

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended **March 31, 2006**

Commission File Number: 001-9249

GRACO INC.

(Exact name of registrant as specified in its charter)

Minnesota

(State of incorporation)

41-0285640

(I.R.S. Employer Identification Number)

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

(Address of principal executive offices)

55413

(Zip Code)

(612) 623-6000

(Registrant's telephone number, including area code)

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

Yes ☒ No ☐

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

Large Accelerated Filer ☒ Accelerated Filer ☐ Non-accelerated Filer ☐

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

Yes ☐ No ☒

68,424,000 of the Registrant's Common Stock, \$1.00 par value were outstanding as of April 21, 2006.

GRACO INC. AND SUBSIDIARIES

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SIGNATURES**EXHIBITS****PART I**

Item 1.

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

	<u>Thirteen Weeks Ended</u>	
	<u>March 31, 2006</u>	<u>April 1, 2005</u>
Net Sales	\$ 192,216	\$ 170,944
Cost of products sold	88,989	85,078
Gross Profit	103,227	85,866
Product development	7,212	6,244
Selling, marketing and distribution	27,942	26,407
General and administrative	13,421	12,048
Operating Earnings	54,652	41,167
Interest expense	125	339
Other expense, net	5	189
Earnings before Income Taxes	54,522	40,639
Income taxes	19,100	13,600
Net Earnings	\$ 35,422	\$ 27,039
Basic Net Earnings per Common Share	\$.52	\$.39
Diluted Net Earnings per Common Share	\$.51	\$.38
Cash Dividends Declared per Common Share	\$.15	\$.13

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In thousands)

	<u>March 31, 2006</u>	<u>Dec. 30, 2005</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 27,183	\$ 18,664
Accounts receivable, less allowances of \$6,100 and \$5,900	129,118	122,854
Inventories	64,562	56,547
Deferred income taxes	15,733	14,038
Other current assets	1,841	1,795
Total current assets	238,437	213,898

Property, Plant and Equipment		
Cost	259,411	255,463
Accumulated depreciation	(152,840)	(148,965)
Property, plant and equipment, net	106,571	106,498
Prepaid Pension	30,026	29,616
Goodwill	52,254	52,009
Other Intangible Assets, net	38,291	39,482
Other Assets	3,944	4,127
Total Assets	\$ 469,523	\$ 445,630

LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities		
Notes payable to banks	\$ 4,341	\$ 8,321
Trade accounts payable	29,640	24,712
Salaries, wages and commissions	13,694	23,430
Dividends payable	9,918	9,929
Other current liabilities	54,314	45,189
Total current liabilities	111,907	111,581
Retirement Benefits and Deferred Compensation	36,145	35,507
Deferred Income Taxes	10,819	10,858
Shareholders' Equity		
Common stock	68,408	68,387
Additional paid-in capital	124,049	110,842
Retained earnings	121,750	112,506
Other, net	(3,555)	(4,051)
Total shareholders' equity	310,652	287,684
Total Liabilities and Shareholders' Equity	\$ 469,523	\$ 445,630

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)
(In thousands)

	<u>Thirteen Weeks Ended</u>	
	<u>March 31, 2006</u>	<u>April 1, 2005</u>
Cash Flows from Operating Activities		
Net Earnings	\$ 35,422	\$ 27,039
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	5,781	5,703
Deferred income taxes	(1,706)	(766)
Share-based compensation	2,164	--
Excess tax benefit related to share-based payment arrangements	(2,000)	--
Change in:		
Accounts receivable	(6,471)	(3,107)
Inventories	(7,934)	(2,329)
Trade accounts payable	4,906	1,824
Salaries, wages and commissions	(9,825)	(9,472)
Retirement benefits and deferred compensation	19	(86)
Other accrued liabilities	11,883	6,182
Other	50	814
Net cash provided by operating activities	32,289	25,802
Cash Flows from Investing Activities		
Property, plant and equipment additions	(4,371)	(3,735)
Proceeds from sale of property, plant and equipment	19	32
Acquisitions of businesses, net of cash acquired	--	(102,534)
Net cash used in investing activities	(4,352)	(106,237)
Cash Flows from Financing Activities		
Borrowings on notes payable and lines of credit	4,333	45,816

Payments on notes payable and lines of credit	(8,310)	(6,062)
Excess tax benefit related to share-based payment arrangements	2,000	--
Common stock issued	10,200	7,946
Common stock retired	(17,404)	(7,017)
Cash dividends paid	(9,922)	(8,969)
Net cash provided by (used in) financing activities	(19,103)	31,714
Effect of exchange rate changes on cash	(315)	488
Net increase (decrease) in cash and cash equivalents	8,519	(48,233)
Cash and cash equivalents		
Beginning of year	18,664	60,554
End of period	\$ 27,183	\$ 12,321

See notes to consolidated financial statements.

GRACO INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

- The consolidated balance sheet of Graco Inc. and Subsidiaries (the Company) as of March 31, 2006 and the related statements of earnings and cash flows for the thirteen weeks then ended have been prepared by the Company without being audited.

In the opinion of management, these consolidated statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of Graco Inc. and Subsidiaries as of March 31, 2006, and the results of operations and cash flows for all periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. Therefore, these statements should be read in conjunction with the financial statements and notes thereto included in the Company's 2005 Annual Report on Form 10-K.

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

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

	<u>Thirteen Weeks Ended</u>	
	<u>March 31, 2006</u>	<u>April 1, 2005</u>
Net earnings available to common shareholders	\$ 35,422	\$ 27,039
Weighted average shares outstanding for basic earnings per share	68,428	69,074
Dilutive effect of stock options computed based on the treasury stock method using the average market price	1,121	1,200
Weighted average shares outstanding for diluted earnings per share	69,549	70,274
Basic earnings per share	\$.52	\$.39
Diluted earnings per share	\$.51	\$.38

Stock options to purchase 1,000 and 311,800 shares are not included in the 2006 and 2005 calculations of diluted earnings per share, respectively, because they would have been anti-dilutive.

- Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" (SFAS No. 123(R)) 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 \$2.2 million of share-based compensation cost in the first quarter of 2006, which reduced net income by \$1.5 million, or \$0.02 per weighted average common share.

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 for the thirteen weeks ended April 1, 2005 would have been reduced as follows (in thousands, except per share amounts):

Net earnings	
As reported	\$27,039
Stock-based compensation, net of related tax effects	(1,058)

Pro forma

\$25,981

Net earnings per common share

Basic as reported	\$.39
Basic pro forma	.38
Diluted as reported	.38
Diluted pro forma	.37

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

	<u>Thirteen Weeks Ended</u>	
	<u>March 31, 2006</u>	<u>April 1, 2005</u>
Pension Benefits		
Service cost	\$ 1,440	\$ 1,251
Interest cost	2,608	2,489
Expected return on assets	(4,175)	(3,950)
Amortization and other	192	157
Net periodic benefit cost (credit)	\$ 65	\$ (53)
Postretirement Medical		
Service cost	\$ 250	\$ 225
Interest cost	420	410
Amortization of net loss	186	115
Net periodic benefit cost	\$ 856	\$ 750

5. Total comprehensive income was as follows (in thousands):

	<u>Thirteen Weeks Ended</u>	
	<u>March 31, 2006</u>	<u>April 1, 2005</u>
Net income	\$ 35,422	\$ 27,039
Foreign currency translation adjustments	515	(117)
Minimum pension liability adjustment, net of tax	(19)	14
Comprehensive income	\$ 35,918	\$ 26,936

6. The Company has three reportable segments: Industrial, Contractor and Lubrication. The Company does not identify assets by segment. Sales and operating earnings by segment for the thirteen weeks ended March 31, 2006 and April 1, 2005 were as follows (in thousands):

	<u>Thirteen Weeks Ended</u>	
	<u>March 31, 2006</u>	<u>April 1, 2005</u>
Net Sales		
Industrial	\$ 100,160	\$ 87,869
Contractor	74,352	67,780
Lubrication	17,704	15,295
Consolidated	\$ 192,216	\$ 170,944
Operating Earnings		
Industrial	\$ 32,083	\$ 21,964
Contractor	21,042	15,086
Lubrication	4,755	4,199
Unallocated corporate expenses	(3,228)	(82)
Consolidated	\$ 54,652	\$ 41,167

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

	<u>March 31, 2006</u>	<u>Dec. 30, 2005</u>
Finished products and components	\$ 44,643	\$ 40,444
Products and components in various stages of completion	22,322	21,788
Raw materials and purchased components	25,660	22,690
Reduction to LIFO cost	92,625 (28,063)	84,922 (28,375)
Total	\$ 64,562	\$ 56,547

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

	Estimated Life (Years)	Original Cost	Amorti- zation	Foreign Currency Translation	Book Value
<u>March 31, 2006</u>					
Customer relationships and distribution network	4 - 8	\$22,402	\$(4,673)	\$(348)	\$17,381
Patents, proprietary technology and product documentation	5 - 15	12,143	(2,380)	(143)	9,620
Trademarks, trade names other	3 - 10	1,624	(764)	--	860
		<u>36,169</u>	<u>(7,817)</u>	<u>(491)</u>	<u>27,861</u>
Not Subject to Amortization: Brand names		10,550	--	(120)	10,430
Total		<u>\$46,719</u>	<u>\$(7,817)</u>	<u>\$(611)</u>	<u>\$38,291</u>
<u>December 30, 2005</u>					
Customer relationships and distribution network	4 - 8	\$22,965	\$(4,419)	\$(427)	\$18,119
Patents, proprietary technology and product documentation	3 - 15	12,266	(2,065)	(174)	10,027
Trademarks, trade names and other	3 - 10	1,774	(837)	--	937
		<u>37,005</u>	<u>(7,321)</u>	<u>(601)</u>	<u>29,083</u>
Not Subject to Amortization: Brand names		10,550	--	(151)	10,399
Total		<u>\$47,555</u>	<u>\$(7,321)</u>	<u>\$(752)</u>	<u>\$39,482</u>

Amortization of intangibles during the first quarter of 2006 was \$1.3 million. Estimated annual amortization expense is as follows: \$5.2 million in 2006, \$5.1 million in 2007, \$4.5 million in 2008, \$4.0 million in 2009, \$3.6 million in 2010 and \$6.7 million thereafter.

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

	<u>March 31, 2006</u>	<u>Dec. 30, 2005</u>
Accrued insurance liabilities	\$ 8,048	\$ 7,848
Accrued warranty and service liabilities	7,418	7,649
Accrued trade promotions	4,909	6,584
Payable for employee stock purchases	996	5,710
Income taxes payable	20,124	4,075
Other	12,819	13,323
	<u>\$ 54,314</u>	<u>\$ 45,189</u>

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

	Thirteen Weeks Ended <u>March 31, 2006</u>	Year Ended <u>Dec. 30, 2005</u>
Balance, beginning of year	\$ 7,649	\$ 9,409
Charged to expense	1,106	6,045
Margin on parts sales reversed	333	1,201
Reductions for claims settled	(1,670)	(9,006)
Balance, end of period	<u>\$ 7,418</u>	<u>\$ 7,649</u>

10. In April 2006, the Company announced that it would close its plant and office facilities in Lakewood, New Jersey. The Company intends to move the Lakewood operation to North Canton, Ohio, where it currently has a manufacturing facility. As part of this consolidation, the Company will build a 60,000 square foot expansion of the North Canton facility. The Company is also moving its spray foam production from Villanova, Spain to Minneapolis, Minnesota.

**Item 2. GRACO INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Results of Operations

Increases in sales and gross profit margin rate, along with smaller increases in expenses, resulted in higher net earnings in the first quarter of 2006. As a percentage of sales, net earnings improved to 18.4 percent, compared to 15.8 percent for the first quarter of 2005. 2006 results include \$2.2 million of share-based compensation cost and a \$1 million contribution to the Company's charitable foundation. There were no comparable costs included in 2005 first quarter results. Foreign currency translation rates had an adverse impact on first quarter sales and net earnings. Translated at consistent exchange rates, sales increased 14 percent, compared to 12 percent translated at actual rates.

Net Sales

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

	<u>Thirteen Weeks Ended</u>	
	<u>March 31, 2006</u>	<u>April 1, 2005</u>
By Segment		
Industrial	\$ 100,160	\$ 87,869
Contractor	74,352	67,780
Lubrication	17,704	15,295
	<hr/>	<hr/>
Consolidated	\$ 192,216	\$ 170,944
	<hr/>	<hr/>
By Geographic Area		
Americas ¹	\$ 132,212	\$ 114,019
Europe ²	39,546	35,709
Asia Pacific	20,458	21,216
	<hr/>	<hr/>
Consolidated	\$ 192,216	\$ 170,944
	<hr/>	<hr/>

¹ North and South America, including the U.S.

² Europe, Africa and Middle East

All reportable segments experienced double-digit percentage growth in sales. Geographically, sales in the Americas and Europe also experienced double-digit percentage growth. Sales in Asia Pacific were 4 percent lower than the first quarter of last year, but bookings and backlog in this region increased.

Industrial sales increased by 14 percent. Translated at consistent exchange rates, sales increased by 17 percent. Demand for this segment's products remained strong in all major product categories.

Contractor sales increased by 10 percent, with contributions from new product introductions and strong growth in the professional paint stores channel.

Lubrication sales increased by 16 percent, with good demand for its key products, including PBL products, acquired in late 2005.

Gross Profit

Gross profit as a percentage of sales was 53.7 percent compared to 50.2 percent for the first quarter last year. Nearly 2 percentage points of the increase was due to the recognition of higher costs assigned to inventories of acquired operations in 2005. Favorable factory productivity, spending and volume in 2006, along with enhanced pricing, contributed to the improvement in gross margin percentage, more than offsetting the adverse impact of currency translation.

Operating Expenses

Total operating expenses increased by \$3.9 million, including \$1.8 million of share-based compensation expense and a \$1 million charitable foundation contribution. Expenses as a percentage of sales decreased to 25.3 percent from 26.1 percent.

Income Taxes

The effective tax rate is 35 percent for 2006, up from 33.5 percent for 2005, due to reduced available tax credits.

Liquidity and Capital Resources

Significant uses of cash in the first quarter of 2006 included \$17 million for purchases and retirement of Company common stock and \$10 million for payment of dividends. During the first quarter of 2005, significant uses of cash included \$103 million for acquisitions of businesses, \$9 million of dividends paid and \$7 million for purchases and retirement of Company common stock. The Company used cash on hand and a \$40 million advance from a line of credit to fund the acquisitions.

The Company had unused lines of credit available at March 31, 2006 totaling \$89 million. Cash balances of \$27 million at March 31, 2006, internally generated funds and unused financing sources provide the Company with the financial flexibility to meet liquidity needs, including the costs, estimated at approximately \$4 to \$6 million, related to the planned move and consolidation of the operations currently located in Lakewood, New Jersey and Villanova, Spain.

Outlook

Results for the first quarter were in line with management's expectations. While management's vision is limited due to the short cycle nature of the business, the sales tempo experienced throughout the quarter was good and management continues to expect growth this year.

SAFE HARBOR CAUTIONARY STATEMENT

A forward-looking statement is any statement made in this report and other reports that the Company files periodically with the Securities and Exchange Commission, or in press or earnings releases, analyst briefings and conference calls, which reflects the Company's current thinking on

market trends and the Company's future financial performance at the time they are made. All forecasts and projections are forward-looking statements.

The Company desires to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 by making cautionary statements concerning any forward-looking statements made by or on behalf of the Company. The Company cannot give any assurance that the results forecasted in any forward-looking statement will actually be achieved. Future results could differ materially from those expressed, due to the impact of changes in various factors. These risk factors include, but are not limited to: economic conditions in the United States and other major world economies, currency fluctuations, political instability, changes in laws and regulations, and changes in product demand. Please refer to Item 1A of, and Exhibit 99 to, the Company's Annual Report on Form 10-K for fiscal year 2005 for a more comprehensive discussion of these and other risk factors.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There are no material changes related to market risk from the disclosures made in the Company's 2005 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

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

Changes in internal controls

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

PART II OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes to the Company's risk factors from those disclosed in the Company's 2005 Annual Report on Form 10-K.

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

Issuer Purchases of Equity Securities

On February 20, 2004, the Board of Directors authorized the Company to purchase up to a total of 3,000,000 shares of its outstanding common stock, primarily through open-market transactions. This authorization effectively expired February 17, 2006, upon Board approval authorizing the purchase of up to 7,000,000 shares, expiring on February 29, 2008.

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

Information on issuer purchases of equity securities follows:

<u>Period</u>	<u>(a) Total Number of Shares Purchased</u>	<u>(b) Average Price Paid per Share</u>	<u>(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (at end of period)</u>
Dec 31, 2005 - Jan 27, 2006	969	\$38.97	--	786,600
Jan 28, 2006 - Feb 24, 2006	143,051	\$39.65	142,100	7,000,000
Feb 25, 2006 - Mar 31, 2006	275,970	\$42.38	255,100	6,774,900

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

None

Item 6. Exhibits

- 4.1 Credit agreement dated April 1, 2006, between the Company and Wachovia Bank, N.A. (Promissory Note and Offering Basis Loan Agreement)
- 31.1 Certification of Chairman, President and Chief Executive Officer pursuant to Rule 13a-14(a)
- 31.2 Certification of Chief Financial Officer and Treasurer pursuant to Rule 13a-14(a)
- 32 Certification of Chairman, President and Chief Executive Officer and Chief Financial Officer and Treasurer pursuant to Section 1350 of Title 18, U.S.C.

SIGNATURES

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

GRACO INC.

Date: April 26, 2006

By: /s/David A. Roberts
David A. Roberts
Chairman, President and Chief Executive Officer
(Principal Executive Officer)

Date: April 26, 2006

By: /s/James A. Graner
James A. Graner
Chief Financial Officer and Treasurer
(Principal Financial Officer)

PROMISSORY NOTE

\$25,000,000

April 1, 2006

Graco Inc.
88 11th Avenue Northwest
Minneapolis, Minnesota 55413
(Individually and collectively "Borrower")

Wachovia Bank, National Association
301 South Tryon Street
Charlotte, North Carolina 28202
(Hereinafter referred to as "Bank")

Borrower promises to pay to the order of Bank, in lawful money of the United States of America, at its office indicated above or wherever else Bank may specify, the sum of \$25,000,000 (as the same may be reduced from time to time pursuant to that Section hereof titled "Reduction or Termination of Commitment", the "Committed Amount") or such sum as may be advanced and outstanding from time to time, with interest on the unpaid principal balance at the rate and on the terms provided in this Promissory Note (including all renewals, extensions or modifications hereof, this "Note").

LINE OF CREDIT ADVANCES. Borrower may borrow, repay and reborrow, and, upon the request of Borrower, Bank shall advance and readvance under this Note from time to time until the maturity hereof (each, including any portion thereof, an "Advance" and together the "Advances"), so long as the principal balance outstanding under this Note after such Advance plus the aggregate amount of undrawn Letters of Credit plus the aggregate amount of unreimbursed drawings under all Letters of Credit does not exceed the Committed Amount. Bank shall have no obligation to make Advances under this Note or issue Letters of Credit if a Default has occurred and is continuing. As of the date of each proposed Advance, Borrower shall be deemed to represent that each representation made in the Loan Documents is true in all material respects as of such date.

USE OF PROCEEDS. Borrower shall use the proceeds of the loan(s) evidenced by this Note for the commercial purposes of Borrower, as follows: refinance of existing debt and general business purposes (including without limitation acquisition financing).

LETTERS OF CREDIT. Upon the request of Borrower, Bank shall issue standby "Letters of Credit", provided that, after such issuance, the aggregate amount of undrawn Letters of Credit plus the aggregate amount of unreimbursed drawings under all Letters of Credit shall not exceed \$10,000,000 and the principal balance outstanding under this Note plus the aggregate amount of undrawn Letters of Credit plus the aggregate amount of unreimbursed drawings under all Letters of Credit shall not exceed the Committed Amount. Subject to the terms of this Note, Borrower may borrow hereunder to pay reimbursement obligations due Bank under Letters of Credit. With respect to each issuance of a Letter of Credit, Borrower shall execute Bank's form "Letter of Credit Application". Upon termination of Bank's obligation to Advance under this Note, whether by maturity, Default or otherwise, Borrower shall deliver immediately to Bank cash collateral in an amount equal to the aggregate amount of outstanding undrawn Letters of Credit or provide Bank with other credit support for such undrawn Letters of Credit reasonably acceptable to Bank.

Letter of Credit Fees. Borrower shall pay a Standby LC Fee with respect to each Letter of Credit from the date of issuance through the date of expiration, draw or other termination, at the Standby LC Fee rate on the amount of each Letter of Credit. Borrower shall pay to Bank Bank's standard processing fees in connection with amendment, issuance, renewal or extension of each Letter of Credit.

FACILITY FEE. Borrower shall pay a Facility Fee from the date hereof through the Maturity Date at the Facility Fee rate on the Committed Amount.

INTEREST RATES AND FEES. The variable pricing grid below is referred to herein as the "Pricing Grid". The "LIBOR Spread", "Facility Fee", and the "Standby LC Fee" shall be determined at any time by reference to the Leveraged Ratio calculated as of the end of the most recent fiscal quarter preceding the day such fee is determined for which financial statements have been delivered under that Section of this Note titled "Financial Information" and the Pricing Grid. All interest and fees are stated as annual rates in the Pricing Grid.

Leverage Ratio	LIBOR Spread	Facility Fee	All-In Drawn	Standby LC Fee	INTEREST RATE DEFINITIONS. LIBOR-Based Rate. "LIBOR-Based Rate" means, with respect to any Advance, LIBOR for the Interest Period applicable to such Advance plus the applicable LIBOR Spread, as the
<.5x	0.33%	0.07%	0.40%	0.40%	
≥.5 x to 1.5x	0.41%	0.09%	0.50%	0.50%	
≥1.5x to 2.5x	0.54%	0.11%	0.65%	0.65%	
≥ 2.5x	0.65%	0.15%	0.80%	0.80%	

applicable LIBOR Spread may change from time to time.

LIBOR. "LIBOR" means, with respect to each Interest Period, the rate for U.S. dollar deposits with a maturity equal to the number of months in such Interest Period, as reported on Telerate page 3750 as of 11:00 a.m., London time, on the second London business day before such Interest Period begins (or if not so reported, then as determined by Bank from another recognized source or interbank quotation).

Prime Rate. "Prime Rate" means Bank's Prime Rate, as that rate may change from time to time with changes to occur on the date Bank's Prime Rate changes.

LIBOR-Based Rate Advance. "LIBOR-Based Rate Advance" means an Advance bearing interest at a rate determined by reference to a LIBOR-Based Rate.

Prime Rate Advance. "Prime Rate Advance" means an Advance bearing interest at a rate determined by reference to the Prime Rate.

Interest Period. "Interest Period" means, in respect of each LIBOR-Based Rate Advance, the period commencing on the date of such Advance or the last day of the immediately preceding Interest Period applicable to such Advance and ending one, two, three or six months thereafter, as the Borrower shall have elected in the applicable notice of borrowing, continuation or conversion; provided (i) any Interest Period that ends in a month

for which there is no day which numerically corresponds to the last day of the immediately preceding Interest Period shall end on the last day of the month and (ii) any Interest Period that would otherwise extend past the Maturity Date of this Note shall end on the Maturity Date of this Note.

INTEREST RATE SELECTION AND ADJUSTMENT. Interest Rate Options. Interest shall accrue on the unpaid principal balance of each Advance from the date of such Advance at a rate per annum equal to a LIBOR-Based Rate or Prime Rate, as selected by Borrower in accordance herewith (each, an "Interest Rate"). Interest for each Interest Period shall accrue each day during such Interest Period, commencing on and including the first day to but excluding the last day.

When the Prime Rate is selected for an Advance, it shall be adjusted from time to time, effective as of the date of each change in Bank's Prime Rate and the Prime Rate shall continue to apply until another Interest Rate option is selected for that Advance pursuant to the subsection entitled "Notice and Manner of Borrowing and Rate Conversion". When a LIBOR-Based Rate is selected for an Advance, the LIBOR component of such rate shall be fixed for each Interest Period for which it is determined, and such Advance shall be continued as a LIBOR-Based Rate Advance with the same Interest Period until another Interest Rate option is selected for that Advance pursuant to the subsection entitled "Notice and Manner of Borrowing and Rate Conversion." There shall be no more than 10 LIBOR-Based Rate Advances having different Interest Periods outstanding at any time. Each borrowing of, conversion to or from, or continuation as, a LIBOR-Based Rate Advance will be in an amount such that, after giving effect thereto, the aggregate outstanding principal amount of all LIBOR-Based Rate Advances having the same Interest Period shall be \$1,000,000 or increments of \$500,000 in excess thereof.

Funding Loss Protection. Borrower shall indemnify Bank against Bank's loss or expense as a consequence of (a) Borrower's failure to make any payment when due on a loan or Advance bearing interest at a LIBOR-Based Rate, (b) any payment, prepayment or conversion of any loan or Advance bearing interest at a LIBOR-Based Rate on a day other than the last day of the Interest Period (whether due to acceleration, maturity or otherwise), or (c) any failure to make a borrowing or conversion after giving notice thereof ("Indemnified Loss or Expense"). The amount of such Indemnified Loss or Expense shall be determined by Bank based upon the assumption that Bank funded 100% of that portion of the loan in the London interbank market and Bank shall provide justification for such to Borrower upon Borrower's request.

Default Rate. In addition to all other rights contained in this Note, if a Default occurs, and as long as a Default continues, (a) Borrower shall no longer have the option to request a LIBOR-Based Rate and (b) the outstanding principal amount of this Note and all other overdue Obligations shall bear interest at a rate per annum equal to the Prime Rate plus 2% ("Default Rate"); provided, however, that during the balance of any Interest Period applicable to an LIBOR-Based Rate Advance, the Default Rate with respect to such Advance shall be a rate per annum equal to the LIBOR-Based Rate applicable to such Advance plus 2%. The Default Rate shall also apply from acceleration until the Obligations or any judgment thereon is paid in full.

Notice and Manner of Borrowing and Rate Conversion. Borrower shall give Bank irrevocable telephonic notice of each proposed Advance not later than noon local time at the office of Bank first shown above on the same business day as such proposed Advance. Each such notice shall specify (i) the date of such Advance, which shall be a business day, (ii) the amount of such Advance, (iii) whether such Advance is to be initially funded as a Prime Rate Advance or a LIBOR-Based Rate Advance, and (iv) in the case of a LIBOR-Based Rate Advance, the duration of the Interest Period applicable thereto. Notices received after noon local time at the office of Bank first shown above shall be deemed received on the next business day.

Subject to the above limitations, Borrower shall have the option from time to time to convert all or any part of an Advance into a Prime Rate Advance or a LIBOR-Based Rate Advance, or to continue all or any part of a LIBOR-Based Rate Advance as such with the same or a different Interest Period; provided, however, that a LIBOR-Based Rate Advance may be converted or continued only on the last day of the Interest Period applicable thereto. Borrower shall give Bank irrevocable telephonic notice of any continuation or conversion of an Advance not later than noon local time at the office of Bank first shown above on the date of the requested continuation or conversion. Each such notice shall specify (i) the date of such continuation or conversion, (ii) the amount to be continued or converted, and (iii) in the case of continuations as or conversions to LIBOR-Based Rate Advances, the Interest Period applicable thereto.

At the Maturity Date or upon acceleration all LIBOR-Based Rate Advances shall automatically convert to Prime Rate Advances.

Interest and Fee Computation. Interest and fees, if any, shall be computed on the basis of the actual days in the year and the actual number of days in the applicable period. The computation determines the annual effective yield by taking the stated (nominal) rate for a year's period and then dividing said rate by number of days in the year to determine the daily periodic rate to be applied for each day in the applicable period.

REPAYMENT TERMS. Accrued interest on each LIBOR-Based Rate Advance shall be due at the sooner of the end of the applicable Interest Period or the Maturity Date. Accrued interest on Prime Rate Advances, accrued Standby LC Fees and accrued Facility Fees shall be due and payable in consecutive monthly payments commencing on April 30, 2006, and continuing on the last day of each month thereafter until fully paid. In any event, all principal and accrued interest shall be due and payable on March 31, 2007 (the "Maturity Date").

If Borrower subscribes to Bank's cash management services and such services are applicable to this line of credit, the terms of such service shall control the manner in which funds are transferred between the applicable demand deposit account and the line of credit for credit or debit to the line of credit.

APPLICATION OF PAYMENTS. Monies received by Bank from any source for application toward payment of the Obligations shall be applied to accrued interest and then to principal. If a Default occurs, and so long as such Default is continuing, monies may be applied to the Obligations in any manner or order deemed appropriate by Bank.

If any payment received by Bank under this Note or other Loan Documents is rescinded, avoided or for any reason returned by Bank because of any adverse claim or threatened action, the returned payment shall remain payable as an obligation of all persons liable under this Note or other Loan Documents as though such payment had not been made.

REDUCTION OR TERMINATION OF COMMITMENT. Borrower may at any time and from time to time, upon not less than three business days' prior written notice to Bank, permanently reduce in part the Commitment Amount or terminate entirely the commitment of the Bank to make Advances under this Note, in each case without premium or penalty, provided that any such partial reduction of the Commitment Amount shall be in integral multiples of \$500,000 and no such partial reduction shall reduce the Commitment Amount to an amount which is less than the sum at the time of the principal balance outstanding under this Note plus the aggregate amount of undrawn Letters of Credit plus the aggregate amount of unreimbursed drawings under all Letters of Credit. Upon any termination by Borrower in its entirety of the commitment of the Bank to make Advances under this Note, Borrower shall pay all of the Obligations in full.

DEFINITIONS. Affiliate. Affiliate shall have the meaning as defined in 11 U.S.C.ss.101, except that the term "Borrower" shall be substituted for the term "Debtor" therein. **Agreement Accounting Principles.** Agreement Accounting Principles means generally accepted accounting principles as

in effect in the United States from time to time. **Loan Documents.** The term "Loan Documents", as used in this Note and the other Loan Documents, refers to all documents executed in connection with or related to the loan evidenced by this Note and any prior notes which evidence all or any portion of the loan evidenced by this Note, and any letters of credit issued pursuant to any loan agreement to which this Note is subject, any applications for such letters of credit and any other documents executed in connection therewith or related thereto and any renewals or modifications thereof, whenever any of the foregoing are executed, but does not include swap agreements (as defined in 11 U.S.C.ss. 101). **Material Adverse Effect.** The term Material Adverse Effect shall mean, with respect to any event, act, condition or occurrence of whatever nature (including any adverse determination in any litigation, arbitration, or governmental investigation or proceeding), whether singly or in conjunction with any other event or events, act or acts, condition or conditions, or occurrence or occurrences whether or not related, a material adverse change in, or a material adverse effect on, (a) the business, results of operations, financial condition, assets or liabilities of Borrower and its Subsidiaries taken as a whole, (b) the ability of Borrower to perform any of its obligations under the Loan Documents, (c) the rights and remedies of the Bank under any of the Loan Documents or (d) the legality, validity or enforceability of any of the Loan Documents. **Obligations.** The term "Obligations", as used in this Note and the other Loan Documents, refers to any and all indebtedness, promises, covenants, agreements and other obligations under this Note and under any other Loan Document. Any reference in this Note or in any other Loan Document to payment, or final payment, in full of the Obligations shall mean the payment in full in cash of all Obligations other than contingent indemnification Obligations (or, in the case of undrawn Letters of Credit, the cash collateralization thereof or provision of other credit support therefor in accordance with the terms of the Section hereof titled "Letters of Credit"). **Subsidiary.** Subsidiary shall mean any business in which Borrower holds, directly or indirectly, a controlling interest. **Certain Other Terms.** All terms that are used but not otherwise defined in any of the Loan Documents shall have the definitions provided in the Uniform Commercial Code.

ATTORNEYS' FEES AND OTHER COLLECTION COSTS. Borrower shall pay all of Bank's reasonable expenses incurred to enforce or collect any of the Obligations including, without limitation, reasonable arbitration, paralegals', attorneys' and experts' fees and expenses, whether incurred without the commencement of a suit, in any trial, arbitration, or administrative proceeding, or in any appellate or bankruptcy proceeding.

USURY. If at any time the effective interest rate under this Note would, but for this paragraph, exceed the maximum lawful rate, the effective interest rate under this Note shall be the maximum lawful rate, and any amount received by Bank in excess of such rate shall be applied to principal and then to fees and expenses, or, if no such amounts are owing, returned to Borrower.

GRACE/CURE PERIOD. Grace Period. The failure of timely payment of the interest or fees shall not be a Default until 5 days after such payment is due. **Cure Period.** Except as provided below, any Default, other than non-payment, may be cured within 30 days after written notice thereof is mailed to Borrower by Bank. Borrower's right to cure shall be applicable only to curable defaults and shall not apply, without limitation, to Defaults based upon False Warranty or, except as provided below, Bankruptcy.

DEFAULT. If any of the following occurs and is not cured within the applicable Cure Period, a default ("Default") under this Note shall exist: **Nonpayment; Nonperformance.** The failure of timely payment or performance of the Obligations or Default, however denominated, under this Note or any other Loan Documents. **False Warranty.** A warranty or representation made or deemed made in the Loan Documents or furnished to Bank by Borrower in connection with the loan evidenced by this Note proves materially false, or if of a continuing nature, becomes materially false. **Cross Default.** At Bank's option, any default in payment or performance of any obligation under any other loans, contracts or agreements of Borrower or any Subsidiary of Borrower with Bank or its affiliates. **Bankruptcy.** Appointment of a receiver for, assignment for the benefit of creditors of, or commencement of any bankruptcy or insolvency proceeding by or against, Borrower or any of its Subsidiaries (which proceeding, if not instituted, consented to or acquiesced in by Borrower or such Subsidiary, remains undismissed or unstayed and in effect for a period of 60 consecutive days). **Material Business Alteration.** Without prior written consent of Bank, a material alteration in the kind or type of Borrower's business.

REMEDIES UPON DEFAULT. If a Default occurs under this Note or any Loan Documents, Bank may at any time thereafter so long as such Default is continuing, take the following actions: **Acceleration Upon Default/Termination.** Accelerate the maturity of this Note and, at Bank's option, any or all other Obligations, whereupon this Note and the accelerated Obligations shall be immediately due and payable, and terminate Bank's obligation to make Advances under this Note or issue Letters of Credit; provided, however, if the Default is based upon a bankruptcy or insolvency proceeding commenced by or against Borrower, all Obligations shall automatically and immediately be due and payable, all LIBOR - Based Rate Advances shall convert to Prime Rate Advances and Bank's obligation to make Advances under this Note or issue Letters of Credit shall terminate. **Cumulative.** Exercise any rights and remedies as provided under the Note and other Loan Documents, or as provided by law or equity.

REPRESENTATIONS. Power and Authorization. Borrower has the power and authority to execute, deliver and perform, and by all necessary action has authorized the execution, delivery and performance of, all of its obligations under this Note and any other Loan Document to which it is a party. **Organization and Authority.** Borrower and each Subsidiary of Borrower is duly created, validly existing and in good standing under the laws of the state of its organization, and has all powers, governmental licenses, authorizations, consents and approvals required to operate its business as now conducted except where the failure to have any such power, governmental license, authorization, consent or approval could not be reasonably expected to have a Material Adverse Effect. Borrower and each Subsidiary of Borrower is duly qualified, registered and in good standing in each jurisdiction where qualification or registration is required by the nature of its business or the character and location of its property, business or customers, and in which the failure to so qualify or be so registered or in good standing, as the case may be, in the aggregate, could be reasonably expected to have a Material Adverse Effect. **No Litigation.** Except as disclosed to Bank in writing prior to the execution and delivery of this Note, there are no pending or, to the knowledge of Borrower, threatened suits, regulatory or administrative proceedings, arbitrations or penalties against Borrower or any Subsidiary of Borrower that could be reasonably expected to have a Material Adverse Effect. **ERISA.** Each employee pension benefit plan, as defined in ERISA, maintained by Borrower meets, as of the date hereof, the minimum funding standards of ERISA and all applicable regulations thereto and requirements thereof, and of the Internal Revenue Code of 1986, as amended. No "Prohibited Transaction" or "Reportable Event" (as both terms are defined by ERISA) has occurred with respect to any such plan. **Regulation U.** None of the proceeds of the credit shall be used directly or indirectly for the purpose of purchasing or carrying any margin stock in violation of any of the provisions of Regulation U of the Board of Governors of the Federal Reserve System ("Regulation U"), or for the purpose of reducing or retiring any indebtedness which was originally incurred to purchase or carry margin stock or for any other purchase which might render the loan evidenced by this Note a "Purpose Credit" within the meaning of Regulation U.

FINANCIAL INFORMATION. Borrower agrees that from the date hereof until payment in full of the Obligations: **Annual.** Borrower shall deliver to Bank, within 120 days after the close of each fiscal year, audited financial statements reflecting its operations during such fiscal year, including, without limitation, a balance sheet, profit and loss statement, statement of cash flows and officer's compliance certificate with supporting schedules; all on a consolidated basis with respect to Borrower and its Subsidiaries, and in reasonable detail, prepared in conformity with generally accepted accounting principles, applied (except as otherwise disclosed in such financial statements) on a basis consistent with that of the preceding year. All such statements shall be examined by Deloitte & Touche LLP or another independent certified public accountant of recognized national standing selected by Borrower. The opinion of such independent certified public accountant shall not be acceptable to Bank if qualified due to any limitations in scope imposed by Borrower or any other person or entity. Any other qualification of the opinion by the accountant shall render the acceptability of the financial statements subject to Bank's approval. **Quarterly.** Borrower shall deliver to Bank, within 120 days after the close of each fiscal year and within 45 days after the end of each of the first three fiscal quarters in any fiscal year, audited quarterly financial statements

including, without limitation, a balance sheet, profit and loss statement, statement of cash flows and officer's compliance certificate, with supporting schedules; all on a consolidated basis with respect to Borrower and its Subsidiaries, all in reasonable detail and (except for the absence of footnote disclosures and subject to year-end adjustments) prepared in conformity with generally accepted accounting principles, applied (except as otherwise disclosed in such financial statements) on a basis consistent with that of the preceding year. **Additional Information.** Borrower shall deliver to Bank such information as Bank may reasonably request from time to time pertaining to Borrower's corporate status, operations and financial condition. Borrower shall permit Bank and its representatives to meet with Borrower and discuss the business and finances of Borrower from time to time as Bank may reasonably request. **Accuracy.** All information provided Bank by Borrower shall be complete and accurate in all material respects.

AFFIRMATIVE COVENANTS. Borrower agrees that from the date hereof until payment in full of the Obligations: **Maintenance of Corporate Status.** Borrower shall maintain its corporate existence and qualification or registration in all jurisdictions where it is required to be qualified or registered under applicable law and shall not suffer loss of good standing status where it is incorporated or in jurisdictions where it is required to be qualified or registered under applicable law (except, in the case of foreign qualification, registration or good standing, where the failure to maintain such qualification or registration or the loss of such good standing status, as the case may be, could not be reasonably expected to have a Material Adverse Effect). **Compliance With Laws.** Borrower will, and will cause each of its Subsidiaries to, comply with all laws, rules, regulations and requirements of any governmental authority applicable to its properties, except where the failure to do so, either individually or in the aggregate, could not reasonably be expected to result in a Material Adverse Effect. **Insurance.** Borrower will, and will cause each of its Subsidiaries to, maintain, with financially sound and reputable insurance companies, adequate insurance coverage with respect to its properties and business against loss or damage of the kinds and in the amounts customarily insured against by companies of established reputation engaged in the same or similar businesses including, without limitation, commercial general liability insurance, workers compensation insurance, and business interruption insurance. **Maintain Properties.** Borrower will, and will cause each of its Subsidiaries to, maintain, preserve and keep its property in good repair, working order and condition, making all needed replacements, additions and improvements thereto.

FINANCIAL COVENANTS. Borrower agrees that from the date hereof until final payment in full of the Obligations, using the financial information for Borrower and its Subsidiaries, calculated on a consolidated basis: **Minimum Consolidated Interest Coverage Ratio.** Borrower will not, as of the last day of any fiscal quarter of Borrower, commencing with the fiscal quarter ending December 31, 2005, permit the Consolidated Interest Coverage Ratio for the period of four fiscal quarters ending on such day, to be less than 3.0 to 1.0. **Maximum Leverage Ratio.** Borrower will not, as of the last day of any fiscal quarter of Borrower, commencing with the fiscal quarter ending December 31, 2005, permit the Leverage Ratio for the period of four consecutive fiscal quarters ending on such day, to be greater than 3.0 to 1.0. **Definitions Applicable to Financial Covenants:** "Consolidated Interest Coverage Ratio" means, for any period of four consecutive fiscal quarters of Borrower, the ratio of (i) Consolidated EBIT for such period to (ii) Consolidated Interest Expense for such period. "Leverage Ratio" means, as of the last day of any fiscal quarter of Borrower, the ratio of (i) Consolidated Total Debt to (ii) Consolidated EBITDA. The Leverage Ratio shall be calculated based upon (a) for Consolidated Total Debt, Consolidated Total Debt as of the last day of each such fiscal quarter, and (b) for Consolidated EBITDA, the actual amount for the period of four consecutive fiscal quarters of Borrower ending on such day. "Consolidated EBIT" means, for any period of four consecutive fiscal quarters of Borrower, on a consolidated basis for Borrower and its Subsidiaries in accordance with Agreement Accounting Principles, the sum of the amounts for such period, without duplication, of (i) net income, plus (ii) interest expense plus (iii) income taxes. "Consolidated Interest Expense" means, for any period of four consecutive fiscal quarters of the Borrower, total interest expense (whether paid or accrued) of the Borrower and its Subsidiaries for such period determined in accordance with Agreement Accounting Principles. "Consolidated Total Debt" means the aggregate principal amount of all Indebtedness on a consolidated basis of Borrower and its Subsidiaries as of a referenced date. "Indebtedness" means, without duplication, (i) obligations for borrowed money, (ii) obligations representing the deferred purchase price of property or services (other than accounts payable or accrued expenses arising in the ordinary course of such person's business payable on terms customary in the trade), (iii) obligations, whether or not assumed, secured by liens on or specifically payable out of the proceeds or production from property now or hereafter owned or acquired by such person, (iv) Letter of Credit obligations and (v) obligations which are evidenced by notes, acceptances, or other instruments. "Consolidated EBITDA", means for any period of four consecutive fiscal quarters of Borrower, on a consolidated basis for Borrower and its Subsidiaries in accordance with Agreement Accounting Principles, the sum of the amounts for such period, without duplication, of (i) Consolidated EBIT, plus (ii) depreciation plus (iii) amortization expense.

INDEMNIFICATION. The Borrower agrees to indemnify and hold harmless Bank, its officers, employees, directors, and authorized agents ("Indemnified Persons") from and against any and all liabilities, losses, damages, penalties, or costs and expenses of any kind, including, without limitation, the reasonable fees and disbursements of counsel, which may be incurred by any of them in connection with any claim or investigative, administrative or judicial proceeding relating to or arising out of the Loan Documents, the Obligations or any actual or proposed use of proceeds of this Note; provided that no Indemnified Persons may recover hereunder any liabilities, losses, damages, penalties, or costs and expenses determined by a court of competent jurisdiction to have been caused by gross negligence or willful misconduct of such Indemnified Person. The foregoing indemnity obligation shall be an Obligation hereunder. The indemnity provided for herein shall survive payment of the Obligations.

WAIVERS AND AMENDMENTS. No waivers, amendments or modifications of this Note and other Loan Documents shall be valid unless in writing and signed by an officer of the party against which enforcement of the same is sought. No waiver by Bank of any Default shall operate as a waiver of any other Default or the same Default on a future occasion. Neither the failure nor any delay on the part of Bank in exercising any right, power, or remedy under this Note and other Loan Documents shall operate as a waiver thereof, nor shall a single or partial exercise thereof preclude any other or further exercise thereof or the exercise of any other right, power or remedy.

Each of Borrower and any other person liable under this Note (an "Obligor") waives presentment, protest, notice of dishonor, demand for payment, notice of intention to accelerate maturity, notice of acceleration of maturity, notice of sale and all other notices of any kind (except for notices expressly required by this Note or any of the other Loan Documents). Further, each Obligor other than Borrower agrees that Bank may extend, modify or renew this Note or make a novation of the loan evidenced by this Note for any period, and each Obligor agrees that Bank may grant any releases, compromises or indulgences with respect to any collateral securing this Note, or with respect to any other Obligor, all without notice to or consent of such Obligor and without affecting the liability of such Obligor.

MISCELLANEOUS PROVISIONS. **Assignment.** This Note and the other Loan Documents shall inure to the benefit of and be binding upon the parties and their respective successors and assigns. Bank's interests in and rights under this Note and the other Loan Documents are assignable, in whole or in part, by Bank only with the prior written consent of Borrower (which may not be unreasonably withheld), except that no such consent of Borrower shall be required at any time a Default has occurred and is continuing. Borrower shall not assign its rights and interest hereunder without the prior written consent of Bank, and any attempt by Borrower to assign without Bank's prior written consent is null and void. Any assignment shall not release Borrower from the Obligations. **Applicable Law.** This Note and, unless otherwise provided in any other Loan Document, the other Loan Documents shall be governed by and construed under the laws of the state named in Bank's address on the first page hereof without regard to that state's conflict of laws principles. **Jurisdiction.** Borrower irrevocably agrees to non-exclusive personal jurisdiction in the state named in Bank's address on the first page hereof. **Severability.** If any provision of this Note or of the other Loan Documents shall be prohibited or invalid under applicable law, such provision shall be ineffective but only to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Note or other such document. **Notices.** Any notices to Borrower shall be sufficiently given, if in writing and mailed or delivered to the Borrower's address shown above or such other address as provided hereunder, and to Bank, if in writing and mailed or delivered to Wachovia Bank, National Association, Mail Code 201 S. College Street, Charlotte,

NC 28244 or such other address as Bank may specify in writing from time to time. Written notices to Bank must include the mail code. Any notice permitted to be given to Bank telephonically shall be given by calling Crystal James (or such other individual as Bank may specify in writing from time to time) at (704) 715-9645 (or such other telephone number as Bank may specify in writing from time to time). In the event that Borrower changes Borrower's address at any time prior to the date the Obligations are paid in full, Borrower agrees to promptly give written notice of said change of address by registered or certified mail, return receipt requested, all charges prepaid. **Plural; Captions.** All references in the Loan Documents to nouns of reference mean both the singular and plural form, as the case may be, and the term "person" shall mean any individual, person or entity. The captions contained in the Loan Documents are inserted for convenience only and shall not affect the meaning or interpretation of the Loan Documents. **Advances.** Bank may, in its sole discretion, make other advances, which shall be deemed to be advances under this Note, even though the stated principal amount of this Note may be exceeded as a result thereof. **Posting of Payments.** All payments received during normal banking hours after 2:00 p.m. local time at the office of Bank first shown above shall be deemed received at the opening of the next banking day. **Fees and Taxes.** Borrower shall promptly pay all documentary, intangible recordation and/or similar taxes on this transaction whether assessed at closing or arising from time to time.

CONFIDENTIALITY. Bank agrees to keep confidential all non-public information provided to it by or on behalf of Borrower or any Subsidiary of Borrower pursuant to this Note or any of the other Loan Documents, and to limit its use of such information to the evaluation, administration and/or enforcement of this Note or any of the other Loan Documents; provided, however, that nothing herein shall prevent Bank from disclosing such information (i) to any actual or prospective assignee in connection with the contemplated assignment of Bank's interests in and rights under this Note so long as such actual or potential assignee has, prior to receiving any such information, agreed in writing to preserve the confidential nature thereof on terms no less restrictive than those contained in this Section, (ii) to its employees, directors, agents, attorneys, accountants and other professional advisors as need to know such information, (iii) in response to any order of any court or other governmental authority or as may otherwise be required by law, or (iv) in connection with the exercise by Bank of any remedy under this Note or any of the other Loan Documents.

ARBITRATION. Upon demand of any party hereto, whether made before or after institution of any judicial proceeding, any claim or controversy arising out of or relating to the Loan Documents between parties hereto (a "Dispute") shall be resolved by binding arbitration conducted under and governed by the Commercial Financial Disputes Arbitration Rules (the "Arbitration Rules") of the American Arbitration Association (the "AAA") and the Federal Arbitration Act. Disputes may include, without limitation, tort claims, counterclaims, a dispute as to whether a matter is subject to arbitration, claims brought as class actions, or claims arising from documents executed in the future. A judgment upon the award may be entered in any court having jurisdiction. Notwithstanding the foregoing, this arbitration provision does not apply to disputes under or related to swap agreements. **Special Rules.** All arbitration hearings shall be conducted in the city named in the address of Bank first stated above. A hearing shall begin within 90 days of demand for arbitration and all hearings shall conclude within 120 days of demand for arbitration. These time limitations may not be extended unless a party shows cause for extension and then for no more than a total of 60 days. The expedited procedures set forth in Rule 51 et seq. of the Arbitration Rules shall be applicable to claims of less than \$1,000,000.00. Arbitrators shall be licensed attorneys selected from the Commercial Financial Dispute Arbitration Panel of the AAA. The parties do not waive applicable Federal or state substantive law except as provided herein. **Preservation and Limitation of Remedies.** Notwithstanding the preceding binding arbitration provisions, the parties agree to preserve, without diminution, certain remedies that any party may exercise before or after an arbitration proceeding is brought. The parties shall have the right to proceed in any court of proper jurisdiction or by self-help to exercise or prosecute the following remedies, as applicable: (i) all rights to foreclose against any real or personal property or other security by exercising a power of sale or under applicable law by judicial foreclosure including a proceeding to confirm the sale; (ii) all rights of self-help including peaceful occupation of real property and collection of rents, set-off, and peaceful possession of personal property; (iii) obtaining provisional or ancillary remedies including injunctive relief, sequestration, garnishment, attachment, appointment of receiver and filing a voluntary or involuntary bankruptcy proceeding; and (iv) when applicable, a judgment by confession of judgment. Any claim or controversy with regard to any party's entitlement to such remedies is a Dispute. **Waiver of Exemplary Damages.** The parties agree that they shall not have a remedy of punitive or exemplary damages against other parties in any Dispute and hereby waive any right or claim to punitive or exemplary damages they have now or which may arise in the future in connection with any Dispute whether the Dispute is resolved by arbitration or judicially. **Waiver of Jury Trial.** THE PARTIES ACKNOWLEDGE THAT BY AGREEING TO BINDING ARBITRATION THEY HAVE IRREVOCABLY WAIVED ANY RIGHT THEY MAY HAVE TO JURY TRIAL WITH REGARD TO A DISPUTE.

IN WITNESS WHEREOF, Borrower, on the day and year first above written, has caused this Note to be executed under seal.

Graco Inc.
Taxpayer Identification Number: 41-0285640

By: /s/James A. Graner (SEAL)

Name: James A. Graner
Title: Chief Financial Officer

Agreed and Accepted as of the
day and year first above written:

Wachovia Bank, National Association

By: /s/C. Jeffrey Seaton

Name: C. Jeffrey Seaton
Title: Managing Director

OFFERING BASIS LOAN AGREEMENT

This Offering Basis Loan Agreement ("Agreement") is entered into on April 1, 2006, by and between Wachovia Bank, National Association ("Bank"), 301 South College Street, Charlotte, North Carolina 28288, and Graco, Inc. ("Borrower"). The Agreement expires on March 30, 2007.

In consideration of the mutual agreements contained herein, Bank may, in its sole and absolute discretion, make available to Borrower loan funds not to exceed an aggregate principal amount outstanding of \$25,000,000 upon the following terms and conditions:

Method of Borrowing. Each advance under this Agreement (the "Advance" and collectively, the "Advances") shall be offered to Borrower through its representative(s) by a duly authorized representative of the Bank, at a specific interest rate for a specific maturity. Requests for, offers of, and acceptance of Advances between Bank and Borrower may be made in writing (including facsimile transmission) or orally (including telephonic communication). All Advances shall be in immediately available funds. The terms of an offered Advance shall be open for acceptance by Borrower

for a period of one hour following notification to Borrower by Bank of such offering; and the offering shall be deemed withdrawn if not accepted within that time period. All terms offered with respect to the Advances shall be determined by Bank in its sole discretion.

Any Advance shall be conclusively presumed to have been made to, for the benefit of, and at the request of Borrower when: (a) (i) the Advance is deposited or credited to an account of Borrower with Bank, or with a financial institution instructed by Borrower, notwithstanding that such Advance was requested, orally or in writing, by someone other than a representative of Borrower, and (ii) any part of such Advance is withdrawn from the account; or (b) the Advance is made in accordance with oral or written instructions of a representative of Borrower.

Interest Rate. Each Advance shall bear interest at an "Offering Rate" which shall mean such interest rates and terms offered by Bank and accepted by Borrower. The term for Advances at the Offering Rate (the "Offering Interest Period") shall not exceed 90 days. Interest on Advances at an Offering Rate shall be payable upon the last day of the respective Offering Interest Period, and at such other time or times as may be agreed to by Bank and Borrower. Interest shall be computed on the basis of a 360 day year for the actual number of days in the interest period ("Actual/360 Computation"). Bank's Actual/360 computation determines the annual effective interest yield by taking the stated (nominal) interest rate for a year's period and then dividing said rate by 360 to determine the daily periodic rate to be applied for each day in the interest period.

Recordation of Advances. Bank will maintain records of the date, amount, maturity, payment schedule, and interest rate applicable to each Advance, the date and amount of any payment of principal or interest, and the principal balance then remaining unpaid. Borrower hereby agrees that the Advances so evidenced in such records shall, for all purposes, constitute prima facie evidence thereof and shall be binding upon Borrower.

Payment of Advances. Borrower promises to pay to the order of Bank at the office of Bank located at the address indicated above, or at such other place as Bank may designate in writing, the unpaid principal amount of each Advance made by Bank to Borrower, and accrued interest, on the maturity date of each respective Advance and on such other dates and terms as may be set forth in Bank's records. All payments shall be made in immediately available lawful money of the United States.

Posting of Payments. All payments received during normal banking hours after 2:00 P.M. Eastern time shall be deemed received at the opening of the next banking day. Payments received by Bank under this Agreement may be applied in any manner or order deemed appropriate by Bank.

Prepayments. In addition to principal, interest and any other amounts due, Borrower shall on demand pay to Bank any "Breakage Fee" due hereunder for any voluntary or mandatory prepayment or acceleration, in whole or in part, of principal occurring prior to the date such principal would, but for that prepayment or acceleration, have become due. For any date of prepayment or acceleration ("Break Date"), a Breakage Fee shall be due if the rate under "A" below exceeds the rate under "B" below and shall be determined as follows:

Breakage Fee = product of ((A-B) x C) for each installment of principal being prepaid, where:

- A = A rate equal to the sum of (i) the bond equivalent yield (bid side) of the U.S. Treasury security with a maturity closest to the Maturity Date as reported by The Wall Street Journal (or other published source) on the funding date, plus (ii) 1/2%.
- B = A rate equal to the bond equivalent yield (bid side) of the U.S. Treasury security with a maturity closest to the Maturity Date as reported by The Wall Street Journal (or other published source) on the Break Date.
- C = The principal installment amount being prepaid times (the number of days remaining until the scheduled due date for such installment divided by 360).

"Maturity Date" is the date on which the payment of principal would, but for any prepayment or acceleration, have become due.

Breakage Fees are payable as liquidated damages, are a reasonable pre-estimate of the losses, costs and expenses Bank would incur in the event of any prepayment or acceleration, are not a penalty, and will not require claim for, or proof of, actual damages. Bank's determination thereof shall be conclusive and binding in the absence of manifest error.

Any prepayment in whole or in part shall include accrued interest and all other sums then due with respect to such Advance. No partial prepayment shall affect the obligation of Borrower to make any payment of principal or interest due with respect to such Advance until such Advance has been paid in full.

Conditions Precedent. Any Advance which has been offered and accepted pursuant to this Agreement is subject to the following conditions precedent: (a) **Non-Default.** Borrower shall be in compliance with all of the terms and conditions set forth herein and an Event of Default as specified herein, or an event which upon notice or lapse of time or both would constitute such an Event of Default, shall not have occurred or be continuing at the time of such Advance. (b) **Borrowing Resolution.** Bank shall have received a certified resolution authorizing borrowings by Borrower under this Agreement. (c) **Financial Information and Documents.** Borrower shall deliver to Bank such information and documents as Bank may request from time to time, including without limitation, financial statements, information pertaining to Borrower's financial condition and additional supporting documents.

Events of Default. Notwithstanding the term of an Advance or Advances as set forth herein, if any of the following occur, an event of default ("Event of Default") shall exist: (a) **Nonpayment; Nonperformance.** Borrower fails to pay any amounts when due or fails to observe or perform any obligation or covenant, as required under this Agreement, or any other document furnished in connection herewith, or contained in any other agreement between Bank and Borrower. (b) **Default on Other Obligations** Occurrence of a Default or an event which, if not cured or but for the passage of time shall become a Default under the Promissory Note between Bank and Borrower dated April 1, 2006. (c) **Bankruptcy.** Borrower (i) files a petition as Debtor under the Bankruptcy Code or makes an assignment for the benefit of creditors, or (ii) becomes the object of insolvency proceedings or is named debtor in an involuntary petition under the Bankruptcy Code and such proceedings or such petition is not dismissed against Borrower within 45 days. (e) **Material Adverse Change.** The expiration of 5 days after Bank has given Borrower notice of Bank's good faith determination that a material adverse change in the financial condition of Borrower has occurred since the date of this Agreement.

Acceleration Upon Default. Upon any Event of Default, Bank may, at Bank's sole discretion and without notice, accelerate the maturity of all Advances and all other obligations of Borrower to Bank, and all such Advances and other obligations shall be immediately due and payable.

Default Rate. In addition to all other rights contained in this Agreement, upon the occurrence and during the continuance of an Event of Default, all outstanding Advances shall bear interest at their respective Offering Rates plus 2% ("Default Rate"). The Default Rate shall apply from the occurrence of an Event of Default until the Advances or any judgment thereon is paid in full.

Attorneys' Fees. Borrower shall pay all of Bank's reasonable expenses incurred to enforce or collect any of the Advances, including, without limitation, reasonable arbitration, attorneys' and experts' fees and expenses, whether incurred without the commencement of a suit, in any trial, arbitration, or administrative proceeding, or in any appellate or bankruptcy proceeding.

Usury. Anything contained herein to the contrary notwithstanding, if for any reason the effective rate of interest on any Advance should exceed the maximum lawful rate, the effective rate shall be deemed reduced to and shall be such maximum lawful rate, and (i) the amount which would be excessive interest shall be deemed applied to the reduction of the principal balance of the Advance and not to the payment of interest, and (ii) if the Advance has been or is thereby paid in full, the excess shall be returned to the party paying same, such application to the principal balance of the Advance or the refunding of the excess to be a complete settlement and acquittance thereof.

Waivers. Borrower hereby waives presentment, protest, notice of dishonor, demand for payment, notice of intention to accelerate maturity, notice of acceleration of maturity, notice of sale and all other notices of any kind whatsoever. Any failure by Bank to exercise any right hereunder shall not be construed as a waiver of the right to exercise the same or any other right at any time.

Amendment and Severability. No amendment to or modification of this Agreement shall be binding upon Bank or the Borrower unless in writing and signed by that party. If any provision of this Agreement shall be prohibited or invalid under applicable law, such provision shall be ineffective but only to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Agreement.

Miscellaneous. This Agreement is fully assignable by Bank and all rights of Bank thereunder shall inure to the benefit of its successors and assigns. This Agreement shall be binding upon Borrower and its successors and assigns. Borrower may only assign its rights or obligation hereunder with the written consent of Bank. The captions contained in this Agreement are inserted for convenience only and shall not affect the meaning or interpretation of the Agreement. This Agreement shall be governed by and interpreted in accordance with the laws of the state where Bank's office as shown herein is located, without regard to that state's conflict of laws principles.

ARBITRATION. Upon demand of any party hereto, whether made before or after institution of any judicial proceeding, any claim or controversy arising out of or relating to this Agreement between parties hereto (a "Dispute") shall be resolved by binding arbitration conducted under and governed by the Commercial Financial Disputes Arbitration Rules (the "Arbitration Rules") of the American Arbitration Association (the "AAA") and the Federal Arbitration Act. Disputes may include, without limitation, tort claims, counterclaims, a dispute as to whether a matter is subject to arbitration, claims brought as class actions, or claims arising from documents executed in the future that pertain to Advances. A judgment upon the award may be entered in any court having jurisdiction. Notwithstanding the foregoing, this arbitration provision does not apply to disputes under or related to swap agreements. **Special Rules.** All arbitration hearings shall be conducted in the city named in the address of Bank first stated above. A hearing shall begin within 90 days of demand for arbitration and all hearings shall conclude within 120 days of demand for arbitration. These time limitations may not be extended unless a party shows cause for extension and then for no more than a total of 60 days. The expedited procedures set forth in Rule 51 et seq. of the Arbitration Rules shall be applicable to claims of less than \$1,000,000.00. Arbitrators shall be licensed attorneys selected from the Commercial Financial Dispute Arbitration Panel of the AAA. The parties do not waive applicable Federal or state substantive law except as provided herein. **Preservation and Limitation of Remedies.** Notwithstanding the preceding binding arbitration provisions, the parties agree to preserve, without diminution, certain remedies that any party may exercise before or after an arbitration proceeding is brought. The parties shall have the right to proceed in any court of proper jurisdiction or by self-help to exercise or prosecute the following remedies, as applicable: (i) all rights to foreclose against any real or personal property or other security by exercising a power of sale or under applicable law by judicial foreclosure including a proceeding to confirm the sale; (ii) all rights of self-help including peaceful occupation of real property and collection of rents, set-off, and peaceful possession of personal property; (iii) obtaining provisional or ancillary remedies including injunctive relief, sequestration, garnishment, attachment, appointment of receiver and filing an involuntary bankruptcy proceeding; and (iv) when applicable, a judgment by confession of judgment. Any claim or controversy with regard to any party's entitlement to such remedies is a Dispute. **Waiver of Exemplary Damages.** The parties agree that they shall not have a remedy of punitive or exemplary damages against other parties in any Dispute and hereby waive any right or claim to punitive or exemplary damages they have now or which may arise in the future in connection with any Dispute whether the Dispute is resolved by arbitration or judicially. **Waiver of Jury Trial.** THE PARTIES ACKNOWLEDGE THAT BY AGREEING TO BINDING ARBITRATION THEY HAVE IRREVOCABLY WAIVED ANY RIGHT THEY MAY HAVE TO JURY TRIAL WITH REGARD TO A DISPUTE.

In Witness Whereof, the parties hereto have duly executed this Agreement as of the date stated above.

Graco Inc.
Taxpayer Identification Number: 41-0285640

By: /s/James A. Graner (SEAL)

Name: James A. Graner
Title: CFO

Wachovia Bank, National Association

By: /s/C. Jeffrey Seaton (SEAL)

Name: C. Jeffrey Seaton
Titel: Managing Director

CERTIFICATION

I, David A. Roberts, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 26, 2006

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

CERTIFICATION

I, James A. Graner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 26, 2006

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

CERTIFICATION UNDER SECTION 1350

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

Date: April 26, 2006

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

Date: April 26, 2006

By: /s/James A. Graner
James A. Graner
Chief Financial Officer and Treasurer