

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended **July 1, 2005**

Commission File Number: 001-9249

GRACO INC.

(Exact name of registrant as specified in its charter)

Minnesota

(State of incorporation)

41-0285640

(I.R.S. Employer Identification Number)

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

(Address of principal executive offices)

55413

(Zip Code)

(612) 623-6000

(Registrant's telephone number, including area code)

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

Yes No

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

Yes No

68,704,000 common shares were outstanding as of July 22, 2005.

GRACO INC. AND SUBSIDIARIES

INDEX

| | | <u>Page Number</u> |
|----------------|--|--------------------|
| PART I | FINANCIAL INFORMATION | |
| Item 1. | Financial Statements | |
| | Consolidated Statements of Earnings | 3 |
| | Consolidated Balance Sheets | 4 |
| | Consolidated Statements of Cash Flows | 5 |
| | Notes to Consolidated Financial Statements | 6-12 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 13-16 |
| Item 4. | Controls and Procedures | 16 |
| PART II | OTHER INFORMATION | |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 17 |
| Item 4. | Submission of Matters to a Vote of Security Holders | 18 |

SIGNATURES**EXHIBITS****PART I****GRACO INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS**

(Unaudited)

(In thousands except per share amounts)

| | <u>Thirteen Weeks Ended</u> | | <u>Twenty-six Weeks Ended</u> | |
|---|-----------------------------|----------------------|-------------------------------|----------------------|
| | <u>July 1, 2005</u> | <u>June 25, 2004</u> | <u>July 1, 2005</u> | <u>June 25, 2004</u> |
| Net Sales | \$ 198,221 | \$ 160,165 | \$ 369,165 | \$ 295,147 |
| Cost of products sold | 95,929 | 75,023 | 181,007 | 136,601 |
| Gross Profit | 102,292 | 85,142 | 188,158 | 158,546 |
| Product development | 6,615 | 5,445 | 12,859 | 10,567 |
| Selling, marketing and distribution | 28,272 | 25,130 | 54,679 | 49,527 |
| General and administrative | 13,061 | 9,570 | 25,109 | 20,013 |
| Operating Earnings | 54,344 | 44,997 | 95,511 | 78,439 |
| Interest expense | 508 | 98 | 847 | 269 |
| Other expense, net | 198 | 220 | 387 | 164 |
| Earnings before Income Taxes | 53,638 | 44,679 | 94,277 | 78,006 |
| Income taxes | 18,000 | 14,700 | 31,600 | 25,700 |
| Net Earnings | \$ 35,638 | \$ 29,979 | \$ 62,677 | \$ 52,306 |
| Basic Net Earnings per Common Share | \$.52 | \$.43 | \$.91 | \$.76 |
| Diluted Net Earnings per Common Share | \$.51 | \$.43 | \$.89 | \$.74 |
| Cash Dividends Declared per Common Share | \$.13 | \$.09 | \$.26 | \$.19 |

See notes to consolidated financial statements.

**GRACO INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS**

(Unaudited)

(In thousands)

| | <u>July 1, 2005</u> | <u>Dec. 31, 2004</u> |
|--|---------------------|----------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 7,111 | \$ 60,554 |
| Accounts receivable, less allowances of \$6,200 and \$5,600 | 132,550 | 109,080 |
| Inventories | 59,011 | 40,219 |
| Deferred income taxes | 15,848 | 15,631 |
| Other current assets | 1,675 | 1,742 |
| Total current assets | 216,195 | 227,226 |
| Property, Plant and Equipment | | |
| Cost | 251,115 | 231,819 |
| Accumulated depreciation | (146,074) | (137,309) |
| Property, plant and equipment, net | 105,041 | 94,510 |
| Prepaid Pension | 28,606 | 27,556 |
| Goodwill | 49,174 | 9,199 |
| Other Intangible Assets, net | 38,089 | 8,959 |
| Other Assets | 4,349 | 4,264 |

Total Assets

\$ 441,454

\$ 371,714

LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities

| | | |
|---------------------------------|-----------|----------|
| Notes payable to banks | \$ 47,752 | \$ 6,021 |
| Trade accounts payable | 23,460 | 18,599 |
| Salaries, wages and commissions | 15,828 | 19,804 |
| Dividends payable | 8,931 | 8,990 |
| Other current liabilities | 43,133 | 43,359 |

Total current liabilities

139,104

96,773

Retirement Benefits and Deferred Compensation

32,623

33,092

Deferred Income Taxes

10,989

11,012

Shareholders' Equity

| | | |
|----------------------------|---------|---------|
| Common stock | 68,698 | 68,979 |
| Additional paid-in capital | 108,574 | 100,180 |
| Retained earnings | 84,194 | 62,773 |
| Other, net | (2,728) | (1,095) |

Total shareholders' equity

258,738

230,837

Total Liabilities and Shareholders' Equity

\$ 441,454

\$ 371,714

See notes to consolidated financial statements.

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

Twenty-six Weeks Ended

July 1, 2005

June 25, 2004

Cash Flows from Operating Activities

| | | |
|--|-----------|-----------|
| Net Earnings | \$ 62,677 | \$ 52,306 |
| Adjustments to reconcile net earnings to net cash provided by operating activities | | |
| Depreciation and amortization | 11,806 | 9,076 |
| Deferred income taxes | (734) | (958) |
| Tax benefit related to stock options exercised | 1,200 | 4,000 |
| Change in | | |
| Accounts receivable | (16,747) | (11,970) |
| Inventories | 1,491 | (5,586) |
| Trade accounts payable | (427) | 4,359 |
| Salaries, wages and commissions | (5,540) | (2,556) |
| Retirement benefits and deferred compensation | (614) | (551) |
| Other accrued liabilities | (3,406) | 3,027 |
| Other | 51 | 216 |

Net cash provided by operating activities

49,757

51,363

Cash Flows from Investing Activities

| | | |
|---|-----------|---------|
| Property, plant and equipment additions | (9,177) | (6,377) |
| Proceeds from sale of property, plant and equipment | 46 | 115 |
| Capitalized software additions | (402) | (802) |
| Acquisitions of businesses, net of cash acquired | (102,797) | -- |

Net cash used in investing activities

(112,330)

(7,064)

Cash Flows from Financing Activities

| | | |
|---|----------|-----------|
| Borrowings on notes payable and lines of credit | 69,749 | 13,367 |
| Payments on notes payable and lines of credit | (27,730) | (8,961) |
| Common stock issued | 8,639 | 12,146 |
| Common stock retired | (25,077) | (23,773) |
| Cash dividends paid | (17,964) | (116,998) |

Net cash used in financing activities

7,617

(124,219)

Effect of exchange rate changes on cash

1,513

241

Net increase (decrease) in cash and cash equivalents

(53,443)

(79,679)

| | | |
|---------------------------|----------|-----------|
| Cash and cash equivalents | | |
| Beginning of year | 60,554 | 112,118 |
| End of period | \$ 7,111 | \$ 32,439 |

See notes to consolidated financial statements.

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

1. The consolidated balance sheet of Graco Inc. and Subsidiaries (the Company) as of July 1, 2005, and the related statements of earnings for the thirteen and twenty-six weeks ended July 1, 2005 and June 25, 2004, and cash flows for the twenty-six weeks ended July 1, 2005 and June 25, 2004 have been prepared by the Company without being audited.

In the opinion of management, these consolidated statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of Graco Inc. and Subsidiaries as of July 1, 2005, and the results of operations and cash flows for all periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. Therefore, these statements should be read in conjunction with the financial statements and notes thereto included in the Company's 2004 Form 10-K.

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

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

| | <u>Thirteen Weeks Ended</u> | | <u>Twenty-six Weeks Ended</u> | |
|--|-----------------------------|----------------------|-------------------------------|----------------------|
| | <u>July 1, 2005</u> | <u>June 25, 2004</u> | <u>July 1, 2005</u> | <u>June 25, 2004</u> |
| Net earnings available to common shareholders | \$ 35,638 | \$ 29,979 | \$ 62,677 | \$ 52,306 |
| Weighted average shares outstanding for basic earnings per share | 68,959 | 69,243 | 69,016 | 69,162 |
| Dilutive effect of stock options computed using the treasury stock method and the average market price | 1,077 | 1,040 | 1,139 | 1,100 |
| Weighted average shares outstanding for diluted earnings per share | 70,036 | 70,283 | 70,155 | 70,262 |
| Basic earnings per share | \$.52 | \$.43 | \$.91 | \$.76 |
| Diluted earnings per share | \$.51 | \$.43 | \$.89 | \$.74 |

Stock options to purchase 382,800 shares are not included in the 2005 calculation of diluted earnings per share because they would have been anti-dilutive.

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

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

| | <u>Thirteen Weeks Ended</u> | | <u>Twenty-six Weeks Ended</u> | |
|--|-----------------------------|----------------------|-------------------------------|----------------------|
| | <u>July 1, 2005</u> | <u>June 25, 2004</u> | <u>July 1, 2005</u> | <u>June 25, 2004</u> |
| Net earnings | | | | |
| As reported | \$35,638 | \$29,979 | \$62,677 | \$52,306 |
| Stock-based compensation, net of related tax effects | 1,246 | 843 | 2,304 | 1,716 |
| Pro forma | \$34,392 | \$29,136 | \$60,373 | \$50,590 |
| Net earnings per common share | | | | |
| Basic as reported | \$.52 | \$.43 | \$.91 | \$.76 |
| Basic pro forma | .50 | .42 | .87 | .73 |
| Diluted as reported | .51 | .43 | .89 | .74 |
| Diluted pro forma | .49 | .41 | .86 | .72 |

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (Revised 2004), "Share-Based Payment" that requires compensation costs related to share-based payment transactions to be recognized in the financial statements. This standard will be effective for the Company starting with the first quarter of 2006. Annual compensation cost, net of tax effects, related to unvested stock compensation as of July 1, 2005 is approximately \$4.8 million in 2005, \$2.6 million in 2006, \$1.8 million in 2007 and \$0.7 million in 2008 (as valued and calculated under SFAS 123 pro forma disclosures.) The Company has not yet determined how it will value future grants or whether it will elect to adjust prior periods upon adoption of SFAS No. 123 (Revised 2004).

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

| | <u>Thirteen Weeks Ended</u> | | <u>Twenty-six Weeks Ended</u> | |
|------------------------------------|-----------------------------|----------------------|-------------------------------|----------------------|
| | <u>July 1, 2005</u> | <u>June 25, 2004</u> | <u>July 1, 2005</u> | <u>June 25, 2004</u> |
| Pension Benefits | | | | |
| Service cost | \$ 1,104 | \$ 1,025 | \$ 2,355 | \$ 2,085 |
| Interest cost | 2,482 | 2,182 | 4,971 | 4,361 |
| Expected return on assets | (3,950) | (3,523) | (7,900) | (7,048) |
| Amortization and other | 68 | 113 | 225 | 258 |
| Net periodic benefit cost (credit) | <u>\$ (296)</u> | <u>\$ (203)</u> | <u>\$ (349)</u> | <u>\$ (344)</u> |
| Postretirement Medical | | | | |
| Service cost | \$ 225 | \$ 135 | \$ 450 | \$ 385 |
| Interest cost | 410 | 363 | 820 | 751 |
| Amortization of net loss | 115 | 114 | 230 | 226 |
| Net periodic benefit cost | <u>\$ 750</u> | <u>\$ 612</u> | <u>\$ 1,500</u> | <u>\$ 1,362</u> |

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

| | <u>Thirteen Weeks Ended</u> | | <u>Twenty-six Weeks Ended</u> | |
|--|-----------------------------|----------------------|-------------------------------|----------------------|
| | <u>July 1, 2005</u> | <u>June 25, 2004</u> | <u>July 1, 2005</u> | <u>June 25, 2004</u> |
| Net income | \$ 35,638 | \$ 29,979 | \$ 62,677 | \$ 52,306 |
| Foreign currency translation adjustments | (1,657) | -- | (1,774) | -- |
| Minimum pension liability adjustment, net of tax | 17 | -- | 31 | (366) |
| Comprehensive income | <u>\$ 33,998</u> | <u>\$ 29,979</u> | <u>\$ 60,934</u> | <u>\$ 51,940</u> |

The functional currency of certain subsidiaries in Great Britain and Spain, each acquired in 2005, is local currency. Accordingly, adjustments resulting from the translation of those subsidiaries' financial statements into U.S. dollars are charged or credited to accumulated other comprehensive income.

6. The Company has three reportable segments; Industrial/Automotive, Contractor and Lubrication. The Company does not identify assets by segment. Sales and operating earnings by segment for the thirteen and twenty-six weeks ended July 1, 2005 and June 25, 2004 were as follows (in thousands):

| | <u>Thirteen Weeks Ended</u> | | <u>Twenty-six Weeks Ended</u> | |
|--------------------------------|-----------------------------|----------------------|-------------------------------|----------------------|
| | <u>July 1, 2005</u> | <u>June 25, 2004</u> | <u>July 1, 2005</u> | <u>June 25, 2004</u> |
| Net Sales | | | | |
| Industrial/Automotive | \$ 93,775 | \$ 66,471 | \$ 181,644 | \$ 129,722 |
| Contractor | 89,567 | 81,610 | 157,347 | 140,585 |
| Lubrication | 14,879 | 12,084 | 30,174 | 24,840 |
| Consolidated | <u>\$ 198,221</u> | <u>\$ 160,165</u> | <u>\$ 369,165</u> | <u>\$ 295,147</u> |
| Operating Earnings | | | | |
| Industrial/Automotive | \$ 24,700 | \$ 20,210 | \$ 46,664 | \$ 40,475 |
| Contractor | 25,754 | 23,371 | 40,840 | 35,296 |
| Lubrication | 4,047 | 2,648 | 8,246 | 5,650 |
| Unallocated Corporate expenses | (157) | (1,232) | (239) | (2,982) |
| Consolidated | <u>\$ 54,344</u> | <u>\$ 44,997</u> | <u>\$ 95,511</u> | <u>\$ 78,439</u> |

Segment operating earnings for 2004 have been restated to conform to 2005, which includes amortization of intangibles formerly classified as unallocated corporate expense.

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

| | <u>July 1, 2005</u> | <u>Dec. 31, 2004</u> |
|---|---------------------|----------------------|
| Finished products and components | \$ 43,338 | \$ 29,263 |
| Products and components in various stages of completion | 22,127 | 18,656 |
| Raw materials and purchased components | 22,066 | 19,929 |
| | <u>87,531</u> | <u>67,848</u> |
| Reduction to LIFO cost | (28,520) | (27,629) |
| | <u>\$ 59,011</u> | <u>\$ 40,219</u> |

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

| | <u>Estimated Life (Years)</u> | <u>Original Cost</u> | <u>Amorti- zation</u> | <u>Foreign Currency Translation</u> | <u>Book Value</u> |
|---|-----------------------------------|--------------------------|---------------------------|---|-----------------------|
| <u>July 1, 2005</u> | | | | | |
| Customer relationships and distribution network | 4 - 8 | \$20,365 | \$(2,937) | \$(322) | \$17,106 |
| Patents, proprietary technology and product documentation | 3 - 15 | 10,871 | (1,291) | (131) | 9,449 |
| Trademarks, trade names favorable lease and other | 3 - 10 | 1,774 | (679) | -- | 1,095 |
| | | <u>33,010</u> | <u>(4,907)</u> | <u>(453)</u> | <u>27,650</u> |
| Not Subject to Amortization: Brand names | | 10,550 | -- | (111) | 10,439 |
| Total | | <u>\$43,560</u> | <u>\$(4,907)</u> | <u>\$(564)</u> | <u>\$38,089</u> |
| <u>December 31, 2004</u> | | | | | |
| Customer relationships and distribution network | 5 | \$ 3,765 | \$(1,543) | \$ -- | \$ 2,222 |
| Patents, proprietary technology and product documentation | 3 - 15 | 1,241 | (611) | -- | 630 |
| Trademarks, trade names and other | 2 - 10 | 1,494 | (667) | -- | 827 |
| | | <u>6,500</u> | <u>(2,821)</u> | <u>--</u> | <u>3,679</u> |
| Not Subject to Amortization: Brand names | | 5,280 | -- | -- | 5,280 |
| Total | | <u>\$11,780</u> | <u>\$(2,821)</u> | <u>\$ --</u> | <u>\$ 8,959</u> |

Amortization of intangibles was \$1.2 million in the second quarter of 2005 and \$2.2 million year-to-date. Estimated annual amortization is as follows: \$4.5 million in 2005, \$4.6 million in 2006, \$4.6 million in 2007, \$3.9 million in 2008, \$3.5 million in 2009 and \$9.2 million thereafter.

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

| | <u>July 1, 2005</u> | <u>Dec. 31, 2004</u> |
|--|---------------------|----------------------|
| Accrued insurance liabilities | \$ 9,007 | \$ 9,139 |
| Accrued warranty and service liabilities | 8,752 | 9,409 |
| Accrued trade promotions | 4,870 | 6,574 |
| Payable for employee stock purchases | 2,665 | 4,913 |
| Income taxes payable | 4,385 | 2,188 |
| Other | 13,454 | 11,136 |
| | <u>\$43,133</u> | <u>\$43,359</u> |

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

| | <u>Twenty-Six Weeks Ended July 1, 2005</u> | <u>Year Ended Dec. 31, 2004</u> |
|----------------------------|--|-------------------------------------|
| Balance, beginning of year | \$ 9,409 | \$ 9,227 |
| Charged to expense | 3,530 | 8,066 |

| | | |
|--------------------------------|-----------------|-----------------|
| Margin on parts sales reversed | 1,076 | 2,516 |
| Reductions for claims settled | (5,263) | (10,400) |
| Balance, end of period | <u>\$ 8,752</u> | <u>\$ 9,409</u> |

10. Effective January 1, 2005, the Company purchased the stock of Liquid Control Corporation, Inc. and its affiliated company Profill Corp. for approximately \$35 million cash. Liquid Control designs and manufactures highly engineered precision resin dispensing equipment, which will expand and complement the Company's Industrial/Automotive business. Liquid Control had sales of approximately \$26 million in 2004. Results of Liquid Control's operations have been included in the Industrial/Automotive segment since the date of acquisition.

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

| | |
|--|-----------------|
| Accounts receivable and prepaid expenses | \$ 2,900 |
| Inventories | 4,900 |
| Property, plant and equipment | 7,800 |
| Identifiable intangible assets | 16,100 |
| Goodwill | 8,600 |
| Total purchase price | <u>40,300</u> |
| Liabilities assumed | <u>(4,900)</u> |
| Net assets acquired | <u>\$35,400</u> |

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

| | |
|--------------------------------------|-----------------|
| Customer relationships (8 years) | \$10,100 |
| Proprietary technology (8 years) | 3,500 |
| Total (8 years) | <u>13,600</u> |
| Brand names (indefinite useful life) | 2,500 |
| Total identifiable intangible assets | <u>\$16,100</u> |

For tax purposes, the transaction will be treated as a purchase of assets and goodwill is expected to be fully deductible.

Effective February 4, 2005, the Company purchased the stock of Gusmer Corporation Inc. and Gusmer Europe, S.L. for approximately \$68 million cash. Gusmer designs and manufactures specialized two-component dispense equipment systems, which will expand and complement the Company's Industrial/Automotive business. Gusmer had sales of approximately \$43 million in 2004. Results of Gusmer's operations have been included in the Industrial/Automotive segment since the date of acquisition.

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

| | |
|--------------------------------|-----------------|
| Cash and cash equivalents | \$ 500 |
| Accounts receivable | 7,400 |
| Inventories | 15,600 |
| Property, plant and equipment | 2,900 |
| Identifiable intangible assets | 15,800 |
| Goodwill | 32,200 |
| Total purchase price | <u>74,400</u> |
| Liabilities assumed | <u>(6,500)</u> |
| Net assets acquired | <u>\$67,900</u> |

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

| | |
|--------------------------------------|-----------------|
| Customer relationships (7 years) | \$ 6,500 |
| Proprietary technology (8 years) | 4,400 |
| Product documentation (5 years) | 1,800 |
| Favorable lease (3 years) | 400 |
| Total (7 years) | <u>13,100</u> |
| Brand names (indefinite useful life) | 2,700 |
| Total identifiable intangible assets | <u>\$15,800</u> |

For tax purposes, the transaction will be treated as a purchase of assets and goodwill is expected to be fully deductible.

The following pro forma information assumes the acquisitions of Liquid Control and Gusmer occurred as of the beginning of each quarter presented. The pro forma information is not necessarily indicative of what would have actually occurred or of future results (in thousands),

except per share amounts).

| | <u>Thirteen Weeks Ended</u> | | <u>Twenty-six Weeks Ended</u> | |
|----------------------------|-----------------------------|----------------------|-------------------------------|----------------------|
| | <u>July 1, 2005</u> | <u>June 25, 2004</u> | <u>July 1, 2005</u> | <u>June 25, 2004</u> |
| Net sales | \$198,221 | \$177,725 | \$373,784 | \$330,266 |
| Net earnings | 35,638 | 29,357 | 62,094 | 49,614 |
| Basic earnings per share | .52 | .42 | .90 | .72 |
| Diluted earnings per share | .51 | .42 | .88 | .71 |

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

Item 2.

Results of Operations

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

| | <u>Thirteen Weeks Ended</u> | | <u>Twenty-six Weeks Ended</u> | |
|-------------------------------------|-----------------------------|----------------------|-------------------------------|----------------------|
| | <u>July 1, 2005</u> | <u>June 25, 2004</u> | <u>July 1, 2005</u> | <u>June 25, 2004</u> |
| Net Sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of products sold | 48.4 | 46.8 | 49.0 | 46.3 |
| Gross Profit | 51.6 | 53.2 | 51.0 | 53.7 |
| Product development | 3.3 | 3.4 | 3.5 | 3.6 |
| Selling, marketing and distribution | 14.3 | 15.7 | 14.8 | 16.7 |
| General and administrative | 6.6 | 6.0 | 6.8 | 6.8 |
| Operating Earnings | 27.4 | 28.1 | 25.9 | 26.6 |
| Interest expense | 0.2 | 0.1 | 0.2 | 0.1 |
| Other (income) expense, net | 0.1 | 0.1 | 0.1 | 0.1 |
| Earnings Before Income Taxes | 27.1 | 27.9 | 25.6 | 26.4 |
| Income taxes | 9.1 | 9.2 | 8.6 | 8.7 |
| Net Earnings | 18.0% | 18.7% | 17.0% | 17.7% |

Net Sales

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

| | <u>Thirteen Weeks Ended</u> | | <u>Twenty-six Weeks Ended</u> | |
|---------------------------|-----------------------------|----------------------|-------------------------------|----------------------|
| | <u>July 1, 2005</u> | <u>June 25, 2004</u> | <u>July 1, 2005</u> | <u>June 25, 2004</u> |
| By Segment | | | | |
| Industrial/Automotive | \$ 93,775 | \$ 66,471 | \$181,644 | \$129,722 |
| Contractor | 89,567 | 81,610 | 157,347 | 140,585 |
| Lubrication | 14,879 | 12,084 | 30,174 | 24,840 |
| Consolidated | \$198,221 | \$160,165 | \$369,165 | \$295,147 |
| By Geographic Area | | | | |
| Americas ¹ | \$132,571 | \$107,767 | \$246,590 | \$197,042 |
| Europe ² | 40,317 | 33,078 | 76,026 | 60,992 |
| Asia Pacific | 25,333 | 19,320 | 46,549 | 37,113 |
| Consolidated | \$198,221 | \$160,165 | \$369,165 | \$295,147 |

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

² Europe, Africa and Middle East

Compared to last year, consolidated sales increased by 24 percent for the quarter and 25 percent year-to-date. Sales from acquired businesses contributed 12 percentage points to the quarter increase and 11 percentage points to the year-to-date increase. The favorable impact of currency translations contributed 1 percentage point to the quarter increase and 2 percentage points year-to-date. All operating segments and geographic regions experienced double-digit percentage growth in sales for both the quarter and year-to-date.

Industrial / Automotive segment sales increased 41 percent for the quarter and 40 percent year-to-date. Acquired businesses contributed 27 and 25 percentage points to the quarterly and year-to date increases, respectively, and favorable currency translations contributed 3 percentage points to both the quarter and year-to-date. The remaining increase was due to strong demand in the Americas and Asia Pacific.

Contractor segment sales increased 10 percent for the quarter and 12 percent year-to-date. In the Americas, sales were higher in both the professional paint store and home center channels due to new products and strong underlying demand. In Europe, demand for the segment's

products remained strong, resulting in double-digit percentage sales growth.

Lubrication segment sales increased 23 percent for the quarter and 21 percent year-to-date. Sales were higher in all major products and all geographic regions.

Gross Profit

Gross profit as a percentage of sales was 51.6 percent for the second quarter and 51.0 percent year-to-date, down from 53.2 percent and 53.7 percent, respectively, last year. Most of the decrease was due to the impact of acquisitions, including lower margins on acquired products and the recognition of costs assigned to inventories as part of the valuation of assets acquired. Gross profit rate is expected to improve as most of the acquired inventory has been sold. Other factors affecting the gross profit rate include higher material costs and the favorable impact of currency translation.

Operating Expenses

Total operating expenses increased due mostly to the expenses of acquired operations. Expenses as a percentage of sales were 24.2 percent for the quarter and 25.1 percent year-to-date, down from 25.1 percent and 27.1 percent last year, respectively.

In addition to the expenses of acquired operations, the Company continued to increase product development spending to meet its stated objective of creating sales growth from new products. Higher payroll costs, including incentives, and information systems spending contributed to the increase in general and administrative expenses in the second quarter.

General and administrative expense includes approximately \$2 million from the amortization of intangible assets related to the businesses acquired in 2005. The annual recurring non-cash expense associated with amortization of intangible assets from those acquired companies is expected to be approximately \$4 million.

Liquidity and Capital Resources

Significant uses of cash in the first half of 2005 included \$103 million for acquisitions of businesses, \$25 million for purchases and retirement of Company common stock and \$18 million of dividends paid. The Company used cash on hand and a \$40 million advance from a line of credit to fund the acquisitions. Accounts receivable balances increased since year-end 2004 due to acquisitions and higher sales activity. Days of sales in accounts receivable improved since year-end 2004.

Significant uses of cash in the first half of 2004 included \$117 million of dividends paid (including \$104 million for a one-time special dividend) and \$24 million for purchases and retirement of company common stock.

The Company had unused lines of credit available at July 1, 2005 totaling \$80 million. Cash balances of \$7 million at July 1, 2005, internally generated funds and unused financing sources provide the Company with the financial flexibility to meet liquidity needs.

Outlook

The Company expects the businesses acquired in 2005 to begin contributing to net earnings in the second half of this year. Management is working with those operations to bring profitability closer to the levels generated by the rest of the Company within the next two years. The Company plans to consolidate the Florida operations of Liquid Control with similar businesses in New Jersey and Ohio by the end of 2005. The Company is also planning to move production of spray equipment from acquired Gusmer factories to existing Minnesota and South Dakota factories beginning in the third quarter of 2005 and continuing into 2006. These actions are not expected to have a material impact on 2005 earnings.

Management continues to be optimistic about the remainder of 2005.

SAFE HARBOR CAUTIONARY STATEMENT

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

The Company desires to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 by making cautionary statements concerning any forward-looking statements made by or on behalf of the Company. The Company cannot give any assurance that the results forecasted in any forward-looking statement will actually be achieved. Future results could differ materially from those expressed, due to the impact of changes in various factors. These risk factors include, but are not limited to: economic conditions in the United States and other major world economies, currency fluctuations, political instability, changes in laws and regulations, and changes in product demand. Please refer to Exhibit 99 to the Company's Annual Report on Form 10-K for fiscal year 2004 for a more comprehensive discussion of these and other risk factors.

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

Item 4.

CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures

As of the end of the fiscal quarter covered by this report, the Company carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures. This evaluation was done under the supervision and with the participation of the Company's President and

Chief Executive Officer, Vice President and Contoller, Vice President and Treasurer, and Vice President, General Counsel and Secretary. Based upon that evaluation, they concluded that the Company's disclosure controls and procedures are effective in gathering, analyzing and disclosing information needed to satisfy the Company's disclosure obligations under the Exchange Act.

Changes in internal controls

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

PART II

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

Issuer Purchases of Equity Securities

On February 22, 2002, the Board of Directors authorized a plan for the Company to purchase up to a total of 2,700,000 shares of its outstanding common stock, primarily through open-market transactions. This plan effectively expired upon approval of a new plan on February 20, 2004, authorizing the purchase of up to 3,000,000 shares and expiring on February 28, 2006.

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

Information on issuer purchases of equity securities follows:

| <u>Period</u> | <u>(a) Total Number of Shares Purchased</u> | <u>(b) Average Price Paid per Share</u> | <u>(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u> | <u>(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (at end of period)</u> |
|-----------------------------|---|---|---|--|
| Apr 2, 2005 - Apr 29, 2005 | 75,500 | \$34.37 | 75,500 | 1,713,200 |
| Apr 30, 2005 - May 27, 2005 | 220,000 | \$34.53 | 220,000 | 1,493,200 |
| May 28, 2005 - Jul 1, 2005 | 227,500 | \$34.59 | 227,500 | 1,265,700 |

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

At the Annual Meeting of Shareholders held on April 22, 2005, four directors were elected to the Board of Directors with the following votes:

| | <u>For</u> | <u>Withheld</u> |
|-------------------|------------|-----------------|
| Lee R. Mitau | 61,318,575 | 1,244,183 |
| James H. Moar | 61,963,677 | 599,081 |
| Martha A. Morfitt | 62,250,434 | 312,324 |
| David A. Roberts | 62,227,701 | 335,057 |

At the same meeting, the selection of Deloitte & Touche LLP as independent auditors for the current year was approved and ratified, with the following votes:

| <u>For</u> | <u>Against</u> | <u>Abstentions</u> | <u>Broker Non-Vote</u> |
|------------|----------------|--------------------|------------------------|
| 60,074,328 | 2,413,869 | 74,561 | -- |

No other matters were voted on at the meeting.

Item 6. Exhibits

- 10.1 Deferred Compensation Plan (2005 statement) as amended.
- 10.2 Deferred Compensation Plan Restated, effective December 1, 1992. (Incorporated by reference to Exhibit 2 to the Company's Report on Form 8-K dated March 11, 1993.) Amendment 1 dated September 1, 1996. (Incorporated by reference to the Company's Report on Form 10-Q for the twenty-six weeks ended June 27, 1997, File No. 001-09249.)
- 31.1 Certification of President and Chief Executive Officer pursuant to Rule 13a-14(a)
- 31.2 Certification of Vice President and Contoller pursuant to Rule 13a-14(a)
- 31.3 Certification of Vice President and Treasurer pursuant to Rule 13a-14(a)

SIGNATURES

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

GRACO INC.

Date: August 1, 2005

By: /s/David A. Roberts

David A. Roberts
President and Chief Executive Officer

Date: August 1, 2005

By: /s/James A. Graner

James A. Graner
Vice President and Controller

Date: August 1, 2005

By: /s/Mark W. Sheahan

Mark W. Sheahan
Vice President and Treasurer

**GRACO
DEFERRED COMPENSATION PLAN
(2005 Statement)**

**GRACO
DEFERRED COMPENSATION PLAN
(2005 Statement)**

TABLE OF CONTENTS

| | Page |
|---|-------------|
| SECTION 1. INTRODUCTION AND DEFINITIONS | 1 |
| 1.1. Preamble | |
| 1.2. Definitions | |
| 1.2.1. Account | |
| 1.2.2. Affiliate | |
| 1.2.3. Annual Valuation Date | |
| 1.2.4. Beneficiary | |
| 1.2.5. Board of Directors | |
| 1.2.6. Code | |
| 1.2.7. Committee | |
| 1.2.8. Compensation | |
| 1.2.9. Deferred Compensation Agreement | |
| 1.2.10. Disability | |
| 1.2.11. Effective Date | |
| 1.2.12. Employer | |
| 1.2.13. ERISA | |
| 1.2.14. Graco | |
| 1.2.15. Participant | |
| 1.2.16. Plan | |
| 1.2.17. Plan Statement | |
| 1.2.18. Plan Year | |
| 1.2.19. Separation from Service | |
| 1.2.20. Valuation Date | |
| 1.2.21. Vested | |
| 1.2.22. Vice President of Human Resources | |
| 1.3. Rules of Interpretation | |
| SECTION 2. ELIGIBILITY TO PARTICIPATION | 5 |
| 2.1. General Eligibility Rule | |
| 2.2. Selection for Participation in the Plan | |
| 2.3. Deferred Compensation Agreement | |
| 2.3.1. Amount of Deferrals | |
| 2.3.2. Initial and Annual Elections | |
| 2.3.3. Effective Date of Elections | |
| 2.3.4. Evergreen Elections | |
| 2.3.5. Ineligible to Defer Compensation | |
| 2.3.6. Separation from Service | |
| SECTION 3. CONTRIBUTIONS AND ALLOCATION THEREOF | 7 |
| 3.1. Deferred Compensation Agreement Contributions | |
| 3.1.1. Amount | |
| 3.1.2. Allocation | |
| 3.2. Employer Contributions | |
| SECTION 4. INVESTMENT AND ADJUSTMENT OF ACCOUNTS | 8 |
| 4.1. Designation of Measuring Investments | |
| 4.2. Operational Rules for Measuring Investments | |
| 4.3. Investment Direction of Participants | |
| 4.3.1. Rights of Participants | |
| 4.3.2. Transmission of Investment Directions | |
| 4.4. Losses Under the Plan | |
| SECTION 5. VESTING | 9 |
| SECTION 6. UNFUNDED PLAN | 10 |
| SECTION 7. DISTRIBUTIONS | 11 |
| 7.1. Distribution | |
| 7.1.1. Time of Distribution | |
| 7.1.2. Form of Distribution | |
| 7.1.3. Taxation of Distribution | |
| 7.1.4. Death Prior to Full Distribution | |
| 7.2. Designation of Beneficiaries | |

| | | | |
|---------------|---------|--|--------|
| | 7.2.1. | Right to Designate | |
| | 7.2.2. | Failure of Designation | |
| | 7.2.3. | Disclaimers by Beneficiaries | |
| | 7.2.4. | Definitions | |
| | 7.2.5. | Special Rules | |
| 7.3. | | General Distribution Rules | |
| | 7.3.1. | Distribution in Cash | |
| | 7.3.2. | Facility of Payment | |
| SECTION 8. | | SPENDTHRIFT PROVISION | 18 |
| SECTION 9. | | AMENDMENT AND TERMINATION | 19 |
| | 9.1. | Amendment | |
| | 9.2. | Discontinuance of Contributions and Termination of Plan | |
| | 9.3. | Merger or Spinoff of Plans | |
| | 9.3.1. | In General | |
| | 9.3.2. | Beneficiary Designations | |
| SECTION 10. | | INDEMNIFICATION | 20 |
| SECTION 11. | | DETERMINATIONS — CLAIM PROCEDURES | 21 |
| | 11.1. | Determinations | |
| | 11.2. | Claim and Review Procedures | |
| | 11.2.1. | Initial Claim | |
| | 11.2.2. | Notice of Initial Adverse Determination | |
| | 11.2.3. | Request for Review | |
| | 11.2.4. | Claim on Review | |
| | 11.2.5. | Notice of Adverse Determination for Claim on Review | |
| | 11.3. | Rules and Regulations | |
| | 11.3.1. | Adoption of Rules | |
| | 11.3.2. | Specific Rules | |
| | 11.4. | Deadline to File Claim | |
| | 11.5. | Exhaustion of Administrative Remedies | |
| | 11.6. | Deadline to File Legal Action | |
| | 11.7. | Knowledge of Fact by Participant Imputed to Beneficiary and Others | |
| SECTION 12. | | PLAN ADMINISTRATION | 26 |
| | 12.1. | Board of Directors | |
| | 12.2. | Committee | |
| | 12.3. | Vice President of Human Resources | |
| | 12.4. | Fiduciary Responsibility — In General | |
| | 12.4.1. | Limitation on Authority | |
| | 12.4.2. | Dual Capacity | |
| | 12.5. | Administrator | |
| | 12.6. | Named Fiduciaries | |
| | 12.7. | Service of Process | |
| | 12.8. | Rules and Regulations | |
| | 12.9. | Method of Executing Instruments | |
| | 12.10. | Information Furnished by Participants | |
| | 12.11. | Receipt of Documents | |
| | 12.12. | Powers of Attorney | |
| | 12.13. | Guardians and Conservators | |
| SECTION 13. | | IN GENERAL | 29 |
| | 13.1. | Disclaimers | |
| | 13.1.1. | Effect on Employment | |
| | 13.1.2. | Sole Source of Benefits | |
| | 13.2. | Applicable Laws | |
| | 13.2.1. | ERISA Status | |
| | 13.2.2. | Internal Revenue Code Status | |
| | 13.3. | Choice of Law | |
| SCHEDULE I- | | EMPLOYERS PARTICIPATING | SI-1 |
| SCHEDULE II- | | COVERED SALARY GRADE LEVELS AND CLASSIFICATIONS | SII-1 |
| SCHEDULE III- | | MEASURING INVESTMENTS | SIII-1 |

**GRACO
PAY DEFERRAL PLAN
(2005 Statement)**

SECTION 1

INTRODUCTION AND DEFINITIONS

1.1. **Preamble.** Effective May 1, 2005, Graco Inc., a Minnesota corporation, established this nonqualified, unfunded, deferred compensation plan under section 409A of the Internal Revenue Code for the benefit of a select group of management or highly compensated employees of Graco Inc. and related Employers.

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

1.2.1. **Account** — the separate bookkeeping account established for each Participant which represents the separate unfunded and unsecured general obligation of the Employers established with respect to each individual who is a Participant in the Plan to track credits and the investment return on those credits.

1.2.2. **Affiliate** — a business entity which is not an Employer but which is part of a “controlled group” with the Employer or under “common control” with the Employer or which is a member of an “affiliated service group” that includes an Employer, as those terms are defined in section 414(b), (c) and (m) of the Code. A business entity which is a predecessor to the Employer shall be treated as an Affiliate if the Employer maintains a plan of such predecessor business entity or if, and to the extent that, such treatment is otherwise required by regulations under section 414(a) of the Code. A business entity shall also be treated as an Affiliate if, and to the extent that, such treatment is required by regulations under section 414(o) of the Code. In addition to said required treatment, the Vice President of Human Resources may designate as an Affiliate any business entity which is not such a “controlled group,” “common control,” “affiliated service group” or “predecessor” business entity but which is otherwise affiliated with an Employer, subject to such limitations as the Vice President of Human Resources may impose.

1.2.3. **Annual Valuation Date** — each December 31.

1.2.4. **Beneficiary** — a person designated by a Participant (or automatically by operation of this Plan Statement) to receive all or a part of the Participant’s Account in the event of the Participant’s death prior to full distribution thereof. A person so designated shall not be considered a Beneficiary until the death of the Participant.

1.2.5. **Board of Directors** — the board of directors of Graco or of its successor. “Board of Directors” also shall mean and refer to any properly authorized committee of the directors.

1.2.6. **Code** — the Internal Revenue Code of 1986, including applicable regulations for the specified section of the Code. Any reference in this Plan Statement to a section of the Code, including the applicable regulation, shall be considered also to mean and refer to any subsequent amendment or replacement of that section or regulation.

1.2.7. **Committee** — the Compensation Committee of the Board of Directors.

1.2.8. **Compensation** — a Participant’s Compensation shall consist of the following:

- (a) **Advance Sales Incentive Awards** — the sales incentive awards, if any, paid during the calendar year.
- (b) **Annual Bonus Awards** — the annual bonus amount, if any, determined by the Employer and paid to the employee before March 15th of the following Plan Year.
- (c) **Base Salary** — the standard amount paid to an employee as salary at regular payroll intervals during a Plan Year by the Employer (which shall exclude any Advance Sales Incentive Awards, Year-End Sales Incentive Awards, or Annual Bonus Awards) prior to the employee’s date of Separation from Service.
- (d) **Year-End Sales Incentive Awards** — the sales incentive awards, if any, paid before March 15th of the following Plan Year after all proper adjustments have been made for Advance Sales Incentive Awards paid during the Plan Year.

Items described in (a), (b), (c) or (d). above shall not be considered Compensation until they are earned by the Participant.

1.2.9. **Deferred Compensation Agreement** — the written agreement made by a Participant pursuant to which the Participant agrees to accept a reduction in Compensation and the Employer agrees to credit the amount of such reduction to the Participant’s Account.

1.2.10. **Disabled or Disability** — an impairment which renders a Participant 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. A Disability must be evidenced by (i) a certification by a doctor of medicine, or (ii) the official written determination that the individual will be eligible for disability benefits under the federal Social Security Act.

1.2.11. **Effective Date** — May 1, 2005.

1.2.12. **Employer** — each of the following employers:

- (a) Graco,
- (b) Any employer affiliated with Graco that adopts the Plan with the consent of Graco and subject to such limitations (not inconsistent with federal law) as Graco may impose with respect to the extent that service with such employer prior to such adoption will be included in determining an employee’s initial eligibility to enroll as a Participant in the Plan, and
- (c) Any successor thereof that adopts the Plan.

The name of each Employer, the effective date of its adoption of the Plan, and a specification of whether an employee’s pre-adoption service with such Employer will be included in determining the Participant’s initial eligibility to enroll as a Participant in the Plan shall be set forth in Schedule I to this Plan Statement.

1.2.13. **ERISA** — the Employee Retirement Income Security Act of 1974, including applicable regulations for the specified section of ERISA. Any reference in this Plan Statement to a section of ERISA, including the applicable regulation, shall be considered also to mean and refer to any subsequent amendment or replacement of that section or regulation.

1.2.14. **Graco** — Graco Inc., a Minnesota corporation, and any successor thereof.

1.2.15. **Participant** — an employee of the Employer who is selected for participation in the Plan. An employee who has become a Participant shall continue as a Participant in the Plan until the date of the Participant's death or, if earlier, the date upon which the Participant has received a distribution of the Participant's entire Account under the Plan.

1.2.16. **Plan** — the nonqualified, unfunded, deferred compensation plan of the Employer established for the benefit of employees eligible to participate therein, as first set forth in this Plan Statement. (As used herein, "Plan" refers to the legal entity established by the Employer and not to the documents pursuant to which the Plan is maintained. Those documents are referred to herein as the "Plan Statement.") The Plan shall be referred to as the "Graco Deferred Compensation Plan."

1.2.17. **Plan Statement** — this document entitled "Graco Deferred Compensation Plan (2005 Statement)," as the same may be amended from time to time.

1.2.18. **Plan Year** — the twelve (12) consecutive month period ending on any Annual Valuation Date.

1.2.19. **Separation from Service** — a separation from service for the purposes of section 409A of the Code.

1.2.20. **Valuation Date** — any day that the U.S. securities markets are open and conducting business.

1.2.21. **Vested** — nonforfeitable.

1.2.22. **Vice President of Human Resources** — the individual who is the Vice President of Human Resources of Graco or such person as designated by the Chief Executive Officer of Graco.

1.3. **Rules of Interpretation.** An individual shall be considered to have attained a given age on the individual's birthday for that age (and not on the day before). The birthday of any individual born on a February 29 shall be deemed to be February 28 in any year that is not a leap year. Whenever appropriate, words used herein in the singular may be read in the plural, or words used herein in the plural may be read in the singular; the masculine may include the feminine; and the words "hereof," "herein" or "hereunder" or other similar compounds of the word "here" shall mean and refer to the entire Plan Statement and not to any particular paragraph or section of this Plan Statement unless the context clearly indicates to the contrary. The titles given to the various sections of this Plan Statement are inserted for convenience of reference only and are not part of this Plan Statement, and they shall not be considered in determining the purpose, meaning or intent of any a provision hereof. Any reference in this Plan Statement to a statute or regulation shall be considered also to mean and refer to any subsequent amendment or replacement of that statute or regulation. This Plan Statement has been executed and shall, except to the extent that federal law is controlling, be construed and enforced in accordance with the laws of the State of Minnesota. 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. For purposes of this section, an individual will be found to have feloniously and intentionally killed a Participant or Beneficiary, only if a final judgment of conviction of felonious and intentional killing of such Participant or Beneficiary has been entered against such individual by the trial court. Notwithstanding anything to the contrary, the Vice President of Human Resources may deny any request for a distribution pending a determination under this section.

SECTION 2

ELIGIBILITY TO PARTICIPATION

2.1. **General Eligibility Rule.** An employee of an Employer who satisfies the following three conditions:

- (a) is in one of the following classifications:
 - (i) the Chief Executive Officer, a Vice President or other executive officer of Graco,
 - (ii) a position, salary schedule, grade or other classification as set forth in Schedule II to this Plan Statement, or
 - (iii) such other position, salary schedule, grade or other classification as determined by the Vice President of Human Resources and specified by amendment in Schedule II,
- (b) is employed by an Employer on or before November 1 of the Plan Year preceding the Plan Year in which the individual would commence to participate in the Plan (if selected for participation), and
- (c) is selected for participation (as described in Section 2.2),

shall be eligible to become a Participant. An employee shall become a Participant as of the January 1 next following the acceptance and approval of such individual's properly completed Deferred Compensation Agreement by the Vice President of Human Resources.

2.2. **Selection for Participation in the Plan.** Only employees who are selected for participation in the Plan by the Vice President of Human Resources shall be eligible to become a participant in the Plan. The Vice President of Human Resources shall not select any employee for participation unless the Vice President of Human Resources determines that such employee is a member of a select group of management or highly compensated employees (as that expression is used in ERISA).

2.3. **Deferred Compensation Agreement.**

2.3.1. **Amount of Deferrals.** Subject to the following rules and any rules adopted by the Vice President of Human Resources, a Participant by entering into a Deferred Compensation Agreement may make elective contributions through a pay reduction equal to but not less than (i) one percent (1%) nor more than fifty percent (50%) (in whole percentages) of the portion of the Participant's Base Salary and Advance Sales Incentives, and (ii) one percent (1%) nor more than one hundred percent (100%) (in whole percentages) of the portion of the Participant's Annual Bonus Awards and Year-End Sales Incentive Awards. The Vice President of Human Resources may, from time to time under rules, change the minimum and maximum allowable elective contributions, although such changes shall not take effect until the following Plan Year. Salary

deferrals will begin as soon as administratively practicable following the January 1 on which the Employee becomes a Participant. The Deferred Compensation Agreement shall remain in effect for the remainder of the Plan Year (unless terminated upon a Participant's death or Separation from Service).

2.3.2. **Initial and Annual Elections.** Employees selected to participate and Participants may enter into a Deferred Compensation Agreement to defer compensation, or increase or decrease the amount of deferred compensation, during the period beginning on November 1 and ending on December 31 of each year for the subsequent Plan Year.

2.3.3. **Effective Date of Elections.** The Participant's Deferred Compensation Agreement will be effective as of the January 1 following the date of the Participant's election.

2.3.4. **Evergreen Elections.** The Participant's Deferred Compensation Agreement shall remain in effect until the Participant timely completes a new Deferred Compensation Agreement during a subsequent period described in Section 2.3.2 (unless terminated as provided in Section 2.3.5 or Section 2.3.6).

2.3.5. **Ineligible to Defer Compensation.** The Deferred Compensation Agreement of a Participant who is determined to be no longer eligible to defer compensation shall terminate as of the last day of the Plan Year in which the Employer makes the determination that the Participant is longer eligible to defer compensation.

2.3.6. **Separation from Service.** The Deferred Compensation Agreement of a Participant shall be terminated automatically as of the date of the Participant's Separation from Service.

SECTION 3

CONTRIBUTIONS AND ALLOCATION THEREOF

3.1. Deferred Compensation Agreement Contributions.

3.1.1. **Amount.** The Employer shall cause to be credited to the Account of each Participant the amount, if any, of such Participant's elective deferrals under the Deferred Compensation Agreement.

3.1.2. **Allocation.** The portion of the contribution made with respect to each Participant shall be allocated to that Participant's Account for the Plan Year with respect to which it is made and, for the purposes of this section, shall be credited as soon as practicable after it is deducted from the Participant's Compensation.

3.2. **Employer Contributions.** An Employer may, in its sole discretion, make employer discretionary contributions to a Participant's Account.

SECTION 4

INVESTMENT AND ADJUSTMENT OF ACCOUNTS

4.1. **Designation of Measuring Investments.** Measuring investments are specified solely as a device for computing the amount of benefits to be paid by the Employer under the Plan, and the Employer is not required to purchase such investments. The measuring investments are listed in Schedule III to this Plan Statement.

4.2. **Operational Rules for Measuring Investments.** The Vice President of Human Resources shall adopt rules specifying the circumstances under which a particular measuring investment may be elected, or shall be automatically utilized, the minimum or maximum amount or percentage of an Account which may be allocated to a measuring investment, the procedures for making or changing measuring investment elections, the extent (if any) to which Beneficiaries of deceased Participants may make measuring investment elections and the effect of a Participant's or Beneficiary's failure to make an effective measuring investment election with respect to all or any portion of an Account.

4.3. Investment Direction of Participants.

4.3.1. **Rights of Participants.** A Participant shall direct the Vice President of Human Resources as to the measuring investments which shall be the standard by which the value of the Participant's Account shall be measured.

4.3.2. **Transmission of Investment Directions.** Through a voice response system (or other written or electronic means) approved by the Vice President of Human Resources, each Participant shall designate the measuring investments that shall be used to determine the value of such Participant's Account (until changed as provided herein): (i) one or more measuring investments for the current Account balance, and (ii) one or more measuring investments for amounts that are credited to the Account in the future.

4.4. **Losses Under the Plan.** The cash value of the Participant's Account shall depend on the investment return experience of the Participant's elected measuring investments. No officer, director or employee of the Employer shall be accountable or liable for any investment losses to a Participant's Account incurred by virtue of implementing the directions of the Participant with respect to the measuring investments of the Account or due to any reasonable administrative delay in implementing such directions.

SECTION 5

VESTING

A Participant shall be fully vested in the funds credited to the Participant's Account at all times.

SECTION 6

UNFUNDED PLAN

The obligations to make payments under the Plan constitute only the unsecured (but legally enforceable) promises of the Participant's Employer and Graco to make such payments. No Participant shall have any lien, prior claim or other security interest in any property of the Employer and

Affiliates. The Employer shall have no obligation to establish or maintain any fund, trust or account (other than a bookkeeping account) for the purpose of funding or paying the benefits promised under the Plan. If such a fund, trust or account is established, the property therein that is allocable to the Employer shall remain the sole and exclusive property of the Employer.

SECTION 7

DISTRIBUTIONS

7.1. Distribution.

7.1.1. Time of Distribution.

- (a) **Election for Distribution as of a Specified Time.** The Participant may elect the year in which distribution of the Participant's Account is to commence. If the Participant elects to commence distribution as of a specified year, distribution shall commence as soon as administratively possible after January 1 of the year elected by the Participant.
- (b) **Effective Date of Elections.** The Participant's election will be effective as of the January 1 following the date of the Participant's election and shall apply to contributions to the Participant's Account made after that date. If the Participant subsequently makes a new election, the new election will be effective as of the January 1 following the date of the Participant's new election and shall apply to contributions to the Participant's Account made after that date. Prior contributions to the Participant's Account shall be subject to the Participant's election in effect at the time a contribution is made (unless the Participant elects to delay the time of distribution as provided below). The Participant may make an initial election as to the time of distribution for subsequent contributions at the time the Participant is selected to participate in the Plan.
- (c) **Election to Delay the Time of Distribution.** The Participant may make a one-time election to change the time of distribution. The election shall delay the distribution to a date that is at least five (5) years after the date the distribution would have been made to the Participant absent the election. The election shall not take effect until the date that is twelve (12) months after the date on which the Participant makes the election. In addition, in the case of a distribution as of a specified time (but not upon a Participant's Separation from Service, Disability, or death), the election shall not take effect unless the Participant makes the election at least twelve (12) months prior to the date the distribution is to commence. If the Participant also desires to change the form of distribution, that election must be made at the time the Participant elects to change the time of distribution.
- (d) **Default Time of Distribution.** Unless the Participant elects otherwise, a Participant's Account (reduced by the amount of any applicable payroll, withholding and other taxes) shall be distributed as soon as administratively possible after the January 1 following the date of the earlier of the Participant's Separation from Service, Disability, or death.
- (e) **Delay in Distribution to Key Employees.** Notwithstanding the foregoing, in the case of a distribution to a Participant who is a key employee where the timing of the distribution is based on the key employee's Separation from Service, the date of distribution to the key employee shall be the first day of the month following the date that is six (6) months after the date of the key employee's Separation from Service (or, if earlier, the date of the Participant's death). A key employee shall be a key employee as defined in section 416(i) of the Code without regard to paragraph 5 of section 416(i) of the Code. All distributions under this Plan shall comply with the requirements of section 409A(a)(2)(B)(i) of the Code.

7.1.2. Form of Distribution.

- (a) **Election of Form of Distribution.** The Participant may elect the form of distribution for the Participant's Account.
 - (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 amount in the Participant's Account on January 1 of the Plan Year in which the installment payment is to be paid divided by the remaining number of installment payments payable to the Participant. The final payment to the Participant shall equal the amount in the Participant's Account as of the payment date.
- (b) **Effective Date of Elections.** The Participant's election will be effective as of the January 1 following the date of the Participant's election and shall apply to contributions to the Participant's Account made after that date. If the Participant subsequently makes a new election, the new election will be effective as of the January 1 following the date of the Participant's new election and shall apply to contributions to the Participant's Account made after that date. Prior contributions to the Participant's Account shall be subject to the Participant's election in effect at the time a contribution is made (unless the Participant elects to delay the time of distribution as provided below). The Participant may make an initial election as to the form of distribution for subsequent contributions at the time the Participant is selected to participate in the Plan.
- (c) **Election to Change the Form of Distribution.** The Participant may make a one-time election to change the form of distribution. The election shall delay the distribution to a date that is at least five (5) years after the date the distribution would have been made to the Participant absent the election. The election shall not take effect until the date that is twelve (12) months after the date on which the Participant makes the election. In addition, in the case of a distribution as of a specified time (but not upon a Participant's Separation from Service, Disability, or death), the election shall not take effect unless the Participant makes the election at least twelve (12) months prior to the date the distribution is to commence. If the Participant also desires to change the time of distribution, that election must be made at the time the Participant elects to change the form of distribution.
- (d) **Default Form of Distribution.** Unless the Participant elects otherwise, the Participant's Account shall be distributed in a single lump sum payment in cash.

7.1.3. **Taxation of Distribution.** The Participant's Account shall be subject to Federal income and employment taxes at the time of payment or such earlier date as provided under the Code. The Participant's Account shall also be subject to applicable state taxes.

7.1.4. **Death Prior to Full Distribution.** If the Participant dies before distribution of the Participant's Account has been commenced or completed, the remainder of the undistributed Account shall be distributed to the Participant's Beneficiary at the time or times elected by the Participant and in the form or forms elected by the Participant. The Beneficiary shall not have the right to elect to change the time or form of distribution.

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 Vice President of Human Resources, 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 Vice President of Human Resources during the Participant's lifetime. The Vice President of Human Resources may establish rules for the use of electronic signatures. Until such rules are established, electronic signatures shall not be effective.

7.2.2. **Failure of Designation.** If a Participant:

- (a) fails to designate a Beneficiary,
- (b) designates a Beneficiary and thereafter revokes such designation without naming another Beneficiary, or
- (c) 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.

7.2.3. **Disclaimers by Beneficiaries.** A Beneficiary entitled to a distribution of all or a portion of a deceased Participant's Account may disclaim his or her interest therein subject to the following requirements. To be eligible to disclaim, a Beneficiary must not have received a distribution of all or any portion of a Account and must have attained at least age twenty-one (21) years at the time such disclaimer is signed and delivered. Any disclaimer must be in writing and must be signed by the Beneficiary and acknowledged by a notary public. The Vice President of Human Resources may establish rules for the use of electronic signatures and acknowledgments. Until such rules are established, electronic signatures and acknowledgments shall not be effective. A disclaimer shall state that the Beneficiary's entire interest in the undistributed Account is disclaimed or shall specify what portion thereof is disclaimed. To be effective, duplicate original signed copies of the disclaimer must be both signed and actually delivered to the Vice President of Human Resources after the date of the Participant's death but not later than nine (9) months after the date of the Participant's death. A disclaimer shall be irrevocable when delivered to the Vice President of Human Resources. A disclaimer shall be considered to be delivered to the Vice President of Human Resources only when actually received by the Vice President of Human Resources. The Vice President of Human Resources shall be the sole judge of the content, interpretation and validity of a purported disclaimer. Upon the filing of a valid disclaimer, the Beneficiary shall be considered not to have survived the Participant as to the interest disclaimed. A disclaimer by a Beneficiary shall not be considered to be a transfer of an interest in violation of the provisions of this Plan Statement and shall not be considered to be an assignment or alienation of benefits in violation of federal law prohibiting the assignment or alienation of benefits under the Plan. No other form of attempted disclaimer shall be recognized by the Vice President of Human Resources.

7.2.4. **Definitions.** When used herein and, unless the Participant has otherwise specified in the Participant's Beneficiary designation, when used in a Beneficiary designation, "issue" means all persons who are lineal descendants of the person whose issue are referred to, subject to the following:

- (a) a legally adopted child and the adopted child's lineal descendants always shall be lineal descendants of each adoptive parent (and of each adoptive parent's lineal ancestors);
- (b) a legally adopted child and the adopted child's lineal descendants never shall be lineal descendants of any former parent whose parental rights were terminated by the adoption (or of that former parent's lineal ancestors); except that if, after a child's parent has died, the child is legally adopted by a stepparent who is the spouse of the child's surviving parent, the child and the child's lineal descendants shall remain lineal descendants of the deceased parent (and the deceased parent's lineal ancestors);
- (c) if the person (or a lineal descendant of the person) whose issue are referred to is the parent of a child (or is treated as such under applicable law) but never received the child into that parent's home and never openly held out the child as that parent's child (unless doing so was precluded solely by death), then neither the child nor the child's lineal descendants shall be issue of the person.

"Child" means an issue of the first generation; "per stirpes" means in equal shares among living children of the person whose issue are referred to and the issue (taken collectively) of each deceased child of such person, with such issue taking by right of representation of such deceased child; and "survive" and "surviving" mean living after the death of the Participant.

7.2.5. **Special Rules.** Unless the Participant has otherwise specified in the Participant's Beneficiary designation, the following rules shall apply:

- (a) If there is not sufficient evidence that a Beneficiary was living at the time of the death of the Participant, it shall be deemed that the Beneficiary was not living at the time of the death of the Participant.
- (b) The automatic Beneficiaries and the Beneficiaries designated by the Participant shall become fixed at the time of the Participant's death so that, if a Beneficiary survives the Participant but dies before the receipt of all payments due such Beneficiary hereunder, such remaining payments shall be payable to the representative of such Beneficiary's estate.

- (c) If the Participant designates as a Beneficiary the person who is the Participant's spouse on the date of the designation, either by name or by relationship, or both, the dissolution, annulment or other legal termination of the marriage between the Participant and such person shall automatically revoke such designation. (The foregoing shall not prevent the Participant from designating a former spouse as a Beneficiary on a form signed by the Participant and received by the Vice President of Human Resources after the date of the legal termination of the marriage between the Participant and such former spouse, and during the Participant's lifetime.)
- (d) Any designation of a nonspouse Beneficiary by name that is accompanied by a description of relationship to the Participant shall be given effect without regard to whether the relationship to the Participant exists either then or at the Participant's death.
- (e) Any designation of a Beneficiary only by statement of relationship to the Participant shall be effective only to designate the person or persons standing in such relationship to the Participant at the Participant's death.

A Beneficiary designation is permanently void if it either is signed or is filed by a Participant who, at the time of such signing or filing, is then a minor under the law of the state of the Participant's legal residence. The Vice President of Human Resources shall be the sole judge of the content, interpretation and validity of a purported Beneficiary designation.

7.3. General Distribution Rules.

7.3.1. **Distribution in Cash.** Distribution of a Participant's Account shall be made in cash.

7.3.2. **Facility of Payment.** In case of the legal disability, including minority, of a Participant or Beneficiary entitled to receive any distribution under the Plan, payment shall be made, if the Vice President of Human Resources shall be advised of the existence of such condition:

- (a) To the duly appointed guardian or conservator of such Participant or Beneficiary, or
- (b) To the duly appointed attorney-in-fact or other legal representative of such Participant or Beneficiary, or
- (c) To a person or institution entrusted with the care or maintenance of the incompetent or disabled Participant or Beneficiary, provided, however, such person or institution has satisfied the Vice President of Human Resources that the payment will be used for the best interest and assist in the care of such Participant or Beneficiary, and provided further, that no prior claim for said payment has been made by a duly appointed guardian, conservator, attorney-in-fact or other legal representative of such Participant or Beneficiary as provided above.

Any payment made in accordance with the foregoing provisions of this section shall constitute a complete discharge of any liability or obligation of the Employer, the Vice President of Human Resources, and the Fund therefore.

SECTION 8

SPENDTHRIFT PROVISION

No Participant or Beneficiary shall have any transmissible interest in any Account nor shall any Participant or Beneficiary have any power to anticipate, alienate, dispose of, pledge or encumber the same, nor shall the Plan recognize any assignment thereof, either in whole or in part, nor shall the Account be subject to attachment, garnishment, execution following judgment or other legal process (including without limitation any domestic relations order, whether or not a "qualified domestic relations order" under section 414(p) of the Code and section 206(d) of ERISA) before the Account is distributed to the Participant or Beneficiary.

The power to designate Beneficiaries to receive the Account of a Participant in the event of death shall not permit or be construed to permit such power or right to be exercised by the Participant so as thereby to anticipate, pledge, mortgage or encumber the Participant's Account or any part thereof, and any attempt of a Participant so to exercise said power in violation of this provision shall be of no force and effect and shall be disregarded by the Employer and the Vice President of Human Resources.

SECTION 9

AMENDMENT AND TERMINATION

9.1. **Amendment.** Graco reserves the power to amend this Plan Statement either prospectively or retroactively or both:

- (a) in any respect by action of its Board of Directors;
- (b) in any respect that does not materially increase the cost of the Plan by action of the Committee; and
- (c) in any respect to eligibility, (i) to add or remove participating employers, and (ii) to add or remove such position, salary schedule, grade or other classification provided in Schedule II by action of the Vice President of Human Resources.

The power to amend this Plan Statement may not be delegated.

9.2. **Discontinuance of Contributions and Termination of Plan.** Graco also reserves the right, by action of its Board of Directors, at any time to totally or partially terminate the Plan, and to reduce, suspend or discontinue contributions to the Plan.

9.3. **Merger or Spinoff of Plans.**

9.3.1. **In General.** The Committee may cause all or a part of the Plan to be merged with all or a part of any other plan. The Committee may cause all or a part of the Plan to be spun off to another plan.

9.3.2. **Beneficiary Designations.** If assets and liabilities are transferred from another plan to the Plan, Beneficiary designations made under that plan shall become void with respect to deaths occurring on or after the date as of which such transfer is made and the Beneficiary designation rules of this Plan Statement shall apply beginning on such date.

SECTION 10

INDEMNIFICATION

Except as prohibited by applicable law, Graco shall defend, indemnify and hold harmless from any and all liabilities, costs and expenses (including legal fees), to the extent not covered by insurance, each officer, director or employee of the Employer, who is a party to or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding with respect to the Plan, whether imposed under ERISA or otherwise, wherever brought, whether civil, criminal, administrative or investigative by reason of the fact that the individual is or was a fiduciary or administrator of the Plan (as defined in ERISA), or by reason of acting in any other capacity in connection with the Plan. No such indemnification, however, shall be required or provided if such liability arises (i) from the individual's claim for the individual's own benefit, (ii) from the proven willful misconduct, fraud or the bad faith of the individual, or (iii) from the criminal misconduct of such individual if the individual had reason to believe the conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith, and, with respect to any criminal action or proceeding, had reasonable cause to believe that the individual's conduct was unlawful. This indemnification shall continue as to an individual who has ceased to be an officer, director or employee of the Employer and shall inure to the benefit of the heirs, executors and administrators of such an individual.

SECTION 11

DETERMINATIONS — CLAIM PROCEDURES

11.1. **Determinations.** The benefits under the Plan will be paid only if the Vice President of Human Resources and, to the extent a Participant appeals a claim, the Committee decide in their discretion that the applicant is entitled to them. The Vice President of Human Resources has discretionary authority to grant or deny benefits under the Plan. The Vice President of Human Resources shall have the sole discretion, authority and responsibility to interpret and construe this Plan Statement and all relevant documents and information, and to determine all factual and legal questions under the Plan, including but not limited to the entitlement of all persons to benefits and the amounts of their benefits. The Vice President of Human Resources shall make such determinations as may be required from time to time in the administration of the Plan. This discretionary authority shall include all matters arising under the Plan. An application for a distribution shall be considered as a claim.

11.2. **Claim and Review Procedures.** Until modified by the Committee, the claim and review procedures set forth in this section 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.

11.2.1. **Initial Claim.** An individual may, subject to any applicable deadline, file with the Vice President of Human Resources a written claim for benefits under the Plan in a form and manner prescribed by the Vice President of Human Resources.

- (a) If the claim is denied in whole or in part, the Vice President of Human Resources shall notify the claimant of the adverse benefit determination within ninety (90) days after receipt of the claim.
- (b) The ninety (90) day period for making the claim determination may be extended for ninety (90) days if the Vice President of Human Resources determines that special circumstances require an extension of time for determination of the claim, provided that the Vice President of Human Resources notifies the claimant, prior to the expiration of the initial ninety (90) day period, of the special circumstances requiring an extension and the date by which a claim determination is expected to be made.

11.2.2. **Notice of Initial Adverse Determination.** A notice of an adverse determination shall set forth in a manner calculated to be understood by the claimant:

- (a) the specific reasons for the adverse determination;
- (b) references to the specific provisions of this Plan Statement (or other applicable Plan document) on which the adverse determination is based;
- (c) a description of any additional material or information necessary to perfect the claim and an explanation of why such material or information is necessary; and
- (d) a description of the claims review procedure, including the time limits applicable to such procedure, and a statement of the claimant's right to bring a civil action under section 502(a) of ERISA following an adverse determination on review.

11.2.3. **Request for Review.** Within sixty (60) days after receipt of an initial adverse benefit determination notice, the claimant may file with the Committee a written request for a review of the adverse determination and may, in connection therewith submit written comments, documents, records and other information relating to the claim benefits. Any request for review of the initial adverse determination not filed within sixty (60) days after receipt of the initial adverse determination notice shall be untimely.

11.2.4. **Claim on Review.** If the claim, upon review, is denied in whole or in part, the Committee shall notify the claimant of the adverse benefit determination within sixty (60) days after receipt of such a request for review.

- (a) The sixty (60) day period for deciding the claim on review may be extended for sixty (60) days if the Committee determines that special circumstances require an extension of time for determination of the claim, provided that the Committee notifies the claimant,

prior to the expiration of the initial sixty (60) day period, of the special circumstances requiring an extension and the date by which a claim determination is expected to be made.

- (b) In the event that the time period is extended due to a claimant's failure to submit information necessary to decide a claim on review, the claimant shall have sixty (60) days within which to provide the necessary information and the period for making the claim determination on review shall be tolled from the date on which the notification of the extension is sent to the claimant until the date on which the claimant responds to the request for additional information or, if earlier, the expiration of sixty (60) days.
- (c) The Committee's review of a denied claim shall take into account all comments, documents, records, and other information submitted by the claimant relating to the claim, without regard to whether such information was submitted or considered in the initial benefit determination.

11.2.5. Notice of Adverse Determination for Claim on Review. A notice of an adverse determination for a claim on review shall set forth in a manner calculated to be understood by the claimant:

- (a) the specific reasons for the denial;
- (b) references to the specific provisions of this Plan Statement (or other applicable Plan document) on which the adverse determination is based;
- (c) a statement that the claimant is entitled to receive, upon request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the claimant's claim for benefits;
- (d) a statement describing any voluntary appeal procedures offered by the Plan and the claimant's right to obtain information about such procedures; and
- (e) a statement of the claimant's right to bring an action under section 502(a) of ERISA.

11.3. Rules and Regulations.

11.3.1. Adoption of Rules. Any rule not in conflict or at variance with the provisions hereof may be adopted by the Vice President of Human Resources or the Committee.

11.3.2. Specific Rules.

- (a) No inquiry or question shall be deemed to be a claim or a request for a review of a denied claim unless made in accordance with the established claim procedures. The Vice President of Human Resources or the Committee may require that any claim for benefits and any request for a review of a denied claim be filed on forms to be furnished by the Vice President of Human Resources or the Committee upon request.
- (b) All decisions on claims shall be made by the Vice President of Human Resources and all decisions on requests for a review of denied claims shall be made by the Committee, unless delegated by either as provided for in the Plan, in which case references in this section shall be treated as references to the delegate of the Vice President of Human Resources or the Committee.
- (c) Claimants may be represented by a lawyer or other representative at their own expense, but the Vice President of Human Resources and the Committee reserve the right to require the claimant to furnish written authorization and establish reasonable procedures for determining whether an individual has been authorized to act on behalf of a claimant. A claimant's representative shall be entitled to copies of all notices given to the claimant.
- (d) The decision on a claim and on a request for a review of a denied claim may be provided to the claimant in electronic form instead of in writing.
- (e) In connection with the review of a denied claim, the claimant or the claimant's representative shall be provided, upon request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the claimant's claim for benefits.
- (f) The time period within which a benefit determination will be made shall begin to run at the time a claim or request for review is filed in accordance with the claims procedures, without regard to whether all the information necessary to make a benefit determination accompanies the filing.
- (g) The claims and review procedures shall be administered with appropriate safeguards so that benefit claim determinations are made in accordance with governing plan documents and, where appropriate, the plan provisions have been applied consistently with respect to similarly situated claimants.
- (h) For the purpose of this section, a document, record, or other information shall be considered "relevant" if such document, record, or other information: (i) was relied upon in making the benefit determination; (ii) was submitted, considered, or generated in the course of making the benefit determination, without regard to whether such document, record, or other information was relied upon in making the benefit determination; (iii) demonstrates compliance with the administration processes and safeguards designed to ensure that the benefit claim determination was made in accordance with governing plan documents and that, where appropriate, the Plan provisions have been applied consistently with respect to similarly situated claimants; and (iv) constitutes a statement of policy or guidance with respect to the Plan concerning the denied treatment option or benefit for the claimant's diagnosis, without regard to whether such advice or statement was relied upon in making the benefit determination.
- (i) The Vice President of Human Resources and the Committee may, in their discretion, rely on any applicable statute of limitation or deadline as a basis for denial of any claim.

11.4. **Deadline to File Claim.** To be considered timely under the Plan's claim and review procedure, a claim must be filed with the Vice President of Human Resources within one (1) year after the claimant knew or reasonably should have known of the principal facts upon which the claim is based. If or to the extent that the claim relates to a failure to effect a Participant's or Beneficiary's investment directions or a Participant's election regarding contributions, a claim must be filed with the Vice President of Human Resources within thirty (30) days after the claimant knew or reasonably should have known of the principal facts upon which the claim is based.

11.5. **Exhaustion of Administrative Remedies.** Notwithstanding any provision in this Plan Statement, the exhaustion of the claim and review procedure is mandatory for resolving every claim and dispute arising under the Plan. As to such claims and disputes:

- (a) no legal action to recover Plan benefits or to enforce or clarify rights under the Plan under any provision of law, whether or not statutory, may be commenced until the claims and review procedure set forth herein have been exhausted in the entirety; and
- (b) in any such legal action all explicit and all implicit determinations by the Vice President of Human Resources (including, but not limited to, determinations as to whether the initial request for benefits or request for review was timely filed) shall be afforded the maximum deference permitted by law.

11.6. **Deadline to File Legal Action.** No legal action to recover Plan benefits or to enforce or clarify rights under the Plan under any provision of law, whether or not statutory, may be brought by any claimant on any matter pertaining to the Plan unless the legal action is commenced in the proper forum before the earlier of:

- (a) thirty (30) months after the date the claimant knew or reasonably should have known of the principal facts on which the claim is based, or
- (b) six (6) months after the date the claimant has exhausted the claim and review procedure.

If or to the extent that the claim relates to a failure to effect a Participant's or Beneficiary's investment directions or a Participant's election regarding contributions, the thirty (30) month period shall be nineteen (19) months.

11.7. **Knowledge of Fact by Participant Imputed to Beneficiary and Others.** Knowledge of all facts that a Participant knew or reasonably should have known shall be imputed to every claimant who is or claims to be a Beneficiary of the Participant or otherwise claims to derive an entitlement by reference to the Participant for the purpose of applying the previously specified periods.

SECTION 12

PLAN ADMINISTRATION

12.1. **Board of Directors.** The Board of Directors shall have the authority to amend, freeze or terminate the Plan.

12.2. **Committee.** Functions generally assigned to the Committee may be delegated to and discharged by Graco's officers or a committee.

12.3. **Vice President of Human Resources.** Functions generally assigned to the Vice President of Human Resources may be delegated to and discharged by employees of Graco's Human Resources Department. The Vice President shall not have any authority with respect to the determination of any matter specially affecting his or her individual interest in the Plan (as distinguished from the interests of all Participants and Beneficiaries or a broad class of Participants and Beneficiaries), all such authority being vested in and exercisable only by the Committee.

12.4. **Fiduciary Responsibility — In General.**

12.4.1. **Limitation on Authority.** No action taken by any fiduciary, if authority to take such action has been delegated or redelegated to it, shall be the responsibility of any other fiduciary except as may be required by the provisions of ERISA. Except to the extent imposed by ERISA, no fiduciary shall have the duty to question whether any other fiduciary is fulfilling all of the responsibility imposed upon such other fiduciary by this Plan Statement or by ERISA

12.4.2. **Dual Capacity.** Any person or group of persons may serve in more than one fiduciary capacity with respect to the Plan.

12.5. **Administrator.** Graco shall be the administrator for purposes of section 3(16)(A) of ERISA.

12.6. **Named Fiduciaries.** The Vice President of Human Resources and the Committee shall be named fiduciaries.

12.7. **Service of Process.** In the absence of any designation to the contrary by Graco, the General Counsel of Graco is designated as the appropriate and exclusive agent for the receipt of service of process directed to the Plan in any legal proceeding, including arbitration, involving the Plan.

12.8. **Rules and Regulations.** Any rule not in conflict or at variance with the provisions hereof may be adopted by the Committee.

12.9. **Method of Executing Instruments.** Information to be supplied or written notices to be made or consents to be given by the Employer or the Committee pursuant to any provision of this Plan Statement may be signed in the name of the Employer by any officer or by any employee who has been authorized to make such certification or to give such notices or consents or by any Committee member.

12.10. **Information Furnished by Participants.** Neither the Employer, the Committee, or the Vice President of Human Resources shall be liable or responsible for any error in the computation of the Account of a Participant resulting from any misstatement of fact made by the Participant, directly or indirectly, to the Employer, the Committee, or the Vice President of Human Resources, and used by them in determining the Participant's Account. Neither the Employer, the Committee, or the Vice President of Human Resources shall be obligated or required to increase the Account of such Participant which, on discovery of the misstatement, is found to be understated as a result of such misstatement of the Participant. However, the Account of any Participant which is overstated by reason of any such misstatement shall be reduced to the amount appropriate for the Participant in view of the truth.

12.11. **Receipt of Documents.** If a form or document must be filed with or received by the Employer, the Committee, or the Vice President of Human Resources (the "appropriate entity"), it must be actually received by the appropriate entity to be effective. The determination of whether or when a form or document has been received by the appropriate entity shall be made by the Vice President of Human Resources on the basis of what documents are acknowledged by the appropriate entity to be in its actual possession without regard to the "mailbox rule" or similar rule of evidence. The absence of a document in the appropriate entity's records and files shall be conclusive and binding proof that the document was not received by the appropriate entity.

12.12. **Powers of Attorney.** The Plan shall recognize a document submitted to the Vice President of Human Resources by which a Participant or Beneficiary appoints another person as his or her attorney in fact, under the following rules:

- (a) that neither Graco or the Vice President of Human Resources shall be required to determine whether the document complies with the applicable state law regarding powers of attorneys or attorneys in fact;
- (b) that if the document enumerates one or more specific powers in addition to a general power to act, the enumeration of one or more specific powers shall not be deemed to limit the generality of the general power to act; in other words, the general power shall continue to be in force; and
- (c) that the document is signed by the Participant or Beneficiary and is notarized.

The Vice President of Human Resources may establish additional rules for the acceptance of powers of attorneys for Plan purposes. The Vice President of Human Resources may review the document as to whether it complies with the rules. If there is a conflict between the action of a court appointed guardian or conservator and an attorney in fact, then the authority of the court appointed guardian or conservator shall be recognized as superior to that of an attorney in fact.

12.13. **Guardians and Conservators.** The Plan shall recognize the authority of a court appointed guardian or conservator to act on behalf of a Participant or Beneficiary to the extent such action is within the authority granted to the court appointed guardian or conservator.

SECTION 13

IN GENERAL

13.1. Disclaimers.

13.1.1. **Effect on Employment.** Neither the terms of this Plan Statement nor the benefits hereunder nor the continuance thereof shall be a term of the employment of any employee, and the Employer shall not be obligated to continue the Plan. The terms of this Plan Statement shall not give any employee the right to be retained in the employment of the Employer.

13.1.2. **Sole Source of Benefits.** Neither the Employer nor any of its officers nor any member of its Board of Directors nor any member of the Committee in any way guarantee Participant Accounts against loss or depreciation, nor do they guarantee the payment of any benefit or amount which may become due and payable hereunder to any Participant, Beneficiary, or other person. Each Participant, Beneficiary, or other person entitled at any time to payments hereunder shall look solely to the assets of the Participant's Employer and Graco for such payments. If an Account shall have been distributed to a former Participant, Beneficiary, or any other person entitled to the receipt thereof, such former Participant, Beneficiary, or other person, as the case may be, shall have no further right or interest in the other assets.

13.2. Applicable Laws.

13.2.1. **ERISA Status.** The Plan is maintained with the understanding that the Plan is an unfunded plan maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees as provided in section 201(2), section 301(3) and section 401(a)(1) of ERISA. Each provision shall be interpreted and administered accordingly.

13.2.2. **Internal Revenue Code Status.** The Plan is intended to be a nonqualified deferred compensation arrangement under section 409A of the Code.

13.3. **Choice of Law.** This instrument has been executed and delivered in the State of Minnesota and, except to the extent that federal law is controlling, shall be construed and enforced in accordance with the laws of the State of Minnesota.

**EXHIBIT A
Amendment
April 4, 2005**

SCHEDULE I

EMPLOYERS PARTICIPATING

| <u>Name of Employer</u> | <u>Effective Date of Plan Adoption</u> |
|-------------------------|--|
| 1. Graco Inc. | 05/01/05 |
| 2. Graco Minnesota Inc. | 05/01/05 |
| 3. Liquid Control Corp. | 05/01/05 |
| 4. Decker Industries | 05/01/05 |
| 5. Profill Corporation | 05/01/05 |
| 6. Gusmer Corporation | 05/01/05 |

SCHEDULE II

COVERED SALARY GRADE LEVELS AND CLASSIFICATIONS

| <u>Name of Employer</u> | <u>Effective Date</u> | <u>Position or Salary Schedule</u> | <u>Grade or Other Classification</u> |
|-------------------------|-----------------------|--|--------------------------------------|
| 1. Graco Inc. | 05/01/05 | Exec, Admin & Engrg | 14-26 |
| | 05/01/05 | Sales | 35-37 |
| | 05/01/05 | Information Systems | 68-70 |
| | 05/01/05 | Legal | 76-79 |
| 2. Graco Minnesota Inc. | 05/01/05 | Exec, Admin & Engrg Plant Management SF | 14-26 57 |
| 3. Liquid Control Corp. | 05/01/05 | President | |
| | 05/01/05 | Director of Finance | |
| | 05/01/05 | Vice President, Sales & Marketing | |
| 4. Decker Industries | 05/01/05 | General Manager | |
| 5. Profill Corp. | 05/01/05 | None | |
| 6. Gusmer Corporation | 05/01/05 | General Manager Director of Opeartions Director of Admin | |

SCHEDULE III

MEASURING INVESTMENTS

A. **Measuring Investments.** The measuring investments shall be the same as the investment options available under the Graco Employee Investment Plan (excluding Graco common stock).

B. **Default Rules.** If a Participant has not designated which measuring investments shall be used to determine the value of the Participant's Account, the value of the Participant's Account will be determined using the same default investment option as provided under the Graco Employee Investment Plan.

CERTIFICATION

I, David A. Roberts, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers 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)) 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 officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 1, 2005

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

CERTIFICATION

I, James A. Graner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers 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)) 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 officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 22, 2005

/s/James A. Graner
James A. Graner
Vice President and Controller

CERTIFICATION

I, Mark W. Sheahan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;
2. Based on my knowledge, this 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 officers 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)) 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 officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 1, 2005

/s/Mark W. Sheahan
Mark W. Sheahan
Vice President and Treasurer

CERTIFICATION UNDER SECTION 1350

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

Date: August 1, 2005

/s/David A. Roberts

David A. Roberts
President and Chief Executive Officer

Date: July 22, 2005

/s/James A. Graner

James A. Graner
Vice President and Controller
Chief Accounting Officer

Date: August 1, 2005

/s/Mark W. Sheahan

Mark W. Sheahan
Vice President and Treasurer
Principal Financial Officer