offering for your employees. Enclosed with your Guaranteed Standard Issue Income Protection offering are detailed plan specifications and an offer acceptance document. Specifically, your customized plan design includes:

Guaranteed Standard Issue (GSI) Supplemental Income Protection Plan

| | |
|------------------------------|---|
| Eligibility | Newly hired or promoted officers and executives earning a minimum of \$105,000 |
| Insurable Income | Base Salary, Bonus + Commission |
| Plan Design | Combination Plan - This plan design covers 66 2/3% of the first \$12,000 of monthly insurable income combining 33 1/3% LTD (capped at \$4,000) and 33 1/3% Individual. Total monthly compensation in excess of \$12,000 is covered by 67% LTD to a maximum cap of \$13,500. |
| LTD Plan | 33 1/3% of the first \$12,000 of total compensation to a maximum cap of \$4,000; total monthly compensation in excess of \$12,000 is covered by 67% LTD to a maximum cap of \$13,500; Employer Paid (taxable). |
| GSI Benefit Maximum | \$4,000 |
| Elimination Period | 180 Days |
| Benefit Period | To Age 65 |
| Contract Type | Income Ill Choice / Non-Cancellable Contract (without Update) |
| Contributory Status: | Employer Paid (taxable) |
| Participation Requirement | 100% |
| Discount | 10% |
| Optional Additional Benefits | Catastrophic: 33% of insurable income to \$8,000 (replacement not to exceed 100%) with limited medical underwriting |
| | Cost of Living Adjustment: CPI - Tied (individual choice basis) |
| | Guaranteed Coverage Increase: Annual up to cap of the offer |

Underwritten by the following subsidiary of UnumProvident Corporation

Provident Life and Accident Insurance Company

1 Fountain Square
Clanton, TN 37402

www.unumprovident.com

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Supplemental Income Protection Plan

Graco, Inc

CONTRACT BENEFITS

Income III Choice / Non-Cancellable Contract (without Update)

Benefit Period

To Age 65

Elimination Period

Benefits begin after a waiting period of 180 Days

Income Replacement for Total Disability

- ~ **For the duration of your Benefit Period:**
a monthly income benefit will be paid if you are disabled in your own occupation, not working in another occupation and under a physician's care
- ~ **Full Mental Disorder Benefit**
- ~ **Monthly Catastrophic Benefit:**
added to your income benefit, replacing up to 100% of your prior income and paying in the event of certain very serious disabilities that are likely to increase your living expenses (your insurance professional can provide information on physical conditions that apply)

Optional Benefits

- ~ **Guaranteed Coverage Increase:**
allows employer to increase monthly benefit without evidence of medical insurability as salary increases occur
- ~ **Cost of Living Adjustments:**
help your benefit keep pace with inflation during disability

Return-To-Work Benefits

- ~ **Rehabilitation Services:**
available to you while you are totally or partially disabled and designed to help you return to work. Include coordination of physical therapy, vocation testing, retraining, career counseling, placement services, worksite modifications, etc.
- ~ **Residual Benefits:**
monthly benefits for less-than-total disability, based on your proportionate loss of income, for the duration of the Benefit Period you chose for your policy
- ~ **Work Incentive Benefit:**
when you return to work, you will receive a short-term incentive for up to 12 months equal to the difference between your prior income and your current income, for up to 100% income replacement (subject to the maximum benefit amount)
- ~ **Recovery Benefit:**
Paid for up to 12 months after you return to work full time in your own occupation but continue to have a loss of earnings while you rebuild your business or customer business

Lifetime Benefits *

- ~ **Lifetime Continuation:**
you can exchange your income protection for long-term care insurance coverage between the ages of 60 and 70. Your base policy LTC benefit will be \$3,000 per month (or \$100 per day, if state-required). Your LTC benefit period will be six years.
** Not available in CT, FL & TX*
- ~ **Purchase Option Guarantee:**
you can exchange your income protection for long-term care insurance coverage between the ages of 60 and 75. Your base policy LTC benefit will be \$3,000 per month (or \$100 per day, if state required). Your LTC benefit period will be six years.
** Only available in TX*

This is a brief summary of the general coverage provided by the Income III (Choice) coverage package of UnumProvident's Income Series (policy 600 or 601). The policy or its provisions may vary or be unavailable in some states. The policy also has exclusions and limitations that may affect any benefits payable. See your insurance professional for complete details on provisions and availability.



Supplemental Income Protection Plan

Graco, Inc

PLAN SPECIFICATIONS

TERMS AND CONDITIONS

Who is eligible This offer is extended to:
Newly hired or promoted officers and executives earning a minimum of \$105,000

All eligibles must be U.S. citizens or permanent U.S. residents possessing a green card.

For the period of time commencing 180 days prior to and including the date of application, applicants must have been able to work full-time (30 hours or more per week), performing all the duties of their occupation without limitation due to injury or sickness, and not have been homebound or hospitalized due to significant injury or sickness.

Basis of Issue A standard offer means no modifications can be made to the contract's premium rate, elimination period, benefit period or monthly benefit amounts to adjust for a pre-existing medical condition.

All applicants will be asked questions for current Activities of Daily Living (ADL) losses. If any ADL loss or applicable pre-existing condition exists on the date of the application, no Lifetime Continuation to Long Term Care (Purchase Option Guarantee in Texas) will be included in the policy and no Catastrophic Benefit will be issued.

The benefit will program around any coverage already in-force or applied for. Total coverage to be in-force would not exceed this plan design or our issue and participation limits. The benefit may be offset by any in-force individual coverage that was issued on a guaranteed standard basis.

Minimum policy size is \$300

Any additional amounts purchased beyond this offer amount will be considered to be outside the plan design and subject to our normal medical and financial underwriting guidelines.

Financial Requirements We will accept a company-provided census (electronic preferred) listing employee, name, date of birth, job title and compensation as income documentation. Insurable income will be based on stable salary plus either a two-year average of variable or last year's variable if less. If only a one-year history of variable income documentation is available due to an individual not having been employed long enough to generate a two-year history, we will consider 75% of the variable income as insurable.

Net Worth and Unearned Income consideration will be disregarded.

Application Type A-32395 Series (short form)



Supplemental Income Protection Plan

Graco, Inc

OFFER REQUEST

OFFER REQUEST

- ~ This offer must be signed and received by our Advanced Underwriting Department before applications can be accepted.
- ~ Written acceptance of this offer must be received by 3/20/2004. If not received, the offer becomes void.
- ~ The above offer is contingent upon current ratebook and state regulations in effect at application time. Any change in plan design, eligibility/participation requirements, premium payer, etc. requires written approval by our Advanced Underwriting Department.

ENROLLMENT PROCESS

- ~ Current insured employees may increase their in-force benefit within 90 days of the renewal letter based on plan design up to the GSI maximum (provided they financially qualify) or \$300 using the Income Series product. (New application required.) The \$300 minimum policy will not be available if total current in-force coverage including Group LTD exceeds 80% of monthly earnings. All future benefit increases up to the GSI maximum will be processed under the Income Series contract.
- ~ New employees will be eligible for benefits based on plan design up to the GSI maximum within 90 days of eligibility.
- ~ Employees who enroll and fully participate in this plan will have the opportunity to update their coverage within the plan design and benefit maximums during a scheduled annual or biannual enrollment period.

OFFER REVIEW PROCESS

This offer will be reviewed every two years and remains in effect subject to our review of the plan design, persistency and overall case success. We may request current case information and census listing eligible individuals, dates of birth, job title and current income to complete our review. Although we do not anticipate doing so, we reserve the right to withdraw or modify this offer at any time. Factors such as experience, non-adherence to offer terms or availability of contract type could make this necessary.

Also, as the amount of this offer was based on the plan design incorporating UnumProvident LTD, we will reserve the right to modify our offer if there is a change in the group LTD carrier.

When appropriate, the Company will provide 90-day notice in advance of any anticipated change to this offer.

We are privileged that you have selected UnumProvident to meet your employees' income protection needs. We appreciate the opportunity to serve you and your employees, and we look forward to a continuing relationship.

Sincerely,

Kathleen Filippone, CLU, ChFC
Underwriter
Advanced Underwriting

I request the offer outlined above and understand that these specifications are only available through the producer to whom this letter is addressed, on behalf of Graco, Inc

(signature)

(signature)

Position and Title

Date

Producer/Agent of Record

Date

cc: Amy Dvorak/Minneapolis

Graco, Inc

Exhibit 31.1**Certification**

I, Patrick J. McHale, certify that:

1. I have reviewed this annual report on Form 10-K of Graco Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 18, 2008


Patrick J. McHale
President and Chief Executive Officer

Exhibit 31.2

Certification

I, James A. Graner, certify that:

1. I have reviewed this annual report on Form 10-K of Graco Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 18, 2008

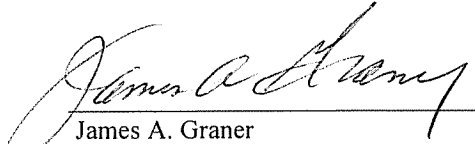
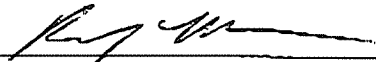

James A. Graner
Chief Financial Officer and Treasurer

Exhibit 32

Certification Under Section 1350

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

Date: February 18, 2008



Patrick J. McHale
President and Chief Executive Officer

Date: February 18, 2008

James A. Graner
Chief Financial Officer and Treasurer

Exhibit 32

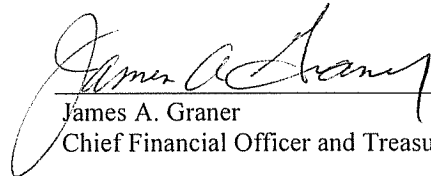
Certification Under Section 1350

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

Date: February 18, 2008

Patrick J. McHale
President and Chief Executive Officer

Date: February 18, 2008



James A. Graner
Chief Financial Officer and Treasurer

Exhibit 99

Cautionary Statement Regarding Forward-Looking Statements

Graco Inc. (our “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 our Company with the Securities and Exchange Commission, including our Company’s Form 10-K, Form 10-Q and Form 8-K, its Annual Report to Shareholders, and press releases, other written documents or oral statements released by our 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 our Company’s expectations concerning the future. Such statements are based upon currently available information, but various risks and uncertainties may cause our Company’s actual results to differ materially from those expressed in these statements. Among the factors which management believes could affect our Company’s operating results are the following:

- With respect to our Company’s business as a whole, our Company’s prospects and operating results may be affected by:
 - changes in world economies, including expansions, downturns or recessions and fluctuations in gross domestic product, capital goods investment activity, interest rates, and foreign currency exchange rates;
 - the ability of our Company to successfully integrate acquisitions;
 - the ability of our Company to successfully divest or discontinue incompatible or unprofitable lines of business;
 - the ability of our Company to successfully maintain quality, customer service and inventory levels in light of the longer lead times created by the establishment of assembly operations in Suzhou, People’s Republic of China, and the expanding use of foreign sources for materials and components, especially in Asia;
 - the ability of our Company to successfully recruit, hire and retain employees with required or desired skills, training and education;
 - international trade factors, including changes in international trade policy, such as export controls, trade sanctions, increased tariff barriers and other restrictions; weaker protection of our Company’s proprietary technology in certain foreign countries; the burden of complying with foreign laws and standards; and potentially burdensome taxes;
 - the ability of our 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; realize productivity and product quality improvements; react expeditiously to fluctuations in demand; offset cost pressures from labor, materials and overhead with price increases; and control expenses;
 - disruption in operations, transportation, communication, customer operations, distribution, payment or sources of supply, including the cost and availability of skilled labor, materials and energy, caused by political or economic instability, acts of God, labor disputes, war, embargo, weather, flood, fire, infectious disease, or other cause beyond its reasonable control, including military conflict in the Middle East or on the Korean peninsula, and terrorist activity throughout the world;
 - cost pressure and lack of availability of key materials and materials used in the manufacture of products;
 - worldwide competition from low-cost manufacturers, including those that copy our Company’s products;

- security breaches, breakdown, interruption in or inadequate upgrading or maintenance of our Company's information processing software, hardware or networks;
 - implementation of an enterprise resource planning software system throughout our Company;
 - changes in the markets in which our Company participates, including consolidation of competitors and major customers, price competition, and products demanded;
 - changes in accounting standards or in the application by our Company of critical accounting policies;
 - compliance with corporate governance requirements;
 - growth in either the severity or magnitude of the products liability claims against our Company; and
 - changes in the return on investments in the Company's retirement plan.
- The prospects and operating results of our Company's Contractor Equipment segment may be affected by: variations in the level of residential, commercial and institutional building and remodeling activity; the loss of, or significant reduction in sales to large customers; the pricing power of large customers; the availability and cost of construction financing; changes in the environmental regulation of coatings; consolidation in the paint equipment manufacturing industry and paint manufacturing industry; changes in the technology of paint and coating applications; changes in the buying and channel preferences of the end user; the Company's success in converting painters outside North America from brush and roller to spray equipment; changes in the business practices (including inventory management) of the major distributors of equipment; changes in construction materials and techniques; changes in 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.
 - The prospects and operating results of our Company's Industrial Equipment segment may be affected by: the capital equipment spending levels of customers; the availability and cost of financing; changes in the environmental regulation of coatings; changes in the technical and performance characteristics of materials, including powder coatings; changes in application technology; the ability of our Company to meet changing customer requirements; consolidation or other change in the channels of distribution; the pricing strategies of competitors; consolidation in the fluid handling equipment manufacturing industry; changes in the worldwide procurement practices of the major automobile manufacturers; changes in automotive manufacturing processes; and consolidation in the automobile manufacturing industry worldwide.
 - The prospects and operating results of our Company's Lubrication Equipment segment may be affected by: consolidation in the oil production industry; the development of extended life lubricants for vehicles; the reduction in the need for changing vehicle lubricants; consumer trends in "do-it-yourself" versus "do-it-for-me" oil changes; the successful development of vehicles that use power sources other than the internal combustion engine; consolidation of automotive dealerships; trends in spending by state and local governments; variations in the equipment spending levels of the major oil companies; and the ability to integrate and profitably grow our newly acquired industrial lubrication business.



February 19, 2008

Electronically Filed

Securities and Exchange Commission
Judiciary Plaza
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Graco Inc.
2007 Annual Report on Form 10-K
File No. 001-09249
CIK No. 0000042888

Gentlemen:

Pursuant to Rule 101 (a) (1) (iii) of Regulation S-T, enclosed for filing is the Graco Inc. Annual Report on Form 10-K for the fiscal year ended December 28, 2007.

Very truly yours,

Karen Park Gallivan
Vice President, General Counsel and Secretary

Enclosures

cc: Society of Corporate Secretaries and Governance Professionals (1 printed copy)