

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 26, 2008**, 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)
No.)

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

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

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 (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 o

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" and "accelerated filer" in Rule 12b-2 of the Exchange Act (Check one): Large accelerated filer ☒ Accelerated filer ___ Non-accelerated filer ___ Smaller reporting company ___

Indicate by 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 60,000,000 shares of common stock held by non-affiliates of the registrant was approximately \$2.3 billion as of June 27, 2008.

As of February 9, 2009, 59,545,500 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 24, 2009, are incorporated by reference into Part III, as specifically set forth in said Part III.

INDEX TO ANNUAL REPORT

ON FORM 10-K

	<u>Page</u>
Part I	
Item 1 Business	3
Item 1A Risk Factors	8
Item 1B Unresolved Staff Comments	9
Item 2 Properties	9
Item 3 Legal Proceedings	10
Item 4 Submission of Matters to a Vote of Security Holders	10
Executive Officers of Our Company	10
Part II	
Item 5 Market for the Company's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities	12
Item 6 Selected Financial Data	14
Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Item 7A Quantitative and Qualitative Disclosures About Market Risk	24
Item 8 Financial Statements and Supplementary Data	25
Management's Report on Internal Control Over Financial Reporting	26
Reports of Independent Registered Public Accounting Firm	27
Consolidated Statements of Earnings	29
Consolidated Statements of Comprehensive Income	29
Consolidated Balance Sheets	30
Consolidated Statements of Cash Flows	31
Consolidated Statements of Shareholders' Equity	32
Item 9 Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	48
Item 9A Controls and Procedures	48
Item 9B Other Information	48
Part III	
Item 10 Directors, Executive Officers and Corporate Governance	48
Item 11 Executive Compensation	49
Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	49
Item 13 Certain Relationships and Related Transactions, and Director Independence	49
Item 14 Principal Accounting Fees and Services	49
Part IV	
Item 15 Exhibits, Financial Statement Schedule	50
Index to Exhibits	53

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, other reports and amendments to those 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 reincorporated 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 55 percent of our Company’s total sales; sales in Europe approximately 29 percent; and sales in Asia Pacific approximately 16 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.”), Australia, 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, manufactured and distributed by our Company’s segments is broadly described as fluid handling equipment. It is used to pump, meter, mix, dispense, and spray a wide variety of fluids and semi-solids in a wide variety of applications in the 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 2008, we generated 26 percent of our sales from new products. In both 2007 and 2006, the percentage of sales represented by new products was 21 percent. Major product development efforts are carried out in facilities located in Minneapolis, Anoka 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, new applications for existing products, and strategic technologies for its specific customer base. Total product development expenditures for all segments were \$37 million in 2008 and \$30 million in both 2007 and 2006.

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 outlets, the penetration of developing markets and the successful completion of strategic 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. 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 the 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). GlasCraft® products were manufactured in a leased building (50,000 sq. ft. manufacturing/warehouse/office) in Indianapolis, Indiana until December 2008. The lease will expire at the end of January 2009. 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 (125,000 sq. ft. assembly/warehouse/office). During 2008, our Company announced that it would close its facility in Vilanova, Spain (7,280 sq. ft. warehouse/office) in February 2009. Products formerly distributed from this facility will be distributed from our warehouse in Maasmechelen, Belgium in the future. The mobile spray rig manufacturing and customer service functions were moved from Mississauga, Ontario to North Canton, Ohio in early 2008. The lease for the Mississauga facility expired at the end of June 2008. 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. A 50,000 sq. ft. warehouse addition to the Maasmechelen facility was completed in July 2008 and a training center is currently being constructed within the warehouse.

Products marketed by the Contractor segment are manufactured primarily 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 manufactures spray guns and accessories for the Contractor segment. Airlessco®-branded products are manufactured in a leased building (10,500 sq. ft. manufacturing/warehouse/office) in Moorpark, California. The lease term extends to December 31, 2010.

The Lubrication segment conducts its manufacturing operations in an owned facility located in Anoka, Minnesota (207,000 sq. ft. manufacturing/office). Management, marketing, engineering, customer service, warehouse, shipping, sales and training functions for the segment are also housed in this building. The lease for the facility in Madison, Wisconsin terminated at the end of January 2008 and the owned facility in Cleveland, Ohio (88,000 sq. ft. manufacturing/warehouse/office) was sold in May 2008. A limited line of Lubrication products is 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. Our Company did not acquire any real estate when it purchased the assets of Lubrication Scientific, Inc. in 2008.

During 2008, our Australian subsidiary entered into a third-party logistics arrangement with a global supplier to inventory, pick, pack and deliver Graco products to Australian distributors. Product shipments began in October. Operations, accounting, customer service and administrative staff are housed in a leased space (1462 sq. ft. office) in Melbourne, Australia.

Industrial Segment

The Industrial segment is the largest of our Company’s businesses and represents approximately 57 percent of our total sales. This segment includes the Industrial Products and the Applied Fluid Technologies divisions. While both divisions market their equipment and services to customers who manufacture, assemble, maintain, 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 then 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 product 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 (“Liquid Finishing”); equipment to move and dispense chemicals and liquid and semi-solid foods (“Process Pumps”); and equipment to refinish and repair automobiles (“Sharpe by Graco”).

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. Liquid finishing equipment is used in the automotive, automotive feeder, truck/bus/RV, military and utility vehicle, aerospace, farm and construction, wood and general metals industries.

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 process equipment is used in food and beverage, dairy, pharmaceutical, cosmetic, oil and gas, electronics, waste water, mining and ceramics applications.

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 protective coatings and foam (“Protective Coatings and Foam”); equipment to apply sealants and adhesives (“Sealants and Adhesives”); and equipment to create reaction injection molded polyurethane parts (“In-Plant Polyurethane”).

Our Company offers a full line of air-operated airless sprayers and plural component proportioning equipment to apply foam and protective coatings to a wide variety of surfaces. The Xtreme® air-operated airless sprayers apply tough protective coatings for use in harsh environmental conditions. These sprayers offer a de-icing feature, reduced noise and easy access to the integrated air controls. A DataTrak™ control that provides material usage information, system diagnostics and runaway control is available as an option. 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, supply pumps and applicators with accurate mix capability. The Reactor® line of plural component pumps is used to apply foam to insulate walls, water heaters, refrigeration, and hot tubs, create commercial roofing membranes and for packaging, architectural design and cavity filling as well as to apply polyurea to cover tanks, pipes, roofs, truck beds and foundations with protective coatings and linings where accurate temperatures and pressures are required to achieve optimal results. The Reactor systems are also available installed in mobile spray rigs that provide portability and accessibility to remote job sites. Spray foam is used in insulating buildings. In 2008 the Company introduced the Fusion® CS spray gun for use in the application of foam and polyurea insulation. Every time an operator pulls the trigger of this gun a “clear shot” of a non-reactive liquid dissolves foam build-up in the mix chamber. The Fusion CS is the first foam gun with a spray pattern that can be adjusted – from a narrow pattern to touch-up a small area to a wide pattern for a large swath of wall.

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, wind turbine and solar panel manufacturing and other industrial assembly operations. We work closely with major material manufacturers to identify and configure Graco equipment suitable for the handling of their materials.

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, potting, doming and gasketing other products. In July 2008, we introduced the Liquid Control PR70v, a variable ratio version of the PR70, the first meter, mix and dispense plural component system having Graco Control Architecture™ with built-in diagnostics. The PR70v has multiple levels of user interface providing more data to the end-user. The PR70 is used in potting, sealing, bonding, gasketing and syringe filling applications.

In-plant polyurethane processing 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 configuration of in-plant polyurethane systems for specific applications.

The Company has established an Application Development Laboratory in our North Canton, Ohio facility where we work with distributors, materials suppliers and end users to test new materials and reconfigure existing equipment for use in new applications.

Our Company acquired GlasCraft Inc., a subsidiary of Cohesant Technologies Inc., in late February 2008. GlasCraft developed the first system for the manufacture of composites over 40 years ago and is recognized worldwide as a leader in the composites market today. Fiberglass composites represent a new market for Graco. GlasCraft equipment meters, mixes and dispenses fiberglass materials into open and closed molds. This process is used to manufacture small and medium sized pleasure boats and watercraft, pools and spas, bathware, automotive and aircraft components and to prevent corrosion. This acquisition also enables Graco to broaden its offering of high-performance systems for the dispensing of polyurethane foam and polyurea coatings.

Our Company offers a wide variety of products for use in the wind energy market. From spraying protective foam and other coatings on wind turbine towers to the manufacture of rotor blades, from the automatic lubrication of bearings, gears, and generators to the evacuation and dispensing of oil, grease, anti-freeze and hydraulic fluids, we offer durable, reliable versatile fluid-handling systems for the manufacture and maintenance of wind power components. Our equipment is used worldwide by wind turbine manufacturers to supply a catalyzed plastic resin for the formation of the blades used on turbines and to apply an adhesive for cementing parts of the blades together. In 2008 our Application Development Lab developed the DC12, an application system for dispensing large volumes of high-viscosity adhesive for wind turbine blade, platform and root bonding applications. Two systems offered by recently acquired GlasCraft are used in the

manufacture and repair of rotor blades. The GlasCraft Gelcoat System sprays polyester and vinyl ester-based coatings in production and repair operations and the GlasCraft Resin Transfer Molding (“RTM”) System injects polyester and vinyl-ester resin into blade molds. Our Automatic Lubrication Systems dispense precise amounts of lubricant at specific intervals to critical bearings points in the wind turbine towers.

Contractor Segment

The Contractor segment generated approximately 32 percent of our Company’s 2008 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 and accessories are distributed globally through the home center channel.

Contractor equipment encompasses 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.

During 2008, there was a great deal of activity in the home center channel world-wide, including the introduction of a new line of upgraded entry-level sprayers, a private-label arrangement with a major equipment supplier in Europe, and a successful test program with a major home center chain in the United States.

A new line of sprayers for striping was introduced in 2008. The LineDriver™ and the LineDriver HD Ride-On Systems enable users to double their production by providing a motorized riding module to attach to their LineLasers. This system has an advanced vibration reduction system, a dual foot pedal for forward and reverse motion, a parking brake and a FlexBeam Break-A-Way Light to permit striping in low light conditions.

Also introduced in 2008 was the Nova™390 ProStep™, a rugged yet lightweight sprayer with an innovative snap on-snap off ProStep that provides the user with an extended reach. The Sherwin-Williams Company, with an extensive nation-wide network of paint stores, selected Graco as its exclusive supplier of entry-level paint sprayers in the fall of 2008. These sprayers, the Tradeworks™ series, offer a range of performance capabilities to support a variety of materials and frequency of use.

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. During 2008 sales teams were created in Europe and Asia Pacific focused exclusively on the development and servicing of distribution and application of contractor equipment in their geographies.

The Contractor segment made two asset acquisitions during 2008: the assets of the Hero-branded airless paint sprayer business from ICTC Holdings Corporation and the Airlessco spray painting assets of Durotech Co. The Company intends to convert Hero™ customers in the rental and paint sprayer business to Graco products. The Airlessco line of paint sprayers which the Company continues to manufacture in California, complement our sprayer and accessory offerings and give the Company entry into additional channels of distribution.

Lubrication Segment

The Lubrication segment represented approximately 11 percent of our Company’s sales during 2008. 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. Systems for the centralized and automatic lubrication of bearings, gears and transmissions are an example. In August 2008, the Company acquired the assets of Lubrication Scientifics, Inc. (“LubeSci™”), based in southern California. LubeSci manufactured and sold automated lubrication systems and components for use in a wide variety of industrial applications and offered an extended line of injectors and metering systems. The Company is integrating LubeSci’s products and customers into its Industrial Lubrication equipment business, a process it expects to be completed by the end of the first quarter of 2009.

The Lubriquip® product line, acquired in 2006, 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. The Lubrication segment is developing products for the wind power market, offering automatic lubrication systems for the lubrication of turbines on site and factory-based lubrication dispense equipment to transfer, unload and evacuate bulk oil and grease and meter and dispense various lubricants.

In 2007, our Company introduced the Dyna-Star 10:1, a high-ratio hydraulically-powered lubrication pump for use in automatic lubrication systems installed on heavy-duty construction and mining equipment, including front-end loaders, mining trucks, shovel fronts, bucket wheel extractors, crushers, ship loaders and sludge pumps. A new line of dispense meters was released in 2008. The LD series is designed for lighter duty lower-volume applications, the HD series for standard and heavier duty higher-volume applications. The Matrix® 3.0 Fluid Management System introduced in late 2008 uses wireless technology to dispense and monitor bulk tank supply of lubricating oils and anti-freeze at auto dealerships, fleet maintenance facilities, off-road maintenance shops and with industrial in-plant lubrication systems. The controls allow the operator to track the use of and control the amount of oil and anti-freeze being dispensed. The new Matrix has three platforms of operating software offering the full range of fluid management solutions to any size shop.

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. During 2008 sales teams were created in Europe and Asia Pacific focused exclusively on the development and servicing of lubrication distribution and applications in their geographies.

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 2008, our Company experienced significant volatility in the price of aluminum, stainless steel and copper and the commodities that contained these materials, from sizable price spikes at the beginning of the year to falling prices for some at the end. In addition, the price of oil in the first six months sparked a large increase in the cost of transportation. The price of steel remains high. Our Company endeavors to address fluctuations in the price and availability of various materials and components through adjustable surcharges and credits, 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.

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 26, 2008.

Employees

As of December 26, 2008, we employed approximately 2,400 persons on a full-time basis. Of this total, approximately 460 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

Economic Environment – Demand for our products depends on the level of commercial and industrial activity worldwide.

The current economic downturn and financial market turmoil has depressed demand for our equipment in all major geographies and in all major markets. If our distributors and OEMs remain unable to purchase our products because of unavailable credit or unfavorable credit terms or are simply unwilling to purchase our products, our net sales and earnings will be adversely affected.

Major Customers — Our Contractor 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.

Our Contractor segment derives 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 this 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.

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 are unable to obtain financing at a reasonable cost, are unsuccessful in acquiring and integrating businesses into our current business model, or do not realize projected efficiencies and cost-savings from the businesses we acquire, we may be unable to meet our growth or profit objectives.

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

In 2008, approximately 53 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 and fluctuations in the price of oil may impact the manufacturing costs of our products and affect our profitability.

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 2008 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.

Our Company’s facilities are in satisfactory condition, suitable for their respective uses and are generally adequate to meet current needs. During 2008, manufacturing capacity met and in the latter part of the year exceeded business demand. 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 2008.

Executive Officers of Our Company

The following are all the executive officers of Graco Inc. as of February 16, 2008:

Patrick J. McHale, 47, 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.

David M. Ahlers, 50, became Vice President, Human Resources in September 2008. Prior to joining Graco, Mr. Ahlers held various human resources positions, including, most recently, Chief Human Resources Officer and Senior Managing Director of GMAC Residential Capital, from August 2003 to August 2008. He joined the Company in September 2008.

Caroline M. Chambers, 44, 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, 52, 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, 64, 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.

Dale D. Johnson, 54, 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, 49, 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, 53, 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, 61, 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, 57, became Vice President of Manufacturing and Distribution Operations in September 2005. He served as Vice President, Manufacturing/Distribution Operations and Information Systems 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, 44, 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, 39, 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, Mark W. Sheahan and David M. Ahlers, the Board of Directors elected each of the above executive officers on April 21, 2006. 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; Mark W. Sheahan was elected Vice President and General Manager, Applied Fluid Technologies Division, effective February 15, 2008; and David M. Ahlers was appointed Vice President, Human Resources, effective September 22, 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 9, 2009, the share price was \$22.26 and there were 59,545,500 shares outstanding and 2,874 common shareholders of record, which includes nominees or broker dealers holding stock on behalf of an estimated 31,500 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, 2003, and all dividends were reinvested).



*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
2008				
Net sales	\$204,120	\$239,230	\$207,231	\$166,689
Gross profit	111,853	128,763	110,160	81,401
Net earnings	35,566	42,459	32,772	10,082
Per common share				
Basic net earnings	.58	.70	.55	.17
Diluted net earnings	.57	.69	.54	.17
Dividends declared	.19	.19	.19	.19
Stock price (per share)				
High	\$36.98	\$41.84	\$40.45	\$35.03
Low	32.37	36.88	34.48	17.67
Close ¹	36.26	38.07	35.61	23.73
Volume (# of shares)	33,416	30,260	39,776	52,431
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

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

Issuer Purchases of Equity Securities

On September 28, 2007, the Board of Directors authorized the Company to purchase up to 7,000,000 shares of its outstanding common stock. This authorization expires on September 30, 2009.

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 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 27, 2008 – Oct 24, 2008	15,000	\$33.02	15,000	3,068,234
Oct 25, 2008 – Nov 21, 2008	—	—	—	3,068,234
Nov 22, 2008 – Dec 26, 2008	—	—	—	3,068,234

Item 6. Selected Financial Data

Graco Inc. and Subsidiaries

(In thousands, except per share amounts)	2008	2007	2006	2005	2004
Net sales	\$817,270	\$841,339	\$816,468	\$731,702	\$605,032
Net earnings	120,879	152,836	149,766	125,854	108,681
Per common share					
Basic net earnings	\$ 2.01	\$ 2.35	\$ 2.21	\$ 1.83	\$ 1.57
Diluted net earnings	1.99	2.32	2.17	1.80	1.55
Total assets	\$579,850	\$536,724	\$511,603	\$445,630	\$371,714
Long-term debt (including current portion)	180,000	107,060	—	—	—
Cash dividends declared per common share	.75	.68	.60	.54	.41

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 Company’s consolidated results of operations, financial condition and liquidity. 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
- § Outlook

Overview

Our Company’s key strategies include offering new products, expanding distribution, opening new markets and completing strategic acquisitions. Long-term financial growth targets accompany these strategies, including 10 percent revenue growth and 12 percent net earnings growth.

Graco’s business is classified by management into three reportable segments, each responsible for product development, manufacturing, 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. Strategic manufacturing expertise is provided by our management team in Minneapolis, which is also 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, China and Australia. In 2007, Lubrication division manufacturing activities were consolidated in Anoka, Minnesota and in 2006, an assembly operation in Suzhou, China began production.

Results of Operations

(In millions, except per share amounts)	2008	2007	2006
Net Sales	\$817.3	\$841.3	\$816.5
Operating Earnings	187.4	232.5	226.0
Net Earnings	120.9	152.8	149.8
Diluted Net Earnings per Common Share	\$ 1.99	\$ 2.32	\$ 2.17

2008 Summary:

- § Sales decline of 3 percent as growth in Europe and Asia Pacific of 8 percent and 3 percent, respectively, did not offset declines in the Americas. Sales in the Industrial segment grew 4 percent worldwide, while sales in the Contactor and Lubrication segments declined by 13 percent and 3 percent, respectively, from the prior year.
- § Net sales increased by approximately \$12 million from favorable currency translation. Net earnings declined by 21 percent from the prior year. Currency translation increased net earnings by approximately \$4 million in 2008.
- § Incoming order rates declined substantially in the fourth quarter, affecting all segments and regions.
- § A workforce reduction affecting approximately 150 people or 6 percent of the global employee base was communicated in December 2008. Early retirement and severance costs were approximately \$5 million. The number of temporary and contract workers was reduced in earlier months.
- § Impairment charges of approximately \$4 million were recorded, primarily due to reduced expectations with respect to future sales of certain branded products within the Industrial segment.
- § Incremental costs associated with the programs to introduce a new entry-level sprayer in the Contractor segment to additional paint and home center outlets were approximately \$12 million. The programs are expected to provide future returns in the form of market share growth.
- § Three businesses were acquired in 2008: GlasCraft, Airlessco and LubeSci, increasing net sales by \$13 million or 2 percent.
- § Investment in product development grew to 4.5 percent of sales in 2008 from 3.6 percent of sales in 2007.
- § Positive cash flows from operations were \$162 million, down 8 percent as compared to the prior year.

2007 Summary:

- § Sales growth of 3 percent in 2007, with strong growth in Europe and Asia Pacific of 23 percent and 18 percent, respectively. Sales in the Americas decreased by 6 percent, primarily due to the weak housing and construction industries.
- § Sales were higher in the Industrial and Lubrication segments, with growth of 7 percent and 13 percent respectively, offset by a 4 percent decline in Contractor.
- § Net sales increased by approximately \$17 million from favorable currency translation.
- § Net earnings grew 2 percent. Currency translation increased net earnings by approximately \$7 million.
- § 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.
- § Increased cash flows from operations.

The following table presents net sales by geographic region.

(In millions)	2008	2007	2006
Geographic Sales			
Americas ¹	\$455.5	\$500.4	\$534.9
Europe ²	232.3	215.5	175.7
Asia Pacific	129.5	125.4	105.9
Total	\$817.3	\$841.3	\$816.5

¹North and South America, including the United States. Sales in the United States were \$384 million in 2008, \$434 million in 2007 and \$474 million in 2006.

²Europe, Africa and Middle East

Sales in the Americas declined by 9 percent overall and by 22 percent and 7 percent in the Contractor and Lubrication segments, respectively, in 2008 as compared to the prior year. Industrial sales increased by 3 percent in the Americas, primarily due to the Glascraft acquisition. Sales grew in Europe and Asia

Pacific in all three segments as a result of continued emphasis on expanding sales and marketing resources and focus on new distribution and acquisitions.

The following table presents components of net sales change:

2008								
				Asia				
	Industrial	Contractor	Lubrication	Consolidated	Americas	Europe	Pacific	Consolidated
Volume & price	0%	(15%)	(4%)	(6%)	(11%)	2%	1%	(6%)
Acquisitions	2%	1%	1%	2%	2%	1%	2%	2%
Currency	2%	1%	0%	1%	0%	5%	0%	1%
Total	4%	(13%)	(3%)	(3%)	(9%)	8%	3%	(3%)

2007								
				Asia				
	Industrial	Contractor	Lubrication	Consolidated	Americas	Europe	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%

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

	2008	2007	2006
Net Sales	100.0	100.0	100.0
Cost of products sold	47.1	46.8	46.8
Gross profit	52.9	53.2	53.2
Product development	4.5	3.6	3.7
Selling, marketing and distribution	17.0	14.8	14.6
General and administrative	8.5	7.2	7.2
Operating earnings	22.9	27.6	27.7
Interest expense	0.9	0.4	0.1
Other expense, net	0.1	0.0	0.1
Earnings before income taxes	21.9	27.2	27.5
Income taxes	7.1	9.0	9.2
Net Earnings	14.8	18.2	18.3

Operating expenses in 2008 were \$245 million compared to \$215 million in the prior year. The increase includes \$8 million related to the rollout of entry-level paint sprayers to additional paint and home center stores, \$7 million from acquired operations, \$4 million of impairment charges and \$3 million related to workforce reductions. During 2008, investment in new product development increased by \$6 million as compared to the prior year, to 4.5 percent of sales. Total operating expenses as a percentage of sales was 30 percent as compared to 26 percent in the prior year.

Operating expenses in 2007 were \$215 million versus \$208 million in 2006. 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 totaling \$2.3 million in 2007 related to the closure and move of the Lubriquip operations in Cleveland, Ohio and Madison, Wisconsin to the Anoka, Minnesota factory.

Consolidated operating earnings decreased 19 percent to \$187 million, or 23 percent of sales in fiscal 2008, with decrease in sales of 3 percent as compared to the prior year and increased expenses. Gross profit margin as a percentage of sales was slightly down from the prior year, as the unfavorable impact of material costs and volume were greater than the impact of favorable currency translation rates and manufacturing productivity improvements.

Consolidated operating earnings increased 3 percent to \$232 million, or 28 percent of sales in fiscal 2007, compared to \$226 million, or 28 percent of sales in fiscal 2006, reflecting 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.

Interest expense increased by \$4 million in 2008 and \$2.5 million in 2007 as the Company increased its utilization of credit lines for acquisitions and to purchase Company stock.

The Company's effective tax rate was 32 percent in 2008, lower than the effective tax rate of 33 percent in both 2007 and 2006. The rate 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)	2008	2007	2006
Segment Sales			
Industrial	\$462.9	\$444.7	\$416.5
Contractor	266.8	306.7	320.5
Lubrication	87.6	89.9	79.5
Consolidated	\$817.3	\$841.3	\$816.5
Segment Operating Earnings			
Industrial	\$138.2	\$152.3	\$128.5
Contractor	47.2	81.5	89.1
Lubrication	12.5	9.3	18.7
Unallocated corporate	(10.5)	(10.6)	(10.3)
Consolidated	\$187.4	\$232.5	\$226.0

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)	2008	2007	2006
Sales			
Americas	\$219.6	\$213.1	\$221.4
Europe	148.1	138.0	115.9
Asia Pacific	95.2	93.6	79.2
Total	\$462.9	\$444.7	\$416.5
Components of Net Sales Change			
Volume & Price	0%	4%	12%
Acquisitions	2%	0%	1%
Currency	2%	3%	1%
Total	4%	7%	14%
Operating Earnings as a Percentage of Sales	30%	34%	31%

In 2008, sales in the Industrial segment increased by 4 percent, with sales growth in all regions. Sales in the Americas increased 3 percent. Sales in Europe grew by 7 percent, including 5 percentage points related to favorable currency translation rates. The sales growth in Asia Pacific was 2 percent and the effect of currency translation rates was not significant.

In 2008, operating earnings in the Industrial segment declined 9 percent and were affected by impairment charges of \$4 million, selling and product development initiatives, costs and expenses resulting from acquisition and integration related activities, workforce reduction costs and unabsorbed manufacturing costs.

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 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, automobile production, building construction and the level of the U.S. dollar versus the euro, the Canadian dollar and various Asian currencies.

Contractor

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

(In millions)	2008	2007	2006
Sales			
Americas	\$165.0	\$210.9	\$244.0
Europe	76.8	71.0	55.3
Asia Pacific	25.0	24.8	21.2
Total	\$266.8	\$306.7	\$320.5
Components of Net Sales Change			
Volume & Price	(15%)	(6%)	4%
Acquisitions	1%	0%	0%
Currency	1%	2%	1%
Total	(13%)	(4%)	5%
Operating Earnings as a Percentage of Sales	18%	27%	28%

In 2008, sales in the Contractor segment decreased by 13 percent. While sales in the Americas decreased by 22 percent, sales in Europe and Asia Pacific grew by 8 percent and 1 percent, respectively. Sales in the Americas reflected sales 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 2008, operating earnings in the Contractor segment decreased by 42 percent. Approximately \$12 million of incremental cost and expense relates to the production and launch of new paint sprayer lines into existing and new paint store and home center outlets. Operating earnings were also affected by increased product development spending, costs of the workforce reduction, costs and lower profit levels of the acquired business and unabsorbed manufacturing costs.

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 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)	2008	2007	2006
Sales			
Americas	\$70.8	\$76.4	\$69.5
Europe	7.5	6.6	4.5
Asia Pacific	9.3	6.9	5.5
Total	\$87.6	\$89.9	\$79.5
Components of Net Sales Change			
Volume & Price	(4%)	(2%)	8%
Acquisitions	1%	14%	25%
Currency	0%	1%	1%
Total	(3%)	13%	34%
Operating Earnings as a Percentage of Sales			
	14%	10%	24%

In 2008, sales in the Lubrication segment decreased by 3 percent. Although sales in the Americas decreased by 7 percent, sales in Europe and Asia Pacific grew by 13 percent and 34 percent, respectively. Sales in the Americas reflected sales declines in the vehicle services product line. Sales growth in both Europe and Asia Pacific is attributed to additional sales and marketing resources, new distribution and growth in industrial lubrication products in Asia Pacific.

In 2008, operating earnings increased by 35 percent. Improvement in operating profitability is related to the integration and consolidation of Lubrication operations in Anoka, Minnesota in 2007. The Lubrication segment incurred costs in 2008 related to the workforce reduction, unabsorbed manufacturing costs and higher investment in new product development.

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 in 2007 than the prior year in new product development, marketing and warranty expense, partially due to the full year impact of the Lubriquip acquisition.

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)	2008	2007	2006
Unallocated corporate (expenses)	\$(10.5)	\$(10.6)	\$(10.3)

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 2008, unallocated corporate included \$9 million of stock compensation and \$2 million of contributions to the Company's charitable foundation.

In 2007, unallocated corporate included \$9 million of stock compensation and \$1 million of contributions to the Company's charitable foundation.

Financial Condition

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

(Dollars in millions)	2008	2007
Working capital	\$139.4	\$123.0
Current ratio	2.2	2.0
Days of sales in receivables outstanding	57	61
Inventory turnover (LIFO)	4.4	5.0

The Company's financial condition and cash flows from operations remain strong. Cash flows from operations totaled \$162 million in 2008. The primary uses of cash included capital expenditures of \$29 million, acquisitions of \$55 million, dividends of \$45 million and share repurchases of \$115 million. Accounts receivable decreased by \$13 million (9 percent) due mostly to lower sales in the fourth quarter compared to the same period in the prior year. Inventories increased \$17 million, including \$8 million from acquired operations and increases to support new distribution initiatives internationally.

In 2007, 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.

Capital Structure. At December 26, 2008, the Company's capital structure included current debt of \$18 million, long-term debt of \$180 million and shareholders' equity of \$168 million.

Shareholders' equity decreased by \$77 million in 2008. The key components of changes in shareholders' equity include current year earnings of \$121 million and common stock issued of \$14 million, reduced by \$45 million of dividends declared, \$112 million of shares repurchased and \$68 million of other

comprehensive loss (mostly from changes in the funded status of pension obligations).

Liquidity and Capital Resources. At December 26, 2008, the Company had various lines of credit totaling \$283 million, including a \$250 million, 5 year credit facility entered into in 2007. At year-end, long-term debt outstanding under this facility was \$180 million. The unused portion of committed credit lines was \$87 million at year-end. In addition, the Company has an unused, uncommitted line of credit for \$20 million. Internally generated funds and unused financing sources are expected to provide the Company with the flexibility to meet its liquidity needs in 2009, including its capital expenditure plan of approximately \$20 million, planned dividends (estimated at \$45 million) and acquisitions.

In December 2008, the Company's Board of Directors increased the Company's regular common dividend from an annual rate of \$0.74 to \$0.76 per share, a 3 percent increase.

Cash Flow

A summary of cash flow follows:

(In millions)	2008	2007	2006
Operating Activities	\$162	\$177	\$156
Investing Activities	(85)	(38)	(65)
Financing Activities	(71)	(138)	(103)
Effect of exchange rates on cash	1	(2)	(1)
Net cash provided (used)	\$ 7	\$ (1)	\$ (13)
Cash and cash equivalents at year-end	\$ 12	\$ 5	\$ 6

Cash Flows Provided by Operating Activities. During 2008, \$162 million was generated from operating cash flows, compared to \$177 million in 2007. Although net earnings decreased by \$32 million in 2008 as compared to the prior year, non-cash items such as depreciation and amortization, deferred income taxes and share-based compensation totaled \$42 million, an increase of \$10 million as compared to the prior year.

During 2007, \$177 million was generated from operating cash flows, compared to \$156 million in 2006. 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.

Cash Flows Used in Investing Activities. During 2008, cash was used to fund \$55 million for business acquisitions and \$29 million of additions to property, plant and equipment. 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.

Cash Flows Used in Financing Activities. During 2008, \$71 million was used in financing activities compared to \$138 million in 2007. Net borrowings on the long-term line of credit totaled \$73 million. Cash was used for share repurchases totaling \$115 million, a decrease of \$116 million from the prior year. Cash dividends paid totaled \$45 million, an increase of \$2 million from the prior year.

In September 2007, the Board of Directors authorized the Company to purchase up to 7 million shares of its outstanding stock, primarily through open-market transactions. This authorization will expire on September 30, 2009. Although the Company decided to suspend share repurchases early in the fourth quarter of 2008, 3 million shares remain available under the current board authorization and the Company may decide to resume share repurchases in the future.

Off-Balance Sheet Arrangements and Contractual Obligations. As of December 26, 2008, 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 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 26, 2008. The Company has also guaranteed the debt of its subsidiaries for up to \$7 million. All debt of subsidiaries is reflected in the consolidated balance sheets.

The total liability for uncertain tax positions under FIN 48 at December 26, 2008 was approximately \$2 million. The Company is not able to reasonably estimate the timing of future payments relating to non-current unrecognized tax benefits.

(In millions)	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt	\$ 180	\$ —	\$ —	\$ 180	\$ —
Capital lease obligations	—	—	—	—	—
Operating leases	7	3	2	1	1
Purchase obligations ¹	35	35	—	—	—
Interest on long-term debt	14	4	8	2	—
Fixed rate payments on interest swap	8	4	4	—	—
Unfunded pension and postretirement medical benefits ²	29	3	6	5	15
Total	\$ 273	\$ 49	\$ 20	\$ 188	\$ 16

¹ The Company is committed to pay suppliers under the terms of open purchase orders issued in the normal course of business. 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.

² The amounts and timing of future Company contributions to the funded qualified defined benefit pension plan are unknown because they are dependent on pension fund asset performance. The Company expects that no contribution to the funded pension plan will be required in 2009.

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 from distributors. The written agreements with distributors typically limit the amount that may be returned. In its arrangements with certain home center customers, the Company may agree to accept returns from the retailer’s end-user customers. The amount of the allowance for sales returns 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.

From time to time, the Company may choose to terminate a distributor relationship and may take back inventory or may promote the sale of new products by agreeing to accept returns of superseded products. These are considered period events and are 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 products 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. The Company reduced its investment return assumption by one-half percentage point, to 8.5 percent for 2009. Mortality rates are based on a common group mortality table for males and females.

Net pension credit in 2008 was \$0.7 million and was allocated to cost of products sold and operating expenses based on salaries and wages. At December 26, 2008, a one-half percentage point decrease in the indicated assumptions would have the following effects (in millions):

Assumption	Funded Status	Expense
Discount rate	\$ (14.9)	\$ 0.5
Expected return on assets	\$ —	\$ 1.1

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. SFAS No. 157 was effective for the Company starting in fiscal 2008 for financial assets and liabilities. The impact of the initial adoption of SFAS No. 157 in 2008 had no impact on the consolidated financial statements. With respect to non-financial assets and liabilities, the statement is effective for the Company starting in fiscal 2009. The Company expects the adoption of this statement as it pertains to non-financial assets and liabilities will not have a significant impact on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities.” This statement expands disclosures but does not change accounting for derivative instruments and hedging activities. The statement is effective for the Company starting in fiscal 2009.

SFAS No. 141 (revised 2007), “Business Combinations,” is effective for acquisitions completed by the Company after fiscal 2008, and had no impact on the 2008 consolidated financial statements. This statement retains the fundamental requirements in SFAS No. 141 that the acquisition method (purchase method) of accounting be used for all business combinations. It provides new guidance for valuation of acquisitions and accounting for such items as transaction costs, contingent consideration, contingent liabilities and in-process R&D.

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 26, 2008, the currencies to which the Company had the most significant balance sheet exchange rate exposure were the euro, Canadian dollar, British pound and various Asian currencies. 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 2007 results, the weaker U.S. dollar versus other currencies helped to increase sales and net earnings. For the year ended December 26, 2008, the impact of currency translation resulted in a calculated increase in net sales and net earnings of approximately \$12 million and \$4 million, respectively. For the year ended December 28, 2007, the calculated impact of currency translation resulted in an increase in net sales and net earnings of approximately \$17 million and \$7 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.

2009 Outlook

Management believes that economic conditions will present a challenging operating environment in the coming year. We will continue to manage capital expenditures, headcount and discretionary expenses closely. As a result of increased investment in new product development, significant new products/platforms are expected to be launched in 2009. Sales and marketing resources in Europe and Asia Pacific increased in 2008. We will continue to expand distribution coverage around the world in the coming year. The Company will continue to look for opportunities to acquire businesses where there is a strategic product or customer fit. An \$18 million increase in pension cost and less favorable currency translation are expected in 2009. 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 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.

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, as well as 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 undertakes no obligation to update these statements in light of new information or future events.

The Company desires to take advantage of the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995 by making cautionary statements concerning any forward-looking statements made by or on behalf of the Company. The Company cannot give any assurance that the results forecasted in any forward-looking statement will actually be achieved. Future results could differ materially from those expressed, due to the impact of changes in various factors. These risk factors include, but are not limited to: economic conditions in the United States and other major world economies, currency fluctuations, political instability, changes in laws and regulations, and changes in product demand. Please refer to Item 1A of, and Exhibit 99 to, this Annual Report on Form 10-K for fiscal year 2008 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

	<u>Page</u>
• Selected Quarterly Financial Data (See Part II, Item 5, Market for the Company's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities)	12
• Management’s Report on Internal Control Over Financial Reporting	26
• Reports of Independent Registered Public Accounting Firm	27
• Consolidated Statements of Earnings for fiscal years 2008, 2007 and 2006	29
• Consolidated Statements of Comprehensive Income for fiscal years 2008, 2007 and 2006	29
• Consolidated Balance Sheets for fiscal years 2008 and 2007	30
• Consolidated Statements of Cash Flows for fiscal years 2008, 2007 and 2006	31
• Consolidated Statements of Shareholders’ Equity for fiscal years 2008, 2007 and 2006	32
• Notes to Consolidated Financial Statements	33

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 26, 2008. 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 26, 2008.

The Company’s independent auditors have issued an attestation report on 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 26, 2008, 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 26, 2008, 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 scheduleas of and for the year ended December 26, 2008, of the Company and our report dated February 16, 2009 expressed an unqualified opinion on those financial statements and financial statement schedule.

DELOITTE & TOUCHE LLP

Minneapolis, Minnesota
February 16, 2009

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 26, 2008 and December 28, 2007, and the related consolidated statements of earnings, comprehensive income, shareholders’ equity, and cash flows for each of the three years in the period ended December 26, 2008. 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 26, 2008 and December 28, 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 26, 2008, 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.

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 26, 2008, 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 16, 2009 expressed an unqualified opinion on the Company’s internal control over financial reporting.

DELOITTE & TOUCHE LLP

Minneapolis, Minnesota
February 16, 2009

CONSOLIDATED STATEMENTS OF EARNINGS

Graco Inc. and Subsidiaries

	Years Ended		
(In thousands, except per share amounts)	December 26, 2008	December 28, 2007	December 29, 2006
Net Sales	\$817,270	\$841,339	\$816,468

Cost of products sold	385,093	393,913	382,511
Gross Profit	432,177	447,426	433,957
Product development	36,558	30,277	29,970
Selling, marketing and distribution	138,665	124,508	119,122
General and administrative	69,589	60,161	58,866
Operating Earnings	187,365	232,480	225,999
Interest expense	7,633	3,433	946
Other expense, net	1,153	211	687
Earnings before Income Taxes	178,579	228,836	224,366
Income taxes	57,700	76,000	74,600
Net Earnings	\$120,879	\$152,836	\$149,766
Basic Net Earnings per Common Share	\$ 2.01	\$ 2.35	\$ 2.21
Diluted Net Earnings per Common Share	\$ 1.99	\$ 2.32	\$ 2.17
Dividends Declared per Common Share	\$.75	\$.68	\$.60

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME Graco Inc. and Subsidiaries

(In thousands)	Years Ended		
	December 26, 2008	December 28, 2007	December 29, 2006
Net Earnings	\$120,879	\$152,836	\$149,766
Other comprehensive income (loss)			
Cumulative translation adjustment	(1,105)	108	2,693
Pension and postretirement medical liability adjustment	(102,741)	(875)	115
Gain (loss) on interest rate hedge contracts	(3,236)	(1,700)	—
Income taxes	39,290	895	(3)
Other comprehensive income (loss)	(67,792)	(1,572)	2,805
Comprehensive Income	\$ 53,087	\$151,264	\$152,571

See Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS Graco Inc. and Subsidiaries

(In thousands, except share and per share amounts)	December 26, 2008	December 28, 2007
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 12,119	\$ 4,922
Accounts receivable, less allowances of \$6,600 and \$6,500	127,505	140,489
Inventories	91,604	74,737
Deferred income taxes	23,007	21,650
Other current assets	6,360	7,034
Total current assets	260,595	248,832
Property, Plant and Equipment, net	149,754	140,594
Prepaid Pension	—	31,823
Goodwill	91,740	67,204
Other Intangible Assets, net	52,231	41,889
Deferred Income Taxes	18,919	—
Other Assets	6,611	6,382
Total Assets	\$579,850	\$536,724
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Notes payable to banks	\$ 18,311	\$ 18,991
Trade accounts payable	18,834	27,379
Salaries, wages and commissions	17,179	20,470
Dividends payable	11,312	11,476
Other current liabilities	55,524	47,561
Total current liabilities	121,160	125,877
Long-Term Debt	180,000	107,060
Retirement Benefits and Deferred Compensation	108,656	40,639
Uncertain Tax Positions	2,400	5,400

Deferred Income Taxes	—	13,074
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Commitments and Contingencies (Note K)

Shareholders' Equity

Common stock, \$1 par value; 97,000,000 shares authorized; 59,516,201 and 61,963,962 shares outstanding in 2008 and 2007	59,516	61,964
Additional paid-in capital	174,161	156,420
Retained earnings	8,445	32,986
Accumulated other comprehensive income (loss)	(74,488)	(6,696)
Total shareholders' equity	167,634	244,674
Total Liabilities and Shareholders' Equity	\$579,850	\$536,724

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Graco Inc. and Subsidiaries

(In thousands)	Years Ended		
	December 26, 2008	December 28, 2007	December 29, 2006
Cash Flows from Operating Activities			
Net earnings	\$120,879	\$152,836	\$149,766
Adjustments to reconcile net earnings to net cash provided by operating activities			
Depreciation, amortization and impairment	35,495	28,665	26,046
Deferred income taxes	(160)	(1,590)	(6,597)
Share-based compensation	9,051	8,583	8,392
Excess tax benefit related to share-based payment arrangements	(2,873)	(4,508)	(2,857)
Change in			
Accounts receivable	14,965	(1,844)	(3,584)
Inventories	(9,937)	2,045	(15,587)
Trade accounts payable	(6,806)	(2,314)	(74)
Salaries, wages and commissions	(3,169)	(6,527)	1,917
Retirement benefits and deferred compensation	(2,672)	(2,290)	(12)
Other accrued liabilities	5,658	4,666	(2,302)
Other	2,047	(625)	521
Net cash provided by operating activities	162,478	177,097	155,629
Cash Flows from Investing Activities			
Property, plant and equipment additions	(29,102)	(36,869)	(33,652)
Proceeds from sale of property, plant and equipment	1,768	296	128
Investment in life insurance	(1,499)	(1,499)	—
Capitalized software and other intangible asset additions	(1,327)	(85)	(202)
Acquisitions of businesses, net of cash acquired	(55,186)	—	(30,676)
Net cash used in investing activities	(85,346)	(38,157)	(64,402)
Cash Flows from Financing Activities			
Net borrowings (payments) on short-term lines of credit	(1,329)	(312)	9,593
Borrowings on long-term line of credit	242,849	158,351	—
Payments on long-term line of credit	(169,909)	(51,295)	—
Excess tax benefit related to share-based payment arrangements	2,873	4,508	2,857
Common stock issued	13,701	24,055	12,008
Common stock retired	(114,836)	(230,412)	(87,570)
Cash dividends paid	(44,702)	(43,188)	(39,429)
Net cash used in financing activities	(71,353)	(138,293)	(102,541)
Effect of exchange rate changes on cash	1,418	(1,596)	(1,479)
Net increase (decrease) in cash and cash equivalents	7,197	(949)	(12,793)
Cash and cash equivalents			
Beginning of year	4,922	5,871	18,664
End of year	\$ 12,119	\$ 4,922	\$ 5,871

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Graco Inc. and Subsidiaries

(In thousands)	Years Ended		
	December 26, 2008	December 28, 2007	December 29, 2006
Common Stock			
Balance, beginning of year	\$ 61,964	\$ 66,805	\$ 68,387

Shares issued	645	1,077	539
Shares repurchased	(3,093)	(5,918)	(2,121)
Balance, end of year	59,516	61,964	66,805
Additional Paid-In Capital			
Balance, beginning of year	156,420	130,621	110,842
Shares issued	13,056	24,093	11,469
Stock compensation cost	9,051	8,583	8,392
Tax benefit related to stock options exercised	3,473	5,808	3,357
Restricted stock cancelled (issued)	254	(1,115)	—
Shares repurchased	(8,093)	(11,570)	(3,439)
Balance, end of year	174,161	156,420	130,621
Retained Earnings			
Balance, beginning of year	32,986	138,702	112,506
Net income	120,879	152,836	149,766
Dividends declared	(44,539)	(43,609)	(40,554)
Shares repurchased	(100,881)	(214,943)	(83,016)
Balance, end of year	8,445	32,986	138,702
Accumulated Other Comprehensive Income (Loss)			
Balance, beginning of year	(6,696)	(5,124)	(4,051)
Other comprehensive income (loss)	(67,792)	(1,572)	2,805
Adjustments to initially apply new accounting standard, net of tax	—	—	(3,878)
Balance, end of year	(74,488)	(6,696)	(5,124)
Total Shareholders' Equity	\$167,634	\$244,674	\$331,004

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Graco Inc. and Subsidiaries

Years Ended December 26, 2008, December 28, 2007 and December 29, 2006

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 26, 2008, December 28, 2007 and December 29, 2006, 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 26, 2008, 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)	2008	2007
Prepaid income taxes	\$4,534	\$4,936
Prepaid expenses and other	1,826	2,098
Total	\$6,360	\$7,034

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	lesser of 5 to 10 years or life of equipment
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)	2008	2007
Industrial	\$59,511	\$42,221

Contractor	12,732	7,939
Lubrication	19,497	17,044
Total	\$91,740	\$67,204

Components of other intangible assets were:

(Dollars in thousands)	Estimated Life (Years)	Cost	Accumulated Amortization	Foreign Currency Translation	Book Value
December 26, 2008					
Customer relationships	3 – 8	\$41,075	\$(12,470)	\$(181)	\$28,424
Patents, proprietary technology and product documentation	3 – 15	23,780	(11,290)	(87)	12,403
Trademarks, trade names and other	3 – 10	5,514	(3,908)	(12)	1,594
		70,369	(27,668)	(280)	42,421
Not Subject to Amortization					
Brand names		9,810	—	—	9,810
Total		\$80,179	\$(27,668)	\$(280)	\$52,231

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		10,160	—	—	10,160
Total		\$63,189	\$(21,367)	\$ 67	\$41,889

Amortization of intangibles was \$10.5 million in 2008 and \$8.5 million in 2007. Estimated future annual amortization is as follows: \$10.7 million in 2009, \$9.7 million in 2010, \$8.6 million in 2011, \$7.7 million in 2012 and \$5.7 million thereafter.

The Company recorded impairment charges totaling \$3.6 million in the fourth quarter of 2008, primarily due to reduced expectations with respect to future sales of certain branded products within the industrial segment. The impairment charges are reflected above as reductions of cost, reducing brand names by \$3.1 million, customer relationships by \$0.3 million and proprietary technology by \$0.2 million.

Other Assets. Components of other assets were:

(In thousands)	2008	2007
Cash surrender value of life insurance	\$2,678	\$1,450
Assets held for sale	—	1,138
Capitalized software	1,436	1,019
Deposits and other	2,497	2,775
Total	\$6,611	\$6,382

The Company paid \$1.5 million in 2008 and \$1.5 million in 2007 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 2008 and 2007.

Operations in Cleveland, Ohio were moved to new facilities in Anoka, Minnesota in 2007. The property that formerly housed those operations was classified in other assets at estimated market value in 2007 and was sold in 2008.

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

Impairment 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. Except for the impairment of certain intangibles noted above, 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)	2008	2007
Accrued self-insured retentions	\$7,896	\$7,842
Accrued warranty and service liabilities	8,033	7,084
Accrued trade promotions	9,001	6,480
Payable for employee stock purchases	5,473	5,829
Income taxes payable	904	678
Other	24,217	19,648
Total	\$55,524	\$47,561

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)	2008	2007
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Balance, beginning of year	\$ 7,084	\$ 6,675
Charged to expense	6,793	6,053
Margin on parts sales reversed	3,698	3,186
Reductions for claims settled	(9,542)	(8,830)
Balance, end of year	\$ 8,033	\$ 7,084

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 with terms requiring recognition 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 shipping 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. From time to time, the Company may promote the sale of new products by agreeing to accept returns of superseded products. In such cases, provisions for estimated returns are recorded as a reduction of net sales.

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, coupons and reimbursement for competitive products. 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.

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.

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 cash flow hedges against interest rate volatility. Consequently, changes in the fair market value are recorded in accumulated other comprehensive income (loss). Net payments under terms of the contracts were charged to interest expense and totaled \$0.9 million in 2008.

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 uses significant other observable inputs to value the derivative instruments used to hedge interest rate volatility and net monetary positions. The fair market value and balance sheet classification of such instruments follows:

(In thousands)	2008	2007
Gain (loss) on interest rate hedge contracts, other current liabilities	\$(4,936)	\$(1,700)
Gain (loss) on foreign currency forward contracts, accounts receivable	1,198	(282)
Total	\$(3,738)	\$(1,982)

The Company may periodically hedge other 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 2008, 2007 and 2006, and there were no such transactions outstanding as of December 26, 2008, and December 28, 2007.

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 value measurements. SFAS No. 157 was effective for the Company starting in fiscal 2008 with respect to financial assets and liabilities. The impact of the initial adoption of SFAS No. 157 in 2008 had no impact on the consolidated financial statements. With respect to non-financial assets and liabilities, the statement is effective for the Company starting in fiscal 2009. The Company expects the adoption of this statement as it pertains to non-financial assets and liabilities will not have a significant impact on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities." This statement expands disclosures but does not change accounting for derivative instruments and hedging activities. The statement is effective for the Company starting in fiscal 2009.

SFAS No. 141 (revised 2007), "Business Combinations," is effective for acquisitions completed by the Company after fiscal 2008, and had no impact on the 2008 consolidated financial statements. This statement retains the fundamental requirements in SFAS No. 141 that the acquisition method (purchase method) of

accounting be used for all business combinations. It provides new guidance for valuation of acquisitions and accounting for such items as transaction costs, contingent consideration, contingent liabilities and in-process R&D.

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 development, manufacturing, marketing and sales of their products. This allows for focused marketing and efficient product development. The segments share common purchasing, certain manufacturing, distribution and administration functions.

(In thousands)			
Reportable Segments	2008	2007	2006
Net sales			
Industrial	\$462,941	\$444,725	\$416,498
Contractor	266,772	306,703	320,476
Lubrication	87,557	89,911	79,494
Total	\$817,270	\$841,339	\$816,468
Operating earnings			
Industrial	\$138,240	\$152,278	\$128,460
Contractor	47,156	81,528	89,064
Lubrication	12,475	9,252	18,744
Unallocated corporate (expense)	(10,506)	(10,578)	(10,269)
Total	\$187,365	\$232,480	\$225,999

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	2008	2007	2006
Net sales (based on customer location)			
United States	\$384,221	\$434,012	\$474,366
Other countries	433,049	407,327	342,102
Total	\$817,270	\$841,339	\$816,468
Long-lived assets			
United States	\$295,860	\$266,722	\$240,341
Other countries	23,395	21,170	32,279
Total	\$319,255	\$287,892	\$272,620

Sales to Major Customers

There were no customers that accounted for 10 percent or more of consolidated sales in 2008 and 2007. Sales to a paint retailer were 10 percent of consolidated sales in 2006.

C. Inventories

Major components of inventories were as follows:

(In thousands)	2008	2007
Finished products and components	\$ 50,703	\$ 46,677
Products and components in various stages of completion	24,938	24,805
Raw materials and purchased components	51,348	37,311
	126,989	108,793
Reduction to LIFO cost	(35,385)	(34,056)
Total	\$ 91,604	\$ 74,737

Inventories valued under the LIFO method were \$58.1 million for 2008 and \$46.6 million for 2007. All other inventory was valued on the FIFO method.

Certain inventory quantities were reduced in 2007, 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)	2008	2007
Land and improvements	\$ 10,303	\$ 10,066
Buildings and improvements	101,445	92,145
Manufacturing equipment	177,044	166,869
Office, warehouse and automotive equipment	31,619	30,580
Additions in progress	6,318	6,413

Total property, plant and equipment	326,729	306,073
Accumulated depreciation	(176,975)	(165,479)
Net property, plant and equipment	\$149,754	\$140,594

Depreciation expense was \$20.9 million in 2008, \$19.5 million in 2007 and \$18.2 million in 2006.

E. Income Taxes

Earnings before income tax expense consist of:

(In thousands)	2008	2007	2006
Domestic	\$159,972	\$203,795	\$197,410
Foreign	18,607	25,041	26,956
Total	\$178,579	\$228,836	\$224,366

Income tax expense consists of:

(In thousands)	2008	2007	2006
Current			
Domestic			
Federal	\$50,483	\$67,255	\$65,652
State and local	2,300	4,600	4,520
Foreign	4,741	6,023	7,206
	57,524	77,878	77,378
Deferred			
Domestic	(436)	(1,874)	(2,611)
Foreign	612	(4)	(167)
	176	(1,878)	(2,778)
Total	\$57,700	\$76,000	\$74,600

Income taxes paid were \$55.8 million, \$74.6 million and \$77.6 million in 2008, 2007 and 2006.

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

	2008	2007	2006
Statutory tax rate	35%	35%	35%
Earnings from non-U.S. sales at lower tax rates	(1)	(1)	(2)
State taxes, net of federal effect	1	2	2
U.S. general business tax credits	(1)	(1)	(1)
Domestic production deduction	(2)	(2)	(1)
Effective tax rate	32%	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)	2008	2007
Inventory valuations	\$ 8,723	\$ 8,986
Self-insurance retention accruals	2,356	2,298
Warranty reserves	2,628	2,331
Vacation accruals	2,036	1,917
Bad debt reserves	1,858	1,888
Stock compensation	2,000	2,000
Interest rate swaps	1,827	—
Other	1,579	2,230
Current	23,007	21,650
Unremitted earnings of consolidated foreign subsidiaries	(1,900)	(1,800)
Excess of tax over book depreciation	(22,307)	(14,483)
Pension liability (asset)	29,751	(8,415)
Postretirement medical	7,932	7,462
Stock compensation	3,864	1,862
Deferred compensation	806	1,965
Other	773	335
Non-current	18,919	(13,074)
Net deferred tax assets	\$41,926	\$ 8,576

Total deferred tax assets were \$78.6 million and \$36.8 million, and total deferred tax liabilities were \$36.7 million and \$28.2 million on December 26, 2008, and December 28, 2007.

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 2002. The Internal Revenue Service (IRS) completed the examination of the Company's U.S. income tax returns for 2004 and 2005 in the first quarter of 2008. Resolution of the audit did not result in a material change to the Company's financial position.

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

(In thousands)	2008	2007
Unrecognized tax benefits beginning balance	\$4,700	\$4,900
Gross Increases – current period tax positions	700	800
Settlements	(1,100)	—
Lapse of statute of limitations	(2,300)	(1,000)

Unrecognized tax benefits ending balance	\$2,000	\$4,700
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At the end of 2008, the Company's liability for uncertain tax positions was \$2.4 million, including \$ 0.4 million of interest and penalties. Unrecognized tax benefits of \$2.0 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 \$0.5 to \$1 million in the next twelve months pursuant to the following events: expiring statute of limitations 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, 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 weighted average interest rate on borrowings against the credit facility was 2.3 percent as of December 26, 2008. 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 26, 2008, the Company had \$283 million in lines of credit, including the \$250 million in committed credit facilities described above and \$33 million with foreign banks. The unused portion of committed credit lines was \$87 million as of December 26, 2008. In addition, the Company has an unused, uncommitted line of credit for \$20 million. 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 3.9 percent, 5.3 percent and 5.2 percent for the years ended December 26, 2008, December 28, 2007 and December 29, 2006. 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 has received from its lenders a waiver with respect to compliance with certain aspects of a covenant requiring minimum pension funding levels. The Company is in compliance with all other financial covenants of its debt agreements.

Interest paid on debt during 2008, 2007 and 2006 was \$8.1 million, \$2.6 million and \$0.9 million.

G. Shareholders' Equity

At December 26, 2008, 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)	2008	2007
Pension and postretirement medical liability adjustment	\$(70,322)	\$(5,672)
Gain (loss) on hedge contracts	(3,109)	(1,072)
Cumulative translation adjustment	(1,057)	48
Total	\$(74,488)	\$(6,696)

H. Share-Based Awards, Purchase Plans and Compensation Cost

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 charged to operations over the vesting period. Compensation cost charged to operations for restricted share awards was \$280,000 in 2008 and \$31,000 in 2007. 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 10,228 shares in 2008, 10,338 shares in 2007 and 10,955 shares in 2006. 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 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
Granted	819	35.56		
Exercised	(419)	16.60		
Canceled	(224)	38.81		
Outstanding, December 26, 2008	3,955	\$30.77	2,186	\$24.98

The following table summarizes information for options outstanding and exercisable at December 26, 2008 (in thousands, except per share and contractual term amounts):

The aggregate intrinsic value of exercisable option shares was \$8.6 million as of December 26, 2008, with a weighted average contractual term of 4.2 years. There were approximately 3.9 million vested share options and share options expected to vest as of December 26, 2008, with an aggregate intrinsic value of \$8.6 million, a weighted average exercise price of \$30.71 and a weighted average contractual term of 6.1 years.

Information related to options exercised follows:

(In thousands)	2008	2007	2006
Cash received	\$6,950	\$16,688	\$4,889
Aggregate intrinsic value	8,734	17,465	8,851
Tax benefit realized	3,100	6,500	3,200

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 216,047 shares under this Plan in 2008, 202,096 shares in 2007 and 204,478 shares in 2006.

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 26, 2008
Stock Incentive Plan (2006)	7,375	3,228
Employee Stock Purchase Plan (2006)	2,000	1,784
Total	9,375	5,012

Amounts available for future issuance exclude outstanding options. Options outstanding as of December 26, 2008, 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.

Share-based Compensation. The Company recognized share-based compensation cost of \$9.1 million in 2008 and \$8.6 million in 2007, which reduced net income by \$6.7 million, or \$0.11 per weighted common share in 2008 and \$6.4 million, or \$0.10 per weighted common share in 2007. As of December 26, 2008, there was \$8.6 million of unrecognized compensation cost related to unvested options, expected to be recognized over a weighted average period of approximately two years.

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:

	2008	2007	2006
Expected life in years	6.0	5.6	6.3
Interest rate	3.2%	4.2%	4.6%
Volatility	25.1%	25.1%	27.8%
Dividend yield	2.1%	1.7%	1.4%
Weighted average fair value per share	\$8.28	\$10.55	\$12.97

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. Expected volatility is based on historical volatility over a period commensurate with the expected life of options.

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:

	2008	2007	2006
Expected life in years	1.0	1.0	1.0
Interest rate	1.5%	4.9%	4.6%
Volatility	27.1%	24.4%	24.0%
Dividend yield	2.1%	1.6%	1.4%
Weighted average fair value per share	\$8.14	\$9.79	\$10.18

I. Earnings per Share

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

(In thousands, except per share amounts)	2008	2007	2006
Numerator			
Net earnings available to common shareholders	\$120,879	\$152,836	\$149,766
Denominators			
Weighted average shares outstanding for basic earnings per share	60,264	65,043	67,807
Dilutive effect of stock options computed based on the treasury stock method using the average market price	571	941	1,170
Denominator for diluted earnings per share	60,835	65,984	68,977
Basic earnings per share	\$ 2.01	\$ 2.35	\$ 2.21
Diluted earnings per share	\$ 1.99	\$ 2.32	\$ 2.17

Stock options to purchase 2,941,000 and 1,142,000 common shares were not included in the 2008 and 2007 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 choose 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 \$3.1 million in 2008, \$3.0 million in 2007 and \$2.6 million in 2006.

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 \$8.3 million at December 26, 2008, and \$13.0 million at December 28, 2007. For the funded pension plan, asset allocations at year-end were as follows:

	2008	2007
Graco common stock	6%	6%
Other equity securities	62%	72%
Debt securities	20%	15%
Real estate	9%	6%
Cash	3%	1%
Total	100%	100%

The Company uses a year-end 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 26, 2008, and December 28, 2007, and a statement of the funded status as of the same dates.

	Pension Benefits		Postretirement Medical Benefits	
(In thousands)	2008	2007	2008	2007
Change in benefit obligation				
Obligation, beginning of year	\$202,182	\$202,578	\$ 23,596	\$ 21,416
Service cost	4,968	5,618	557	537
Interest cost	12,223	11,504	1,381	1,345
Actuarial loss (gain)	4,960	(10,615)	393	1,772
Plan amendments	514	—	385	873
Exchange rate changes	(317)	914	—	—
Benefit payments	(9,376)	(7,817)	(2,530)	(2,347)
Obligation, end of year	\$215,154	\$202,182	\$23,782	\$23,596
Change in plan assets				
Fair value, beginning of year	\$215,378	\$212,819	\$ —	\$ —
Actual return on assets	(78,935)	9,492	—	—
Employer contributions	1,653	884	2,530	2,347
Benefit payments	(9,376)	(7,817)	(2,530)	(2,347)
Fair value, end of year	\$128,720	\$215,378	\$ —	\$ —
Funded status	\$(86,434)	\$ 13,196	\$(23,782)	\$(23,596)
Amounts recognized in consolidated balance sheets				
Non-current assets	\$ —	\$ 31,823	\$ —	\$ —
Current liabilities	726	645	2,222	2,344
Non-current liabilities	85,708	17,982	21,560	21,252
Net assets (liabilities)	\$(86,434)	\$ 13,196	\$(23,782)	\$(23,596)

The accumulated benefit obligation as of year-end for all defined benefit pension plans was \$195 million for 2008 and \$182 million for 2007. Information for plans with an accumulated benefit obligation in excess of plan assets follows:

(In thousands)	2008	2007
Projected benefit obligation	\$215,154	\$18,628
Accumulated benefit obligation	195,307	15,806
Fair value of plan assets	128,720	—

The components of net periodic benefit cost for the plans for 2008, 2007 and 2006 were as follows:

	Pension Benefits			Postretirement Medical Benefits		
(In thousands)	2008	2007	2006	2008	2007	2006
Service cost – benefits earned during the period	\$ 4,968	\$ 5,618	\$ 5,444	\$ 557	\$ 537	\$ 849
Interest cost on projected benefit obligation	12,223	11,504	10,541	1,381	1,345	1,511
Expected return on assets	(18,981)	(18,795)	(16,582)	—	—	—
Early retirement incentives	530	—	—	385	—	—
Amortization of prior service cost (credit)	232	244	147	(658)	(739)	(161)
Amortization of net loss (gain)	176	236	535	641	811	595
Cost of pension plans which are not significant and have not adopted SFAS No. 87	136	478	320	N/A	N/A	N/A
Net periodic benefit cost (credit)	\$ (716)	\$ (715)	\$ 405	\$2,306	\$1,954	\$2,794

Amounts recognized in other comprehensive (income) loss in 2008 and 2007 were as follows:

(In thousands)	Pension Benefits		Postretirement Medical Benefits	
	2008	2007	2008	2007
Prior service cost (credit) arising during the period	\$ 514	\$ —	\$ 385	\$ 873
Net loss (gain) arising during the period	102,755	(1,218)	393	1,772
Amortization of prior service credit (cost)	(232)	(244)	658	739
Amortization of net gain (loss)	(706)	(236)	(1,026)	(811)
Total	\$102,331	\$(1,698)	\$ 410	\$2,573

Amounts included in accumulated other comprehensive (income) loss as of December 26, 2008 and December 28, 2007, that had not yet been recognized as components of net periodic benefit cost, were as follows:

(In thousands)	Pension Benefits		Postretirement Medical Benefits	
	2008	2007	2008	2007
Prior service cost (credit)	\$ 431	\$ 742	\$(5,732)	\$(6,390)
Net loss	107,605	4,963	9,352	9,600
Net before income taxes	108,036	5,705	3,620	3,210
Income taxes	(39,995)	(2,055)	(1,338)	(1,188)
Net	\$ 68,041	\$3,650	\$2,282	\$2,022

Amounts included in accumulated other comprehensive (income) loss that are expected to be recognized as components of net periodic benefit cost in 2009 were as follows:

(In thousands)	Pension Benefits		Postretirement Medical Benefits	
	2008	2007	2008	2007
Prior service cost (credit)	\$ 182		\$(658)	
Net loss (gain)	9,362		673	
Net before income taxes	9,544		15	
Income taxes	(3,531)		(6)	
Net	\$ 6,013		\$ 9	

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

	Pension Benefits		Postretirement Medical Benefits	
	2008	2007	2008	2007
Weighted average assumptions				
Discount rate	6.0%	6.2%	6.0%	6.3%
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:

	Pension Benefits			Postretirement Medical Benefits		
	2008	2007	2006	2008	2007	2006
Weighted average assumptions						
Discount rate	6.2%	5.7%	5.5%	6.3%	5.8%	5.5%
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 percent for 2009, decreasing by one-half percentage point each year to a constant rate of 5 percent in 2017 and thereafter, subject to the plan's annual increase limitation.

At December 26, 2008, 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 \$0.7 million to its unfunded pension plans and \$2.2 million to the postretirement medical plan in 2009. The Company expects that no contribution to the funded pension plan will be required in 2009. Estimated future benefit payments are as follows:

(In thousands)	Pension Benefits	Postretirement Medical Benefits
2009	\$ 9,200	\$2,200
2010	9,900	2,100
2011	10,600	2,000
2012	11,300	1,800
2013	12,100	1,700
Years 2014 – 2018	73,500	8,000

K. Commitments and Contingencies

Lease Commitments. Aggregate annual rental commitments under operating leases with noncancelable terms of more than one year were \$7.2 million at December 26, 2008, payable as follows:

(In thousands)	Buildings	Vehicles & Equipment	Total
2009	\$1,210	\$1,868	\$3,078
2010	745	1,010	1,755
2011	326	485	811

2012	300	179	479
2013	256	57	313
Thereafter	728	43	771
Total	\$3,565	\$3,642	\$7,207

Total rental expense was \$2.6 million for 2008, \$2.3 million for 2007 and \$1.8 million for 2006.

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 \$15 million at December 26, 2008. 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 \$20 million. In addition, the Company could be obligated to perform under standby letters of credit totaling \$2 million at December 26, 2008. The Company has also guaranteed the debt of its subsidiaries for up to \$7 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

In February 2008, the Company acquired GlasCraft Inc. for approximately \$35 million cash. GlasCraft had sales of approximately \$18 million in 2007. It designs, manufactures and sells spray systems for the composites manufacturing industry and high performance dispense systems for the polyurethane foam and polyurea coatings industries. The products, brands, distribution channels and engineering capabilities of GlasCraft expand and complement the Company's Industrial Equipment business. GlasCraft operations were moved from Indiana to Company facilities in Ohio, South Dakota and Minnesota in 2008.

In September 2008, the Company acquired certain assets of Lubrication Scientifics, Inc. (LubeSci) for approximately \$5 million cash. LubeSci designed and manufactured automated lubrication equipment used in industrial markets and had sales of approximately \$3 million in 2007. LubeSci operations were moved to Company facilities in Minnesota from California in 2008.

In October 2008, the Company acquired the Airlessco assets of Durotech Co. in Moorpark, California, for approximately \$15 million cash. Airlessco is a line of spray-painting equipment that generated approximately \$14 million of sales in 2007, and complements the Company's Contractor Equipment business.

The purchase price of each acquisition was allocated based on estimated fair values as follows:

(In thousands)	GlasCraft	LubeSci	Airlessco
Accounts receivable and prepaid expenses	\$ 2,200	\$ —	\$ 2,400
Inventories	3,700	500	3,000
Deferred income taxes	700	—	—
Property, plant and equipment	700	600	500
Identifiable intangible assets	18,200	900	5,500
Goodwill	17,700	2,500	4,800
Total purchase price	43,200	4,500	16,200
Current liabilities assumed	(1,000)	—	(800)
Deferred income taxes	(6,900)	—	—
Net assets acquired	\$35,300	\$4,500	\$15,400

Identifiable intangible assets and estimated useful life were as follows:

	GlasCraft	LubeSci	Airlessco
Product documentation (5 years)	\$ 900	\$ —	\$ —
Customer relationships (5 – 6 years)	14,100	600	4,600
Proprietary technology (3 – 5 years)	500	300	—
Tradenames and trademarks (3 years)	—	—	800
Patents (3 years)	—	—	100
Total (6 years, weighted average)	15,500	900	5,500
Brand names (indefinite useful life)	2,700	—	—
Total identifiable intangible assets	\$18,200	\$900	\$5,500

None of the GlasCraft goodwill or identifiable intangible assets is deductible for tax purposes. Goodwill and identifiable intangible assets from the acquisitions of LubeSci and Airlessco are 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 2008 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 2008 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 2008 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 2009 Annual Meeting of Shareholders, to be held on April 24, 2009 (the “Proxy Statement”), is 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 15, 2008. 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 2008 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 Code of Ethics and Business Conduct (Code of Ethics) that applies 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 Code of Ethics, 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 Code of Ethics 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 “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 Accounts

All other schedules are omitted because they are not applicable, or are 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 26, 2008					
Allowance for doubtful accounts	\$2,500	\$ —	\$ 400	\$ 100	\$2,200
Allowance for returns and credits	4,000	12,000	11,600	—	4,400
	\$6,500	\$12,000	\$12,000	\$ 100	\$6,600
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

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.

/s/PATRICK J. MCHALE February 16, 2009
Patrick J. McHale
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/PATRICK J. MCHALE February 16, 2009
Patrick J. McHale
President and Chief Executive Officer
(Principal Executive Officer)

/s/JAMES A. GRANER February 16, 2009
James A. Graner
Chief Financial Officer and Treasurer
(Principal Financial Officer)

/s/CAROLINE M. CHAMGERS February 16, 2009
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.

/s/PATRICK J. MCHALE February 16, 2009

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

Exhibit Index

Exhibit

<u>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 as amended and restated December 23, 2008.
*10.2	Executive Officer Annual Incentive Bonus Plan as amended and restated December 23, 2008.
*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.) First Amendment 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.) Second Amendment dated May 27, 2000. (Incorporated by reference to Exhibit 10.7 to the Company's 2005 Annual Report on Form 10-K.) Third Amendment adopted on December 19, 2002. (Incorporated by reference to Exhibit 10.7 to the Company's 2005 Annual Report on Form 10-K.) Fourth Amendment 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.) Second Amendment dated November 1, 2005. (Incorporated by reference to Exhibit 10.8 to the Company's 2005 Annual Report on Form 10-K.) Third Amendment adopted on December 29, 2008.
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.) First Amendment adopted on December 29, 2008.

- *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.) Third Amendment adopted March 27, 2008. (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the thirteen weeks ended March 28, 2008.) Fourth Amendment adopted December 29, 2008.
- *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.)
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- *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.) Amended form of agreement for awards made to nonemployee directors in 2008. (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirteen weeks ended June 27, 2008.)
- *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.) Amended form of agreement for awards made to executive officers in 2008 (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirteen weeks ended March 28, 2008.)
- *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.) Amended form of agreement for awards made to chief executive officer in 2008 (Incorporated by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the thirteen weeks ended March 28, 2008.)
- *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 First Amendment, effective September 1, 1990. (Incorporated by reference to Exhibit 3 to the Company's Report on Form 8-K dated March 11, 1993.) As further amended by agreement, effective December 4, 2008.
- *10.20 Executive Officer Restricted Stock Agreement. Form of agreement used to award restricted stock to selected executive officers. (Incorporated by reference to Exhibit 10.20 to the Company's 2007 Annual Report on Form 10-K.)
- *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. (Incorporated by reference to Exhibit 10.22 to the Company's 2007 Annual Report on Form 10-K.) Amended form of agreement used for 2009 plan year.
- *10.23 Key Employee Agreement. Form of agreement used with chief executive officer. (Incorporated by reference to Exhibit 10.24 to the Company's 2007 Annual Report on Form 10-K.)
- *10.24 Key Employee Agreement. Form of agreement used with executive officers reporting to the chief executive officer. (Incorporated by reference to Exhibit 10.25 to the Company's 2007 Annual Report on Form 10-K.)
- *10.25 Key Employee Agreement. Form of agreement used with executive officer reporting to an executive officer other than the chief executive officer. (Incorporated by reference to Exhibit 10.26 to the Company's 2007 Annual Report on Form 10-K.)
- *10.26 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. (Incorporated by reference to Exhibit 10.28 to the Company's Annual Report on Form 10-K.)
- 11 Statement of Computation of Earnings per share included in Note I on page 43.
- 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 26, 2008.

Subsidiary	Jurisdiction of Organization	Percentage of Voting Securities Owned by the Company
GlasCraft, Inc.	United States	100% ⁷
Graco Australia Pty Ltd.	Australia	100% ³
Graco California Inc.	United States	100%
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

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.

⁷ Shares 100% owned by Graco Indiana.

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 16, 2009, relating to the financial statements and financial statement schedule of Graco Inc. and Subsidiaries (the “Company”), 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 26, 2008.

DELOITTE & TOUCHE LLP

Minneapolis, Minnesota

February 16, 2009

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 26, 2008, 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 13, 2009</u>
<u>/s/JACK W. EUGSTER</u> Jack W. Eugster	<u>February 13, 2009</u>
<u>/s/J. KEVIN GILLIGAN</u> J. Kevin Gilligan	<u>February 13, 2009</u>
<u>/s/PATRICK J. MCHALE</u> Patrick J. McHale	<u>February 13, 2009</u>
<u>/s/LEE R. MITAU</u> Lee R. Mitau	<u>February 13, 2009</u>
<u>/s/MARTI MORFITT</u> Marti Morfitt	<u>February 13, 2009</u>
<u>/s/MARK H. RAUENHORST</u> Mark H. Rauenhurst	<u>February 13, 2009</u>
<u>/s/WILLIAM G. VAN DYKE</u> William G. Van Dyke	<u>February 13, 2009</u>
<u>/s/R. WILLIAM VAN SANT</u> R. William Van Sant	<u>February 13, 2009</u>

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 16, 2009

/s/PATRICK J. MCHALE
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 16, 2009

/s/JAMES A. GRANER

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 16, 2009

/s/PATRICK J. MCHALE

Patrick J. McHale

President and Chief Executive Officer

Date: February 16, 2009

/s/JAMES A. GRANER

James A. Graner

Chief Financial Officer and Treasurer

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 to locate and access reasonably priced financing;
 - 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 by adjusting our cost structure; 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 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 major manufacturers; changes in manufacturing processes; and consolidation in the 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; 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 develop and profitably market innovative high-quality products and meet competitive challenges in our industrial lubrication business.

**GRACO INC.
EXECUTIVE OFFICER
BONUS PLAN**

1. **Definitions.** When the following terms are used herein with initial capital letters, they shall have the following meanings:

- 1.1 **Base Salary** – the annual fixed salary paid to a Participant because of the position he/she holds.
- 1.2 **Bonus Award** – the incentive structure established for each Participant by the Compensation Committee for each Performance Period pursuant to Section 3.1 hereof.
- 1.3 **Bonus Payment** – means an amount payable to a Participant pursuant to Section 3.2 hereof.
- 1.4 **Compensation Committee** - the Management Organization and Compensation Committee of the Board of Directors of Graco Inc.
- 1.5 **Code** - the Internal Revenue Code of 1986, as it may be amended from time to time, and any proposed, temporary or final Treasury Regulations promulgated thereunder.
- 1.6 **Company** - Graco Inc., a Minnesota corporation, and any of its affiliates that adopt the Plan.
- 1.7 **Eligible Employee** - any executive officer of the Company designated by the Compensation Committee.
- 1.8 **Participant** - an Eligible Employee designated by the Compensation Committee as subject to the Plan.
- 1.9 **Performance Period** - the Company's fiscal year.
- 1.10 **Plan** - this Executive Officer Bonus Plan.
- 1.11 **Performance Target(s)** - the financial and other target(s) established by the Compensation Committee for a Performance Period and reflected in a document adopted by the Compensation Committee in accordance with the terms of this Plan. The Financial Performance Target(s) shall be tied to one or more of the following financial measures: consolidated net sales, consolidated net earnings, divisional net sales, regional net sales, divisional earnings, regional earnings, consolidated pre-tax earnings, consolidated operating earnings, earnings before interest and taxes, earnings before interest, taxes, depreciation, and amortization, operating cash flow, return on equity, return on assets, or earnings per share [hereinafter "Financial Measure(s)"] for the applicable Performance Period, all as computed in accordance with generally accepted accounting principles as in effect from time to time and as applied by the Company in the preparation of its financial statements, and subject to other special rules and conditions as the Compensation Committee may establish. Any Financial Measure may be stated in absolute terms or as compared to any other company or companies. Where the Compensation Committee deems it appropriate, it may select one or more non-financial measures [hereinafter "Non-Financial Measures"] to evaluate the performance of a Participant in addition to one or more Financial Measures. All Non-Financial Measures shall be applied in a manner consistent with usual Company practice and such rules and conditions as the Compensation Committee may establish.

2. **Administration.**

2.1 **Authority of Compensation Committee.** The Compensation Committee shall have the authority to select applicable Financial and Non-Financial Measures, identify the weights thereof, establish Performance Targets, determine the relationship between Performance Targets and Bonus Payments and otherwise administer the Plan. Such authority shall include making adjustments in Bonus Payments based on unusual or unique circumstances, and determining the impact of acquisitions, divestitures or other major unusual events on the achievement of Performance Targets. The Compensation Committee's interpretation of the Plan and of any Bonus Payments made or to be made under the Plan shall be final and binding on all persons with an interest therein. The Compensation Committee shall have the power to establish regulations to administer the Plan and to change such regulations.

3. **Bonus for each Performance Period.**

3.1 **Bonus Award** - Each Performance Period, the Compensation Committee shall designate the Participants in the Plan for that Performance Period; select applicable Financial and Non-Financial Measures; identify the weights thereof; establish Performance Targets; and determine the relationship between Performance Targets and Bonus Payments. Such determinations shall be memorialized in written documents adopted by the Compensation Committee.

3.2 **Bonus Payment** – Following the close of each Performance Period and prior to the making of any Bonus Payment, the Compensation Committee shall determine whether and to what extent Performance Target(s) and all other factors upon which the Bonus Payment is based have been attained by each Participant. Payment of the Bonus Payment shall in all events be made in the calendar year following the calendar year in which the Performance Period ends.

3.3 **Limitations**

(a) **If Performance Targets are not achieved** - If Performance Targets are not achieved during the Performance Period, the Compensation Committee may decide to pay a bonus to the Participant, but must state the bases for its decision in writing.

(b) **Pro-rata or elimination of Bonus Payment** - Participation in the Plan ceases with resignation, termination, retirement, death or long-term disability. A Participant who resigns or is terminated effective during the Performance Period is ineligible for a bonus payment unless the Compensation Committee directs otherwise. A Participant who is employed by the Company through the last day of the fiscal year shall be eligible for a Bonus Payment. A Participant who retires, dies or becomes eligible for long-term disability benefits under the Company's long-term disability benefit plan during the Performance Period may be paid a bonus in accordance with the direction of the Compensation Committee. For purposes of this Plan, a Participant who has attained age 65, or age 55 and 10 years of service with the Company or an affiliate shall, upon termination for any reason other than "cause" (as defined below) be deemed to have retired. As used herein, the term "cause" shall mean termination as a result of gross misconduct, commission of a felony or material breach of the Company's Conduct of Business Guidelines.

4. **Time and Form of Payments; Taxability** - Subject to any deferred compensation election pursuant to any such plans of the Company, a Bonus Payment shall be made to the Participant in one or more cash payments within thirty (30) days after the Compensation Committee has confirmed that the Performance Target(s) and all other factors upon which the Bonus Payment for the Participant is based have been achieved.

4.1 **Nontransferability** - Participants and beneficiaries shall not have the right to assign, encumber or otherwise anticipate the payments to be made under the Plan, and the benefits provided hereunder shall not be subject to seizure for payment of any debts or judgments against any Participant or any beneficiary.

4.2 **Tax Withholding** - In order to comply with all applicable federal or state income tax laws or regulations, the Company may take such action as it deems appropriate to ensure that all applicable federal or state payroll, withholding, income or other taxes, which are the sole and absolute responsibility of a Participant, are withheld or collected from such Participant.

5. **Amendment** - The Compensation Committee may amend the Plan prospectively at any time and for any reason deemed sufficient by it without prior notice to any person affected by the Plan.

6. **Miscellaneous**

6.1 **Effective Date** - January 1, 2005

6.2 **Term of the Plan** - The Plan shall continue in existence until affirmatively discontinued or terminated by the Committee. No Bonus Payment shall be granted after the termination of the Plan; provided, however, that a Bonus Payment with respect to a Performance Period which begins before such termination may be made thereafter.

6.3 **Headings** - Headings are given to the sections and subsections of the Plan solely as a convenience to facilitate reference. Such headings shall not be deemed in any way material or relevant to the construction or interpretation of the Plan or any provision thereof.

6.4 **Applicability to Successors** - The Plan shall be binding upon and inure to the benefit of the Company and each Participant, the successors and assigns of the Company, and the beneficiaries, personal representatives and heirs of each Participant. If the Company becomes a party to any merger, consolidation or reorganization, this Plan shall remain in full force and effect as an obligation of the Company or its successors in interest.

6.5 **Employment Rights and Other Benefit Programs**

a. The provisions of the Plan shall not give any Participant any right to be retained in the employment of the Company. In the absence of any specific agreement to the contrary, the Plan shall not affect any right of the Company, or of any affiliate of the Company, to terminate, with or without cause, the Participant's employment at any time. The Plan shall not replace any contract of employment, whether oral or written, between the Company and any Participant, but shall be considered a supplement thereto.

b. Bonus Payments received by a Participant pursuant to the Plan shall not be deemed a part of the Participant's regular, recurring compensation for purposes of the termination, indemnity or severance pay law of any country and shall not be included in, nor have any effect on, the determination of benefits under any other employee benefit plan, contract or similar arrangement provided by the Company or any affiliate unless expressly so provided by such plan, contract or arrangement, or unless the Compensation Committee expressly determines that an Bonus Payment or portion of a Bonus Payment should be included to accurately reflect competitive practices or to recognize that a Bonus Payment has been made in lieu of a portion of competitive cash compensation.

6.6 **No Trust or Fund Created** - The Plan shall not create or be construed to create a trust or separate fund of any kind or a fiduciary relationship between the Company or any affiliate and a Participant or any other person. To the extent that any person acquires a right to receive payments from the Company or any affiliate pursuant to the Plan, such right shall be no greater than the right of any unsecured general creditor of the Company or of any affiliate.

6.7 **Governing Law** - To the extent that federal law does not otherwise control, the validity, construction and effect of the Plan or any bonus payable under the Plan shall be determined in accordance with the laws of the State of Minnesota.

6.8 **Severability** - If any provision of the Plan is or becomes or is deemed to be invalid, illegal or unenforceable in any jurisdiction such provision shall be construed or deemed amended to conform to applicable laws, or if it cannot be so construed or deemed amended without, in the determination of the Compensation Committee, materially altering the purpose or intent of the Plan, such provision shall be stricken as to such jurisdiction, and the remainder of the Plan shall remain in full force and effect.

6.9 **Qualified Performance-Based Compensation** - All of the terms and conditions of the Plan shall be interpreted in such a fashion as to qualify all compensation paid hereunder as qualified performance-based compensation within the meaning of Section 409A of the Code.

12/23/08

**EXECUTIVE OFFICER
ANNUAL INCENTIVE BONUS PLAN**

1. **Definitions.** When the following terms are used herein with initial capital letters, they shall have the following meanings:

- 1.1 **Base Salary** - the base salary for each Participant as set forth in Schedule A.
- 1.2 **Compensation Committee** - the Management Organization and Compensation Committee of the Board of Directors of Graco Inc.; it is intended that the Compensation Committee will satisfy the requirements of Section 162(m) of the Code by being comprised of two or more "outside directors."
- 1.3 **Code** - the Internal Revenue Code of 1986, as it may be amended from time to time, and any proposed, temporary or final Treasury Regulations promulgated thereunder.
- 1.4 **Company** - Graco Inc., a Minnesota corporation, and any of its affiliates that adopt the Plan.
- 1.5 **Eligible Employee** - the chief executive officer and any executive officer of the Company designated by the Compensation Committee.
- 1.6 **Participant** - an Eligible Employee designated by the Compensation Committee, at any time ending on or before the 90th day of each Performance Period, as subject to the Plan.
- 1.7 **Performance Period** - the Company's fiscal year.
- 1.8 **Plan** - this Executive Officer Annual Incentive Bonus Plan.
- 1.9 **Minimum Bonus Percentage** - the minimum potential bonus payout expressed as a percentage of the Participant's Base Salary as identified in Schedule B.
- 1.10 **Target Bonus Percentage** - the target potential bonus payout expressed as a percentage of the Participant's Base Salary as identified in Schedule B.
- 1.11 **Maximum Bonus Percentage** - the maximum potential bonus payout expressed as a percentage of the Participant's Base Salary as identified in Schedule B.
- 1.12 **Company Performance Target(s)** - the financial growth target(s) established by the Compensation Committee for a Performance Period and reflected in the percentages identified in Schedule C for each of minimum, target and maximum performance targets. The Company Performance Target(s) shall be directly tied to one or more of the following financial measures: consolidated pre-tax earnings, net revenues, net earnings, operating income, earnings before interest and taxes, cash flow, return on equity, return on assets, or earnings per share (hereinafter "Financial Measure(s)") for the applicable Performance Period, all as computed in accordance with generally accepted accounting principles as in effect from time to time and as applied by the Company in the preparation of its financial statements, and subject to other special rules and conditions as the Compensation Committee may establish at any time ending on or before the 90th day of the applicable Performance Period. Any Financial Measure may be stated in absolute terms or as compared to another company or companies. Such Financial Measures shall constitute the sole bases upon which the Company Performance Targets shall be based.
- 1.13 **Retirement** - when a Participant's employment is terminated and the Participant has, as of the date of termination, reached the age of 55 or more and has at least ten years of service with the Company, or has reached at least age 65.

2. **Administration.**

- 2.1 **Determinations must be made prior to each Performance Period** - At any time ending on or before the 90th day of each Performance Period, the Compensation Committee shall:
 - (a) designate the Participants in the Plan for that Performance Period;
 - (b) indicate the Base Salary of each Participant for the Performance Period by amending Schedule A in writing;
 - (c) establish Targeted Bonus Percentages for the Performance Period by amending Schedule B in writing;
 - (d) establish Company Performance Target(s) for the Performance Period by amending Schedule C in writing.
- 2.2 **Certification** - Following the close of each Performance Period and prior to payment of any bonus under the Plan, the Compensation Committee must certify in writing that the Company Performance Target(s) and any other material terms were in fact satisfied.
- 2.3 **Shareholder Approval** - The material terms of the Plan shall be disclosed to and approved by shareholders of the Company in accordance with Section 162(m) of the Code. No bonus shall be paid under the Plan unless such shareholder approval has been obtained.

3. **Bonus Payment**

- 3.1 **Maximum** - Each Participant shall receive a bonus payment for each Performance Period calculated in accordance with the formula set forth in subparagraph 3.2 and in an amount not greater than the Participant's Maximum Bonus Percentage multiplied by the Participant's Base Salary.
- 3.2 **Formula** - Subject to other provisions of this Plan, each Participant shall receive a bonus payment for each Performance Period calculated as follows:
 - (a) Each of the Company Performance Targets shall be assigned a weight expressed as a percent of the Participant's Maximum Bonus Percentage.
 - (b) At the conclusion of each Performance Period, the percent of the Participant's Maximum Bonus Percentage achieved for each applicable Financial Measure shall be calculated.
 - (c) The percentages achieved by performing the calculation described in subparagraph 3.2(b) shall be added together and this sum shall be multiplied by the Participant's Maximum Bonus Percentage.
 - (d) The amount obtained by performing the calculation described in subparagraph 3.2(c) shall be multiplied by the Participant's Base Salary.
- 3.3 **Limitations**
 - (a) **No payment if Company Performance Targets not achieved** - In no event shall any Participant receive a bonus payment hereunder if the Company Performance Targets and all other factors on which the bonus payment is based are not achieved during the Performance Period.
 - (b) **No payment in excess of preestablished amount** - No Participant shall receive a payment under the Plan for any Performance Period in excess of Two Million (\$2,000,000).

(c) **Pro-ratio or elimination of Bonus payment** - Participation in the Plan ceases with resignation, termination, Retirement, death or long-term disability. A Participant who resigns or is terminated effective during the Performance Period is ineligible for a bonus payment. A Participant who Retires, dies or becomes eligible for long-term disability benefits under the Company's long-term disability benefit plan during the Performance Period will be paid a bonus based on a calculation performed in accordance with the provisions of subparagraph 3.2.

4. **Time and Form of Payments; Taxability** - Subject to any deferred compensation election pursuant to any such plans of the Company, a bonus payment shall be made to the Participant in one payment in the following year as soon as determined by the Compensation Committee after it has certified that the Company Performance Target(s) and all other factors upon which the bonus payment for the Participant is based have been achieved.

4.1 **Nontransferability** - Participants and beneficiaries shall not have the right to assign, encumber or otherwise anticipate the payments to be made under the Plan, and the benefits provided hereunder shall not be subject to seizure for payment of any debts or judgments against any Participant or any beneficiary.

4.2 **Tax Withholding** - In order to comply with all applicable federal or state income tax laws or regulations, the Company may take such action as it deems appropriate to ensure that all applicable federal or state payroll, withholding, income or other taxes, which are the sole and absolute responsibility of a Participant, are withheld or collected from such Participant.

5. **Amendment and Termination** - The Compensation Committee may amend the Plan prospectively at any time and for any reason deemed sufficient by it without notice to any person affected by the Plan and may likewise terminate or curtail the benefits of the Plan, both with regard to persons expecting to receive benefits hereunder in the future and persons with outstanding awards to receive bonus payments at the time of such action, provided that no amendment to the Plan shall be effective which would increase the maximum amount payable to a Participant under paragraph 3.3(b), which would change the Financial Measures upon which Company Performance Targets must be based as set forth in subparagraph 1.10 of this Plan or which would modify the requirements for eligibility under subparagraph 1.5, unless the shareholders of the Company shall have approved such change in accordance with the requirements of Section 162(m).

6. **Miscellaneous**

6.1 **Effective Date** - January 1, 2008

6.2 **Term of the Plan** - Unless the Plan shall have been discontinued or terminated, the Plan shall terminate on December 31, 2012. No bonus shall be granted after the termination of the Plan; provided, however, that a payment with respect to a Performance Period which begins before such termination may be made thereafter. In addition, the authority of the Compensation Committee to amend the Plan shall extend beyond the termination of the Plan.

6.3 **Headings** - Headings are given to the Sections and subsections of the Plan solely as a convenience to facilitate reference. Such headings shall not be deemed in any way material or relevant to the construction or interpretation of the Plan or any provision thereof.

6.4 **Applicability to Successors** - The Plan shall be binding upon and inure to the benefit of the Company and each Participant, the successors and assigns of the Company, and the beneficiaries, personal representatives and heirs of each Participant. If the Company becomes a party to any merger, consolidation or reorganization, this Plan shall remain in full force and effect as an obligation of the Company or its successors in interest.

6.5 **Employment Rights and Other Benefit Programs** - The provisions of the Plan shall not give any Participant any right to be retained in the employment of the Company. In the absence of any specific agreement to the contrary, the Plan shall not affect any right of the Company, or of any affiliate of the Company, to terminate, with or without cause, the Participant's employment at any time. The Plan shall not replace any contract of employment, whether oral or written, between the Company and any Participant, but shall be considered a supplement thereto. The Plan is in addition to, and not in lieu of, any other employee benefit plan or program in which any Participant may be or become eligible to participate by reason of employment with the Company. Receipt of benefits hereunder shall have such effect on contributions to and benefits under such other plans or programs as the provisions of each such other plan or program may specify.

6.6 **No Trust or Fund Created** - The Plan shall not create or be construed to create a trust or separate fund of any kind or a fiduciary relationship between the Company or any affiliate and a Participant or any other person. To the extent that any person acquires a right to receive payments from the Company or any affiliate pursuant to the Plan, such right shall be no greater than the right of any unsecured general creditor of the Company or of any affiliate.

6.7 **Governing Law** - The validity, construction and effect of the Plan or any bonus payable under the Plan shall be determined in accordance with the laws of the State of Minnesota.

6.8 **Severability** - If any provision of the Plan is or becomes or is deemed to be invalid, illegal or unenforceable in any jurisdiction such provision shall be construed or deemed amended to conform to applicable laws, or if it cannot be so construed or deemed amended without, in the determination of the Compensation Committee, materially altering the purpose or intent of the Plan, such provision shall be stricken as to such jurisdiction, and the remainder of the Plan shall remain in full force and effect.

6.9 **Qualified Performance-Based Compensation** - All of the terms and conditions of the Plan shall be interpreted in such a fashion as to qualify all compensation paid hereunder as qualified performance-based compensation within the meaning of Section 162(m) of the Code.

SCHEDULE A

**BASE SALARY FOR PERFORMANCE PERIOD
BEGINNING _____ AND ENDING _____**

Name

Base Salary

Actual paid salary for the calendar year that most closely
coincides with the Performance Period

SCHEDULE B

BONUS PERCENTAGE FOR PERFORMANCE PERIOD
BEGINNING _____ AND ENDING _____

Name	Minimum Bonus Percentage as a Percentage of Base Salary	Target Bonus Percentage as a Percentage of Base Salary	Maximum Bonus Percentage as a Percentage of Base Salary
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SCHEDULE C

**COMPANY PERFORMANCE TARGETS
FOR PERFORMANCE PERIOD
BEGINNING _____ AND ENDING _____**

Financial Measure(s)	Company Performance Target(s) Weight	Minimum Company Performance Target(s)	Target Company Performance Target(s)	Maximum Company Performance Target(s)
	_____ %	\$ _____	\$ _____	\$ _____
	_____ %	\$ _____	\$ _____	\$ _____

**THIRD AMENDMENT
GRACO DEFERRED COMPENSATION PLAN
(2005 Restatement)**

Graco Inc. hereby amends the “GRACO DEFERRED COMPENSATION PLAN (2005 Statement)” (as amended, the “Plan Statement”) as follows:

1. DISABILITY. Effective for determinations of disability on and after January 1, 2009, Section 1.2.10 of the Plan Statement shall be amended to read as follows:

1.2.10. Disability or Disabled — a Participant will be considered disabled if the Participant (i) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, or (ii) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, receiving income replacement benefits for a period of not less than three (3) months under an accident and health plan covering employees of the Participant’s employer.

2. SPECIFIED EMPLOYEE. Effective for determinations of who is a specified employee on and after January 1, 2009, a new Section 1.2.19 shall be added to the Plan Statement (with the prior Section 1.2.19 and subsequent sections and cross references renumbered as appropriate) that reads as follows:

1.2.19. Specified Employee — a Participant who is a specified employee for purposes of section 409A of the Code.

3. VICE PRESIDENT OF HUMAN RESOURCES. Effective January 1, 2009, Section 1.2.23 of the Plan Statement (Section 1.22 prior to this amendment) is amended to read as follows:

1.2.23. Vice President of Human Resources — the Vice President of Human Resources or, if such position does not exist, the senior officer responsible for the human resources function.

4. EVERGREEN ELECTIONS. Effective December 31, 2008, Section 2.3.4 of the Plan Statement is deleted (with subsequent sections and cross references renumbered as appropriate).

5. DISTRIBUTION. Effective January 1, 2009, Section 7.1 of the Plan Statement is amended to read as follows:

7.1. Distribution. Prior to the start of each Plan Year (the calendar year), a Participant may enter into a Deferred Compensation Agreement that specified the amount of compensation to be deferred (as provided under Section 3) and the time and form of payment for the compensation deferred for that Plan Year (along with any earnings or losses on the compensation deferred for the Plan Year).

6. ELECTION. Effective for distributions made on and after January 1, 2005, Section 7.1.1(a) of the Plan Statement is amended to read as follows:

- (a) **Election for Distribution as of a Specified Time.** The Participant may elect to commence distribution of the amount deferred by the Participant for a Plan Year as of (i) a specified year, or (ii) the Participant’s Separation from Service. If the Participant elects to commence distribution as of a specified year, distribution shall be made on January 1 of that year (or as soon as practicable after that date but in all cases within the time period permitted under section 409 of the Code). If the Participant elects to commence distribution as of the Participant’s Separation from Service, distribution shall be made as of the date that is sixty (60) days after the Participant’s Separation from Service (or as soon as practicable after that date but in all cases within the time period permitted under section 409 of the Code).

7. EFFECTIVE DATE OF ELECTIONS. Effective January 1, 2009, the last sentence of Section 7.1.1(b) of the Plan Statement is deleted.

8. ELECTION TO DELAY TIME OF DISTRIBUTION. Effective for distributions made on and after January 1, 2009, Section 7.1.1(c) of the Plan Statement is amended so that the first sentence reads as follows: The Participant may make a one-time election to change the time of distribution for an amount deferred for a Plan Year (the Participant may make one such election with respect to an amount deferred for each Plan Year).

9. DEFAULT TIME OF DISTRIBUTION. Effective for distributions made on and after January 1, 2009, Sections 7.1.1(d), is amended to read as follows:

- (d) **Default Time of Distribution.** Unless the Participant elects otherwise, a Participant’s amount deferred for a Plan Year (reduced by the amount of any applicable payroll, withholding and other taxes) shall be distributed as of the January 1 following the date of the Participant’s Separation from Service (or as soon as practicable after that date but in all cases within the time period permitted under section 409 of the Code).

10. DELAY IN DISTRIBUTION TO SPECIFIED EMPLOYEES. Effective for distributions made on and after January 1, 2009, Section 7.1.1(e) of the Plan Statement is amended to read as follows:

- (e) **Delay for Specified Employees.** If a Participant is a Specified Employee as of the date of distribution a Participant’s amount deferred for a Plan Year and the distribution is due to Participant’s Separation from Service (rather than a specified year), distribution shall commence the later of (i) the date distribution is to be made, or (ii) the first day of the month following the date that is six (6) months after the date of the Participant’s Separation from Service (or, if earlier, the date of the Participant’s death). If the Participant has elected to receive installments, distributions that would have been made during the six (6)-month delay period shall all be paid to the Participant on the first day of the month following the date that is six (6) months after the date of the Participant’s Separation from Service (along with the regular payment that is to be paid on that date).

11. ELECTION OF FORM OF DISTRIBUTION. Effective for distributions made on and after January 1, 2009, Sections 7.1.2(a) of the Plan Statement is amended to read as follows:

- (a) **Election of Form of Distribution.** The Participant may elect the form of distribution for a Participant’s amount deferred for a Plan Year.
 - (i) **Lump Sum.** The Participant may elect distribution to be made in a single lump sum payment in cash.
 - (ii) **Installments.** A Participant may elect distribution to be made in a series of cash installment payments payable annually over a period of five (5), ten (10), or fifteen (15) years. The amount of an installment payment to a Participant shall be substantially equal to the value of the Participant’s amount deferred for a Plan Year divided by the remaining number of installment payments payable to the Participant.

12. EFFECTIVE DATE OF ELECTION. Effective January 1, 2009, the last sentence of Section 7.1.2(b) of the Plan Statement is deleted.

13. ELECTION TO CHANGE THE FORM OF DISTRIBUTION. Effective for distributions made on and after January 1, 2009, Section 7.1.2(c) of the Plan Statement is amended so that the first sentence reads as follows: The Participant may make a one-time election to change the form of distribution for an amount deferred for a Plan Year (the Participant may make one such election with respect to an amount deferred for each Plan Year).

- 14. DEFAULT FORM OF DISTRIBUTION.** Effective for distributions made on and after January 1, 2009, Section 7.1.2(d) of the Plan Statement is amended so that the first sentence reads as follows:
- (d) **Default Form of Distribution.** Unless the Participant elects otherwise, a Participant’s amount deferred for a Plan Year (reduced by the amount of any applicable payroll, withholding and other taxes) shall be paid in a single lump sum payment in cash.
- 15. SMALL AMOUNT DISTRIBUTION.** Effective for distributions made on and after January 1, 2009, a new Section 7.1.2(e) is added to the Plan Statement that reads as follows:
- (e) **Small Amount Lump Sum Distribution.** If the value of a Participant’s benefit under the Plan as of the date benefit is to commence is equal to or less than the limit under section 402(g)(1)(B) of the Code (as adjusted for the applicable year), the benefit shall be paid in a single lump sum payment.
- 16. BENEFICIARIES.** Effective January 1, 2009, Section 7.2 (including Sections 7.2.1 through 7.2.5) of the Plan Statement is amended to read as follows:
- 7.2 Designation of Beneficiaries.**
- 7.2.1. **Right to Designate.** Each Participant may designate, upon forms to be furnished by and filed in accordance with procedures established by the Committee, one or more primary Beneficiaries or alternative Beneficiaries to receive all or a specified part of the Participant’s Account in the event of the Participant’s death. The Participant may change or revoke any such designation from time to time without notice to or consent from any Beneficiary or spouse. No such designation, change or revocation shall be effective unless signed by the Participant and received by the Committee during the Participant’s lifetime. The Committee may establish rules for the use of electronic signatures. Until such rules are established, electronic signatures shall not be effective. Notwithstanding any other provision of this Plan Statement or any election or designation made under the Plan, any individual who feloniously and intentionally kills a Participant or Beneficiary shall be deemed for all purposes of the Plan and all elections and designations made under the Plan to have died before such Participant or Beneficiary.
- 7.2.2. **Failure of Designation.** If a Participant: (i) fails to designate a Beneficiary, (ii) designates a Beneficiary and thereafter revokes such designation without naming another Beneficiary, or (iii) designates one or more Beneficiaries and all such Beneficiaries so designated fail to survive the Participant, such Participant’s Account, or the part thereof as to which such Participant’s designation fails, as the case may be, shall be payable to the first class of the following classes of automatic Beneficiaries with a member surviving the Participant and (except in the case of the Participant’s surviving issue) in equal shares if there is more than one member in such class surviving the Participant:
- Participant’s surviving spouse
- Participant’s surviving issue per stirpes and not per capita
- Participant’s surviving parents
- Participant’s surviving brothers and sisters
- Representative of Participant’s estate.
- 17. CLAIM AND REVIEW PROCEDURES.** Effective for distributions made on and after January 1, 2009, Section 11.2 of the Plan Statement is amended to be read as follows (and Sections 11.3 through 11.7 shall be deleted):
- 11.2. **Claim and Review Procedures** . Until modified by the Committee, the claim and review procedures set forth in Section 10.2 of the Graco Employee Retirement Plan shall be the mandatory claims and review procedure for the resolution of disputes and disposition of claims filed under the Plan to be reviewed by the Vice President of Human Resources and the Committee.
- 18. INTERNAL REVENUE CODE STATUS.** Effective January 1, 2009, Section 13.2.2 of the Plan Statement shall be amended to read as follows:
- 13.2.2. **Internal Revenue Code Status.** The Plan is maintained as a nonqualified deferred compensation arrangement under section 409A of the Code. The rules of section 401(a) *et. seq.* of the Code shall not apply to the Plan. The rules of sections 3121(v) and 3306(r)(2) of the Code shall apply to the Plan. Each provision shall be interpreted and administered accordingly. Notwithstanding the foregoing, neither the Employer nor any of its officers, directors, agents or affiliates shall be obligated, directly or indirectly, to any Participant or any other person for any taxes, penalties, interest or like amounts that may be imposed on the Participant or other person on account of any amounts under this Plan or on account of any failure to comply with the Code.
- 19. CHOICE OF LAW.** Effective for claims filed on and after January 1, 2009, Section 13.3 of the Plan Statement shall be amended to read as follows:
- 13.3. **Choice of Law.** Except to the extent that federal law is controlling, the Plan shall be construed and enforced in accordance with the laws of the State of Minnesota (except that the state law will be applied without regard to any choice of law provisions).
- 20. CHOICE OF VENUE.** Effective for claims filed on and after January 1, 2009, a new Section 13.4 shall be added to the Plan Statement that reads as follows:
- 13.4. **Choice of Venue.** Any claim or action brought with respect to this Plan shall be brought in the Federal courts of the State of Minnesota.
- 21. PLAN STATEMENT CONTROLS.** Effective for claims filed on and after January 1, 2009, a new Section 13.5 shall be added to the Plan Statement that reads as follows:
- 13.5. **Plan Statement Controls.** If there is a discrepancy between this Plan Statement and other documents prepared with respect to the Plan, including any plan overview or summary, the terms of this Plan Statement shall control and govern over the other document.
- 22. SAVINGS CLAUSE.** Save and except as hereinabove expressly amended, the Plan Statement shall continue in full force and effect.

FIRST AMENDMENT
GRACO INC. RETIREMENT PLAN FOR NON-EMPLOYEE DIRECTORS
(1998 Statement)

Graco Inc. hereby amends the “GRACO INC. RETIREMENT PLAN FOR NON-EMPLOYEE DIRECTORS (1998 Statement)” (the “Plan”) as follows:

1. EFFECTIVE DATE. Effective January 1, 2009, the new second paragraph is added to Section 1 that reads as follows:

The Plan was frozen to new Participants in 2002. Effective January 1, 2009, Graco amended the to comply with section 409A of the Internal Revenue Code (“Code”). For Participants whose entire benefit under the Plan is a Grandfathered Benefit (a “Grandfathered Participant”), the following rules apply: (i) the Grandfathered Participant’s time and form of payment (and any rights to change the same) shall remain as provided under the prior plan statement and shall not be affected by this amendment, and (ii) no amendment that is a material modification of the Plan’s terms shall apply to the Grandfathered Participant’s benefit. The “Grandfathered Benefit” is a Participant’s benefit under the Plan which was earned and Vested as of December 31, 2004 (if any), and the adjustments of that benefit as permitted under section 409A of the Code. A Participant’s Grandfathered Benefit is the amount provided under section 1.409A-6(a)(3) of the Treasury Regulations, which is the present value of the amount to which the Participant would have been entitled under the plan if the Participant voluntarily terminated services without cause on December 31, 2004, and received a payment of the benefits available from the Plan on the earliest possible date allowed under the Plan to receive a payment of benefits following the termination of services, and received the benefits in the form with the maximum value. With respect to benefits that are not Grandfathered Benefits, the Plan is intended to comply with section 409A of the Code and shall be interpreted in that manner.

2. FREQUENCY. Effective January 1, 2009 for non-Grandfathered Benefits, a new sentence is added to the end of Section 3.3 that reads in full as follows: Participants shall receive four quarterly payments each year (even if the payment schedule for the active members of the Board of Directors changes).

3. DURATION. Effective January 1, 2009 for non-Grandfathered Benefits, the second and third sentences are deleted.

4. PAYMENT ON DEATH. Effective January 1, 2009 for non-Grandfathered Benefits, Section 4 is amended to reads in full as follows:

4. Payments Upon Death. If a Participant dies, before, on, or after Retirement, then payment shall be made to such Participant’s beneficiary as follows:

5. PAYMENT ON DEATH. Effective January 1, 2009 for non-Grandfathered Benefits, Section 4.1 is amended to reads in full as follows:

4.1. Amount. Payment shall be made in one lump sum of the remaining amount due to the Participant (if no amount has been paid, the lump sum will be of the Participant’s entire amount).

6. DATE OF PAYMENT. Effective January 1, 2009 for non-Grandfathered Benefits, Section 4.2 is amended to read in full as follows:

4.2. Date of Payment. Payment shall be made as of the January 1 (or as soon as practicable thereafter, but in all events in the same year as the January 1) following the date of the Participant’s death.

7. RETIREMENT. Effective January 1, 2009 for non-Grandfathered Benefits, two new sentences are added to the end of Section 5.1 that reads in full as follows:

A Retirement shall occur only if it constitutes a separation from service as defined under section 409A of the Code. If a Participant is a specified employee as defined under section 409A of the Code and payment is due based on the participant’s Retirement, then the delay in payment rules for specified employees under the Graco Deferred Compensation Plan shall be applied to the Participant.

8. SAVINGS CLAUSE. Save and except as hereinabove expressly amended, the Plan Statement shall continue in full force and effect.

**FOURTH AMENDMENT
GRACO RESTORATION PLAN
(2005 Statement)**

Graco Inc. hereby amends the “GRACO RESTORATION PLAN (2005 Statement)” (as amended, the “Plan Statement”) as follows:

1. PREAMBLE. Effective January 1, 2009, the second paragraph of Section 1.1 of the Plan Statement (which begins, “Effective January 1, 2005...”) shall be amended to read as follows:

Effective January 1, 2005, Graco restated the Plan in this nonqualified, unfunded, deferred compensation plan for the benefit of a select group of management or highly compensated employees of Graco and participating Employers. For Participants whose entire benefit under the Plan is a Grandfathered Benefit (a “Grandfathered Participant”), the following rules apply: (i) the Grandfathered Participant’s time and form of payment (and any rights to change the same) shall remain as provided under the prior plan statement and shall not be affected by this restatement, (ii) the Grandfathered Participant shall not be eligible for any increase in amount of benefit or additional options provided for under this Plan Statement, and (iii) no amendment that is a material modification of the prior plan statement’s terms shall apply to the Grandfathered Participant’s benefit. The provisions of this Plan Statement that do not affect the time and form of payment, the amount of payment, and payment options (such as the claim and review procedure under Section 11) shall apply to the Grandfathered Participant and the Grandfathered Benefit (unless guidance from the Internal Revenue Service indicates that application of such sections, such as Section 9 (amendment), Section 11 (claim and review procedures), Section 12 (administration), Section 13 (miscellaneous), or other administrative provisions in this Plan Statement are a material modification, in which case the particular provision that is a material modification shall not apply). The “Grandfathered Benefit” is a Participant’s benefit under the Plan which was earned and Vested as of December 31, 2004 (if any), and the adjustments of that benefit as permitted under section 409A of the Code. A Participant’s Grandfathered Benefit is the amount provided under section 1.409A-6(a)(3) of the Treasury Regulations, which is the present value of the amount to which the Participant would have been entitled under the plan if the service provider voluntarily terminated services without cause on December 31, 2004, and received a payment of the benefits available from the Plan on the earliest possible date allowed under the Plan to receive a payment of benefits following the termination of services, and received the benefits in the form with the maximum value.

2. CHIEF ADMINISTRATIVE OFFICER. Effective January 1, 2009, Section 1.2.1 is deleted (with subsequent sections and cross references renumbered as appropriate) and the term “Chief Administrative Officer” in the document shall be replaced by the term “Vice President of Human Resources” (which is being added as a new definition).

3. DISABILITY. Effective for determinations of disability on and after January 1, 2009, Section 1.2.3 of the Plan Statement (prior to this amendment Section 1.2.4) shall be amended to read as follows:

1.2.3. Disability or Disabled. — a Participant will be considered disabled if the Participant (i) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, or (ii) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, receiving income replacement benefits for a period of not less than three (3) months under an accident and health plan covering employees of the Participant’s employer.

4. SPECIFIED EMPLOYEE. Effective for determinations of who is a specified employee on and after January 1, 2009, a new Section 1.2.12 shall be added to the Plan Statement that reads as follows:

1.2.12. Specified Employee — a Participant who is a specified employee for purposes of section 409A of the Code.

5. VICE PRESIDENT OF HUMAN RESOURCES. Effective January 1, 2009, a new Section 1.2.13 shall be added to the Plan Statement that reads as follows:

1.2.13. Vice President of Human Resources. — the Vice President of Human Resources or, if such position does not exist, the senior officer responsible for the human resources function.

6. DELAY IN DISTRIBUTION TO SPECIFIED EMPLOYEES. Effective for distributions made on and after January 1, 2009, Section 7.1.1(b) of the Plan Statement is amended to read as follows:

(b) **Delay for Specified Employees.** If a Participant is a Specified Employee as of the date of distribution, distribution shall commence the later of (i) the date distribution is to be made, or (ii) the first day of the month following the date that is six (6) months after the date of the Participant’s Separation from Service (or, if earlier, the date of the Participant’s death). Distributions that would have been made during the six (6)–month delay period shall all be paid to the Participant on the first day of the month following the date that is six (6) months after the date of the Participant’s Separation from Service (along with the regular payment that is to be paid on that date).

7. ALTERNATE FORMS OF DISTRIBUTION. Effective for distributions made on and after January 1, 2009, Section 7.1.2(c) of the Plan Statement is amended to add two additional sentences at the end (after the sentence that begins, “The actuarial determination...”) that read as follows: The survivor forms of annuities are available only if the Participant is married at the time benefits commence and the survivor named is the Participant’s spouse as of the date benefits commence. If the Participant’s Beneficiary is an individual other than the Participant’s spouse, the Participant’s beneficiary designation is effective only if the Participant elects to receive a term certain annuity or a single lump sum payment.

8. SMALL AMOUNT DISTRIBUTION. Effective for distributions made on and after January 1, 2009, Section 7.1.2(d) of the Plan Statement is amended to read as follows:

(d) **Small Amount Lump Sum Distribution.** If the value of a Participant’s benefit under the Plan as of the date benefit is to commence is equal to or less than the limit under section 402(g)(1)(B) of the Code (as adjusted for the applicable year), the benefit shall be paid in a single lump sum payment.

9. DEATH PRIOR TO FULL DISTRIBUTION. Effective for distributions made on and after January 1, 2009, a new Section 7.1.4 is added to the Plan Statement that reads as follows:

7.1.4. Death Prior to Full Distribution. If the Participant dies before distribution of the Participant’s benefit has been commenced or completed, the remainder of the undistributed benefit shall be distributed in the form provided for before the Participant’s death. The Beneficiary shall not have the right to elect to change the time or form of distribution.

10. GENERAL DISTRIBUTION RULES - BENEFICIARIES. Effective January 1, 2009, Sections 7.2, 7.2.1, and 7.2.2 are re-numbered as Sections 7.3, 7.31, and 7.3.2 respectively, and Section 7.2 of the Plan Statement is amended to read as follows:

7.2. Designation of Beneficiaries

7.2.1. Right to Designate. Each Participant may designate, upon forms to be furnished by and filed in accordance with procedures established by the Committee, one or more primary Beneficiaries or alternative Beneficiaries to receive all or a specified part of the Participant’s Account in the event of the Participant’s death. The Participant may change or revoke any such designation from time to time without notice to or consent from any Beneficiary or spouse. No such designation, change or revocation shall be effective unless signed by the Participant and received by the Committee during the Participant’s lifetime. The Committee may establish rules for the use of electronic signatures. Until such rules are established, electronic signatures shall not be effective. Notwithstanding any other provision of this Plan Statement or any election or designation made under the Plan, any individual who feloniously and intentionally kills a Participant or Beneficiary shall be deemed for all purposes of the Plan and all elections and designations made under the Plan to have died before such Participant or Beneficiary. With respect to the survivor forms of annuities, the only Beneficiary allowed is a Participant’s spouse as of the date payment commences.

7.2.2. Failure of Designation. If a Participant: (i) fails to designate a Beneficiary, (ii) designates a Beneficiary and thereafter revokes such designation without naming another Beneficiary, or (iii) designates one or more Beneficiaries and all such Beneficiaries so designated fail to survive the Participant, such Participant’s Account, or the part thereof as to which such Participant’s designation fails, as the case may be, shall be payable to the first class of the following classes of automatic Beneficiaries with a member surviving the Participant and (except in the case of the Participant’s surviving issue) in equal shares if there is more than one member in such class surviving the Participant:

Participant’s surviving spouse
Participant’s surviving issue per stirpes and not per capita
Participant’s surviving parents
Participant’s surviving brothers and sisters
Representative of Participant’s estate.

- 11. NON-DUPPLICATION OF BENEFITS.** Effective January 1, 2009, Section 7.2.3 is re-numbered as Section 7.4.
- 12. CLAIM AND REVIEW PROCEDURES.** Effective for distributions made on and after January 1, 2009, Section 11.2 of the Plan Statement is amended to be read as follows:
- 11.2. **Claim and Review Procedures.** Until modified by the Committee, the claim and review procedures set forth in Section 10.2 of the Graco Employee Retirement Plan shall be the mandatory claims and review procedure for the resolution of disputes and disposition of claims filed under the Plan to be reviewed by the Vice President of Human Resources and the Committee.
- 13. CHOICE OF LAW.** Effective for claims filed on and after January 1, 2009, Section 13.3 of the Plan Statement shall be amended to read as follows:
- 13.3. **Choice of Law.** Except to the extent that federal law is controlling, the Plan shall be construed and enforced in accordance with the laws of the State of Minnesota (except that the state law will be applied without regard to any choice of law provisions).
- 14. CHOICE OF VENUE.** Effective for claims filed on and after January 1, 2009, a new Section 13.4 shall be added to the Plan Statement that reads as follows:
- 13.4. **Choice of Venue.** Any claim or action brought with respect to this Plan shall be brought in the Federal courts of the State of Minnesota.
- 15. PLAN STATEMENT CONTROLS.** Effective for claims filed on and after January 1, 2009, a new Section 13.5 shall be added to the Plan Statement that reads as follows:
- 13.5. **Plan Statement Controls.** If there is a discrepancy between this Plan Statement and other documents prepared with respect to the Plan, including any plan overview or summary, the terms of this Plan Statement shall control and govern over the other document.
- 16. SAVINGS CLAUSE.** Save and except as hereinabove expressly amended, the Plan Statement shall continue in full force and effect.

AGREEMENT

AGREEMENT ENTERED INTO this 4th day of December 4, 2008, (“Agreement”) by and between GRACO INC., a Minnesota corporation, with its principal place of business at 88 11th Avenue N.E., Minneapolis, Minnesota 55413, (hereinafter “Company”) and <<NAME>>, an individual (hereinafter “Employee”)

WHEREAS the Company and the Employee entered into a written agreement in 1994 (“1994 Agreement”) whereby the Company, *inter alia*, agreed to make certain payments to the Employee after his retirement;

WHEREAS, the Company ratified the 1994 Agreement in 2002 because the original agreement could not be found and on the 28th day of June 2002 reaffirmed its commitment to provide the benefits set forth therein with an effective date of the 1st day of January 1994;

WHEREAS, Section 409A of the Internal Revenue Code as amended applies to the benefits described therein from and after January 1, 2005;

WHEREAS, in order to comply with Section 409A and the regulations promulgated thereunder, the 1994 Agreement must be amended; and

WHEREAS, the Management Organization and Compensation Committee of the Company, at its meeting dated December 4, 2008, approved a present value lump sum payout of the future benefit amount payable to the Employee under the terms of the Agreement, with such payout to occur in early 2009.

NOW, THEREFORE, the parties mutually agree as follows:

- I. Notwithstanding anything to the contrary in the Agreement, the Agreement shall be amended to provide for the present value lump sum payout of the future benefit amount payable to the Employee under the terms of the Agreement, with such payout to occur in January 2009, in lieu of all benefit payment obligations thereunder.
- II. The effective date of this amendment shall be December 4, 2008.

IN WITNESS WHEREOF, the parties execute this Agreement as of the day and year first above written.

GRACO INC.

EMPLOYEE

By _____

<<NAME>>

Its _____

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:	<div></div> <div>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.</div>

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)*	Secondary Beneficiary(ies)* (If no primary beneficiary survives you)
Name _____	Name _____
Address _____	Address _____
_____	_____
Name _____	Name _____
Address _____	Address _____
_____	_____
*Your Primary Beneficiaries will share equally unless any beneficiary dies before you or unless you specify otherwise above.	*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.

6.1.1. Rules. Unless a Participating Director has otherwise specified in his Beneficiary designation, the following rules shall apply:

(a) If there is insufficient evidence that a Beneficiary was living at the time of the death of the Participating Director, the Beneficiary shall be deemed to be not living at the time of the Participating Director's death.

(b) The Beneficiaries designated by the Participating Director shall become fixed at the time of the Participating Director's death so that, if a Beneficiary survives the Participating Director but dies before the receipt of payment due such Beneficiary hereunder, such payment shall be made to the representatives of such Beneficiary's estate.

(c) If the Participating Director designates as a Beneficiary the person who is the Participating Director's spouse on the date of the designation, either by name or relationship, or both, the dissolution, annulment or other legal termination of the marriage between the Participating Director and such person shall automatically revoke such designation. The foregoing shall not prevent the Participating Director from designating a former spouse as a Beneficiary on a form signed by the Participating Director and received by the Secretary of the Company after the date of the legal termination of the marriage between the Participating Director and such former spouse, and during the Participating Director's lifetime. Notwithstanding the foregoing, if the Participating Director has elected to have the Stock registered in the name of the Participating Director and another person, and the Participating Director has commenced receiving payment under the Program, the joint owner of the Stock may not be changed.

(d) Any designation of a Beneficiary by name accompanied by a description of the relationship of the Beneficiary to the Participating Director shall be given effect without regard to whether the relationship to the Participating Director exists either then or at the time of the Participating Director's death.

(e) Any designation of a Beneficiary only by statement of the Beneficiary's relationship to the Participating Director shall be effective only to designate the person or persons standing in that relationship to the Participating Director at the time of the Participating Director's death.

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.