

**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 **April 1, 2011**

Commission File Number: 001-09249

GRACO INC.

(Exact name of registrant as specified in its charter)

Minnesota

(State of incorporation)

41-0285640

(I.R.S. Employer Identification Number)

88 — 1st 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	<input checked="" type="checkbox"/>	Accelerated Filer	<input type="checkbox"/>
Non-accelerated Filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

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

Yes No

60,649,000 shares of the Registrant's Common Stock, \$1.00 par value, were outstanding as of April 20, 2011.

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PART I

Item 1.

GRACO INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

(In thousands except per share amounts)

	Thirteen Weeks Ended	
	April 1, 2011	March 26, 2010
Net Sales	\$ 217,679	\$ 164,721
Cost of products sold	93,282	75,426
Gross Profit	124,397	89,295
Product development	9,931	9,474
Selling, marketing and distribution	37,483	29,160
General and administrative	19,914	17,955
Operating Earnings	57,069	32,706
Interest expense	616	1,080
Other expense, net	-	161
Earnings Before Income Taxes	56,453	31,465
Income taxes	19,200	10,900
Net Earnings	\$ 37,253	\$ 20,565
Basic Net Earnings per Common Share	\$ 0.62	\$ 0.34
Diluted Net Earnings per Common Share	\$ 0.61	\$ 0.34
Cash Dividends Declared per Common Share	\$ 0.21	\$ 0.20

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Unaudited)
(In thousands)

	April 1, 2011	Dec 31, 2010
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 102,509	\$ 9,591
Accounts receivable, less allowances of \$5,500 and \$5,600	153,541	124,593
Inventories	102,785	91,620
Deferred income taxes	19,272	18,647
Other current assets	<u>2,418</u>	<u>7,957</u>
Total current assets	380,525	252,408
Property, Plant and Equipment		
Cost	342,777	344,854
Accumulated depreciation	<u>(209,388)</u>	<u>(210,669)</u>
Property, plant and equipment, net	133,389	134,185
Goodwill	91,740	91,740
Other Intangible Assets, net	25,461	28,338
Deferred Income Taxes	15,267	14,696
Other Assets	<u>9,040</u>	<u>9,107</u>
Total Assets	<u>\$ 655,422</u>	<u>\$ 530,474</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Notes payable to banks	\$ 11,192	\$ 8,183
Trade accounts payable	28,930	19,669
Salaries and incentives	18,362	34,907
Dividends payable	12,621	12,610
Other current liabilities	<u>50,658</u>	<u>44,385</u>
Total current liabilities	121,763	119,754
Long-term Debt	150,000	70,255
Retirement Benefits and Deferred Compensation	77,437	76,351
Shareholders' Equity		
Common stock	60,625	60,048
Additional paid-in-capital	227,823	212,073
Retained earnings	69,066	44,436
Accumulated other comprehensive income (loss)	<u>(51,292)</u>	<u>(52,443)</u>
Total shareholders' equity	<u>306,222</u>	<u>264,114</u>
Total Liabilities and Shareholders' Equity	<u>\$ 655,422</u>	<u>\$ 530,474</u>

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited) (In thousands)

	Thirteen Weeks Ended	
	April 1, 2011	March 26, 2010
Cash Flows From Operating Activities		
Net Earnings	\$ 37,253	\$ 20,565
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	8,427	8,578
Deferred income taxes	(1,795)	(3,254)
Share-based compensation	2,658	2,108
Excess tax benefit related to share-based payment arrangements	(1,200)	(700)
Change in		
Accounts receivable	(27,372)	(19,601)
Inventories	(11,037)	(7,849)
Trade accounts payable	9,193	6,088
Salaries and incentives	(17,139)	1,333
Retirement benefits and deferred compensation	2,025	2,714
Other accrued liabilities	7,853	6,153
Other	5,314	(94)
Net cash provided by operating activities	14,180	16,041
Cash Flows From Investing Activities		
Property, plant and equipment additions	(4,517)	(2,847)
Proceeds from sale of property, plant and equipment	143	57
Capitalized software and other intangible asset additions	-	(125)
Net cash used in investing activities	(4,374)	(2,915)
Cash Flows From Financing Activities		
Borrowings on short-term lines of credit	7,861	3,851
Payments on short-term lines of credit	(5,220)	(960)
Borrowings on long-term notes and line of credit	252,175	17,315
Payments on long-term line of credit	(172,430)	(23,575)
Excess tax benefit related to share-based payment arrangements	1,200	700
Common stock issued	12,437	7,984
Common stock repurchased	-	(52)
Cash dividends paid	(12,612)	(12,002)
Net cash provided by (used in) financing activities	83,411	(6,739)
Effect of exchange rate changes on cash	(299)	(166)
Net increase (decrease) in cash and cash equivalents	92,918	6,221
Cash and cash equivalents		
Beginning of year	9,591	5,412
End of period	\$ 102,509	\$ 11,633

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 April 1, 2011 and the related statements of earnings for the thirteen weeks ended April 1, 2011 and March 26, 2010, and cash flows for the thirteen weeks ended April 1, 2011 and March 26, 2010 have been prepared by the Company and have not been audited.

In the opinion of management, these consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of Graco Inc. and Subsidiaries as of April 1, 2011, and the results of operations and cash flows for all periods presented.

In the fourth quarter of 2010, the Company changed its cash flow presentation of notes payable activity, for all periods presented, to separately disclose borrowings and payments. The Company also changed the cash flow presentation of activity on the swingline portion of its long-term revolving credit arrangement by changing the method it uses to accumulate borrowing and payment amounts. In prior periods, such activity was disclosed on a net basis. The effect of this change was to increase both borrowings and payments on long-term line of credit by \$17 million in the first quarter of 2010. These changes had no impact on net cash used in financing activities.

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 2010 Annual Report on Form 10-K.

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

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>April 1, 2011</u>	<u>March 26, 2010</u>
Net earnings available to common shareholders	\$ 37,253	\$ 20,565
Weighted average shares outstanding for basic earnings per share	60,270	60,206
Dilutive effect of stock options computed using the treasury stock method and the average market price	1,090	507
Weighted average shares outstanding for diluted earnings per share	61,360	60,713
Basic earnings per share	\$ 0.62	\$ 0.34
Diluted earnings per share	\$ 0.61	\$ 0.34

Stock options to purchase 828,000 and 3,103,000 shares were not included in the 2011 and 2010 computations of diluted earnings per share, respectively, because they would have been anti-dilutive.

3. Information on option shares outstanding and option activity for the thirteen weeks ended April 1, 2011 is shown below (in thousands, except per share amounts):

	<u>Option Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Options Exercisable</u>	<u>Weighted Average Exercise Price</u>
Outstanding, December 31, 2010	5,509	\$ 30.42	2,980	\$ 31.99
Granted	497	42.73		
Exercised	(235)	20.69		
Canceled	(17)	37.25		
Outstanding, April 1, 2011	<u>5,754</u>	\$ 31.86	3,410	\$ 32.08

The Company recognized year-to-date share-based compensation of \$2.7 million in 2011 and \$2.1 million in 2010. As of April 1, 2011, there was \$13.0 million of unrecognized compensation cost related to unvested options, expected to be recognized over a weighted average period of 2.4 years.

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

	Thirteen Weeks Ended	
	April 1, 2011	March 26, 2010
Expected life in years	6.5	6.0
Interest rate	2.8 %	2.7 %
Volatility	33.7 %	33.8 %
Dividend yield	2.0 %	3.0 %
Weighted average fair value per share	\$ 13.21	\$ 7.16

Under the Company's Employee Stock Purchase Plan, the Company issued 313,000 shares in 2011 and 436,000 shares in 2010. The fair value of the employees' purchase rights under this Plan was estimated on the date of grant. The benefit of the 15 percent discount from the lesser of the fair market value per common share on the first day and the last day of the plan year was added to the fair value of the employees' purchase rights determined using the Black-Scholes option-pricing model with the following assumptions and results:

	Thirteen Weeks Ended	
	April 1, 2011	March 26, 2010
Expected life in years	1.0	1.0
Interest rate	0.3 %	0.3 %
Volatility	27.8 %	42.8 %
Dividend yield	2.1 %	2.9 %
Weighted average fair value per share	\$ 10.05	\$ 8.48

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

	Thirteen Weeks Ended	
	April 1, 2011	March 26, 2010
Pension Benefits		
Service cost	\$ 1,233	\$ 1,241
Interest cost	3,370	3,277
Expected return on assets	(4,000)	(3,475)
Amortization and other	1,481	1,504
Net periodic benefit cost	<u>\$ 2,084</u>	<u>\$ 2,547</u>
Postretirement Medical		
Service cost	\$ 125	\$ 125
Interest cost	325	325
Net periodic benefit cost	<u>\$ 450</u>	<u>\$ 450</u>

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

	<u>Thirteen Weeks Ended</u>	
	<u>April 1, 2011</u>	<u>March 26, 2010</u>
Net earnings	\$ 37,253	\$ 20,565
Pension and postretirement medical liability adjustment	1,363	1,468
Gain (loss) on interest rate hedge contracts	454	705
Income taxes	(666)	(805)
Comprehensive income	<u>\$ 38,404</u>	<u>\$ 21,933</u>

Components of accumulated other comprehensive income (loss) were (in thousands):

	<u>April 1, 2011</u>	<u>Dec 31, 2010</u>
Pension and postretirement medical liability adjustment	\$ (50,469)	\$ (51,334)
Gain (loss) on interest rate hedge contracts	-	(286)
Cumulative translation adjustment	(823)	(823)
Total	<u>\$ (51,292)</u>	<u>\$ (52,443)</u>

6. The Company has three reportable segments: Industrial, Contractor and Lubrication. Sales and operating earnings by segment for the thirteen weeks ended April 1, 2011 and March 26, 2010 were as follows (in thousands):

	<u>Thirteen Weeks Ended</u>	
	<u>April 1, 2011</u>	<u>March 26, 2010</u>
Net Sales		
Industrial	\$ 122,830	\$ 96,792
Contractor	70,205	50,797
Lubrication	24,644	17,132
Total	<u>\$ 217,679</u>	<u>\$ 164,721</u>
Operating Earnings		
Industrial	\$ 45,025	\$ 30,474
Contractor	11,115	4,883
Lubrication	5,227	1,707
Unallocated corporate (expense)	(4,298)	(4,358)
Total	<u>\$ 57,069</u>	<u>\$ 32,706</u>

Assets by segment were as follows (in thousands):

	<u>April 1,</u> <u>2011</u>	<u>Dec 31,</u> <u>2010</u>
Industrial	\$286,027	\$270,160
Contractor	155,261	134,938
Lubrication	85,017	81,746
Unallocated corporate	<u>129,117</u>	<u>43,630</u>
Total	<u>\$655,422</u>	<u>\$530,474</u>

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

	<u>April 1,</u> <u>2011</u>	<u>Dec 31,</u> <u>2010</u>
Finished products and components	\$ 53,719	\$ 48,670
Products and components in various stages of completion	36,028	31,275
Raw materials and purchased components	<u>48,630</u>	<u>46,693</u>
	138,377	126,638
Reduction to LIFO cost	<u>(35,592)</u>	<u>(35,018)</u>
Total	<u>\$102,785</u>	<u>\$ 91,620</u>

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

	Estimated Life (years)	Original Cost	Accumulated Amortization	Foreign Currency Translation	Book Value
<u>April 1, 2011</u>					
Customer relationships	5-8	\$40,875	\$ (26,180)	\$ (181)	\$14,514
Patents, proprietary technology and product documentation	3-10	19,452	(14,233)	(87)	5,132
Trademarks, trade names and other	3	<u>6,960</u>	<u>(4,325)</u>	<u>-</u>	<u>2,635</u>
		67,287	(44,738)	(268)	22,281
Not Subject to Amortization:					
Brand names		<u>3,180</u>	<u>-</u>	<u>-</u>	<u>3,180</u>
Total		<u>\$70,467</u>	<u>\$ (44,738)</u>	<u>\$ (268)</u>	<u>\$25,461</u>
<u>December 31, 2010</u>					
Customer relationships	3-8	\$41,075	\$ (24,840)	\$ (181)	\$16,054
Patents, proprietary technology and product documentation	3-10	19,902	(13,956)	(87)	5,859
Trademarks, trade names and other	3-10	<u>8,154</u>	<u>(4,909)</u>	<u>-</u>	<u>3,245</u>
		69,131	(43,705)	(268)	25,158
Not Subject to Amortization:					
Brand names		<u>3,180</u>	<u>-</u>	<u>-</u>	<u>3,180</u>
Total		<u>\$72,311</u>	<u>\$ (43,705)</u>	<u>\$ (268)</u>	<u>\$28,338</u>

Amortization of intangibles was \$2.9 million in the first quarter of 2011. Estimated annual amortization expense is as follows: \$10.7 million in 2011, \$8.8 million in 2012, \$4.1 million in 2013, \$0.9 million in 2014, \$0.5 million in 2015 and \$0.2 million thereafter.

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

	April 1, <u>2011</u>	Dec 31, <u>2010</u>
Accrued self-insurance retentions	\$ 6,797	\$ 6,675
Accrued warranty and service liabilities	6,907	6,862
Accrued trade promotions	3,673	5,947
Payable for employee stock purchases	1,276	5,655
Income taxes payable	13,007	733
Other	<u>18,998</u>	<u>18,513</u>
Total other current liabilities	<u>\$50,658</u>	<u>\$44,385</u>

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

	Thirteen Weeks Ended April 1, <u>2011</u>	Year Ended Dec 31, <u>2010</u>
Balance, beginning of year	\$ 6,862	\$ 7,437
Charged to expense	1,189	3,484
Margin on parts sales reversed	789	3,412
Reductions for claims settled	<u>(1,933)</u>	<u>(7,471)</u>
Balance, end of period	<u>\$ 6,907</u>	<u>\$ 6,862</u>

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

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

The Company periodically evaluates its monetary asset and liability positions denominated in foreign currencies. The Company enters into forward contracts or options, or borrows in various currencies, in order to hedge its net monetary positions. These instruments are recorded at current market values and the gains and losses are

included in other expense (income), net. There were seven contracts outstanding as of April 1, 2011, with notional amounts totaling \$21 million. The Company believes it uses strong financial counterparts in these transactions and that the resulting credit risk under these hedging strategies is not significant.

The Company uses significant other observable inputs to value the derivative instruments used to hedge interest rate volatility and net monetary positions, including reference to market prices and financial models that incorporate relevant market assumptions. The fair market value and balance sheet classification of such instruments follows (in thousands):

	Balance Sheet Classification	April 1, 2011	Dec 31, 2010
Gain (loss) on interest rate hedge contracts	Other current liabilities	\$ —	\$ (454)
Gain (loss) on foreign currency forward contracts			
Gains		\$ 186	\$ 92
Losses		(263)	(284)
Net	Other current liabilities	\$ (77)	\$ (192)

11. In March 2011, the Company entered into a note agreement and sold \$150 million of unsecured notes (series A and B) in a private placement. Proceeds were used to repay revolving line of credit borrowings and invested in cash equivalents. The note agreement provides for the issuance and sale of an additional \$150 million in unsecured notes (series C and D) on or before July 26, 2011.

Interest rates and maturity dates on the four series of notes are as follows (dollars in millions):

Series	Amount	Rate	Maturity
A	\$ 75	4.00%	March 2018
B	\$ 75	5.01%	March 2023
C	\$ 75	4.88%	January 2020
D	\$ 75	5.35%	July 2026

The note agreement requires the Company to maintain certain financial ratios as to cash flow leverage and interest coverage.

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

The estimated fair value of the notes sold in March 2011 is not significantly different from the \$150 million carrying amount as of April 1, 2011.

12. In April 2011, the Company entered into a definitive agreement to purchase the finishing businesses of Illinois Tool Works Inc. (ITW) in a \$650 million cash transaction. The agreement contemplates a closing date on or after June 1, 2011, subject to regulatory reviews and other customary closing conditions. The Company currently expects the transaction to close in the third quarter of 2011. The Company plans to finance the acquisition through a new committed \$450 million revolving credit facility and funds available under the long-term notes referenced above.

Item 2. GRACO INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The Company designs, manufactures and markets systems and equipment to move, measure, control, dispense and spray fluid materials. Management classifies the Company's business into three reportable segments: Industrial, Contractor and Lubrication. Key strategies include developing and marketing new products, expanding distribution globally, opening new markets with technology and channel expansion and completing strategic acquisitions.

The following Management's Discussion and Analysis reviews significant factors affecting the Company's results of operations and financial condition. This discussion should be read in conjunction with the financial statements and the accompanying notes to the financial statements.

Results of Operations

Net sales, net earnings and earnings per share were as follows (in millions except per share amounts and percentages):

	Thirteen Weeks Ended		
	April 1, <u>2011</u>	March 26, <u>2010</u>	% <u>Change</u>
Net Sales	\$ 217.7	\$ 164.7	32%
Net Earnings	\$ 37.3	\$ 20.6	81%
Diluted Net Earnings per Common Share	\$ 0.61	\$ 0.34	79%

All segments and geographic regions had double-digit percentage revenue growth for the first quarter. Volume increases drove improvements in gross margin rates and net earnings. Currency translation did not have a significant effect on consolidated results for the quarter.

Consolidated Results

Sales by geographic area were as follows (in millions):

	<u>Thirteen Weeks Ended</u>	
	<u>April 1, 2011</u>	<u>March 26, 2010</u>
Americas ¹	\$ 115.6	\$ 86.7
Europe ²	53.3	41.8
Asia Pacific	<u>48.8</u>	<u>36.2</u>
Consolidated	<u>\$ 217.7</u>	<u>\$ 164.7</u>

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

2 Europe, Africa and Middle East

First quarter sales increased 33 percent in the Americas, 27 percent in Europe and 35 percent in Asia Pacific (31 percent at consistent translation rates). Translation rates did not have a significant impact on the overall sales increase of 32 percent.

Gross profit margin, expressed as a percentage of sales, was 57 percent, up from 54 percent for the first quarter last year. Higher production volume was the major factor in the improvement. Selling price increases also contributed to the increase in margin rates.

Total operating expenses increased \$11 million (19 percent) compared to first quarter last year, including increases of \$8 million in selling and marketing and \$2 million in general and administrative. Increases in payroll (headcount and incentives) and product promotion (mostly Contractor segment) were related to higher levels of business activity. As a percentage of sales, operating expenses decreased to 31 percent from 34 percent for the first quarter last year.

The effective income tax rate was 34 percent compared to 34½ percent for the first quarter last year. The decrease is mostly due to the federal R&D credit included in the 2011 rate. There was no R&D credit included in the rate for the first quarter of 2010.

Segment Results

Certain measurements of segment operations compared to last year are summarized below:

Industrial

	<u>Thirteen Weeks Ended</u>	
	<u>April 1, 2011</u>	<u>March 26, 2010</u>
Net sales (in millions)		
Americas	\$ 52.9	\$ 41.9
Europe	34.4	27.9
Asia Pacific	35.5	27.0
Total	<u>\$ 122.8</u>	<u>\$ 96.8</u>

Operating earnings as a percentage of net sales	<u>37%</u>	<u>31%</u>
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Industrial segment sales increased 26 percent in the Americas, 24 percent in Europe and 31 percent in Asia Pacific.

Higher volume and expense leverage contributed to the improvement in operating earnings as a percentage of sales.

Contractor

	<u>Thirteen Weeks Ended</u>	
	<u>April 1, 2011</u>	<u>March 26, 2010</u>
Net sales (in millions)		
Americas	\$ 44.9	\$ 31.9
Europe	16.7	12.6
Asia Pacific	8.6	6.3
Total	<u>\$ 70.2</u>	<u>\$ 50.8</u>

Operating earnings as a percentage of net sales	<u>16%</u>	<u>10%</u>
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Contractor segment sales increased 41 percent in the Americas, with substantial gains in both the paint store and home center channels. Sales increased 33 percent in Europe and 38 percent in Asia Pacific.

Higher volume and expense leverage contributed to the improvement in operating earnings as a percentage of sales. High product development expenses affected operating margin rate in 2010, and increased marketing, including product launch and promotion expenses, moderated the improvement in 2011.

Lubrication

	<u>Thirteen Weeks Ended</u>	
	<u>April 1,</u> <u>2011</u>	<u>March 26,</u> <u>2010</u>
Net sales (in millions)		
Americas	\$ 17.8	\$ 12.8
Europe	2.2	1.4
Asia Pacific	4.6	2.9
Total	<u>\$ 24.6</u>	<u>\$ 17.1</u>
Operating earnings as a percentage of net sales	<u>21%</u>	<u>10%</u>

Lubrication segment sales increased 39 percent in the Americas. From small bases, sales increased 55 percent in Europe and 61 percent in Asia Pacific.

Higher volume and expense leverage contributed to the improvement in operating earnings as a percentage of sales.

Liquidity and Capital Resources

Net cash provided by operating activities was \$14 million in 2011 and \$16 million in 2010. The effect of higher net earnings was offset by larger increases in inventories and receivables and higher 2010 incentive and bonus payments made in the first quarter of 2011.

Since the end of 2010, inventories increased by \$11 million to meet higher demand, and accounts receivable increased by \$29 million due to higher sales levels.

At April 1, 2011, the Company had various lines of credit totaling \$271 million, of which \$262 million was unused.

In March 2011, the Company entered into a note agreement and sold \$150 million of unsecured notes in a private placement. One series of notes totaling \$75 million bears interest at 4.0 percent and matures in 2018. Another series of notes totaling \$75 million bears interest at 5.01 percent and matures in 2023. Proceeds were used to repay revolving line of credit borrowings and invested in cash equivalents. The note agreement provides for the issuance and sale of an additional \$150 million in unsecured notes on or before July 26, 2011. One series of notes to be issued totaling \$75 million will bear interest at 4.88 percent and mature in 2020. Another series of notes to be issued totaling \$75 million will bear interest at 5.35 percent and mature in 2026.

Under terms of the note agreement, interest is payable quarterly. The Company is required to maintain a cash flow leverage ratio of not more than 3.25 to 1.00 and an interest coverage ratio of not less than 3.00 to 1.00. If a significant acquisition is consummated, the agreement allows, for a one-year period, for a cash flow leverage ratio of 3.75 to 1.00 and an interest coverage ratio of not less than 2.50 to 1.00. The note agreement contains covenants typical of unsecured credit facilities, including customary default provisions. If an event of default occurs, all outstanding obligations may become immediately due and payable. The Company was in compliance with all financial covenants at April 1, 2011.

In April 2011, the Company entered into a definitive agreement to purchase the finishing business operations of Illinois Tool Works Inc. (ITW) in a \$650 million cash transaction. The agreement contemplates a closing date on or after June 1, 2011, subject to regulatory reviews and other customary closing conditions. The Company currently expects the transaction to close in the third quarter of 2011. The Company plans to finance the acquisition through a new committed \$450 million revolving credit facility and funds available under the long-term notes referenced above.

Internally generated funds and unused financing sources are expected to provide the Company with the flexibility to meet its liquidity needs in 2011.

Outlook

Management is optimistic that sales momentum will continue throughout 2011, although percentage gains may decline due to tougher sales comparisons, particularly in the Contractor segment, where the initial stocking of new handheld products occurred in the second quarter of 2010.

The pending acquisition of the ITW finishing businesses would advance all of the Company's stated core growth strategies, including new products and technology, geographic expansion, and new markets.

SAFE HARBOR CAUTIONARY STATEMENT

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

The Company desires to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 by making cautionary statements concerning any forward-looking statements made by or on behalf of the Company. The Company cannot give any assurance that the results forecasted in any forward-looking statement will actually be achieved. Future results could differ materially from those expressed, due to the impact of changes in various factors. These risk factors include, but are not limited to: economic conditions in the United States and other major world economies, currency fluctuations, political instability, changes in laws and regulations, and changes in product demand. In addition, risk factors related to the Company's pending acquisition of the ITW finishing business include: whether and when the required regulatory approvals will be obtained, whether and when the closing conditions will be satisfied and whether and when the transaction will close, the ability to close on committed financing on satisfactory terms, the amount of debt that the Company will incur to complete the transaction, completion of purchase price valuation for acquired assets, whether and when the Company will be able to realize the expected financial results and accretive effect of the transaction, how customers, competitors, suppliers and employees will react to the transaction, and economic changes in global markets. Please refer to Item 1A of, and Exhibit 99 to, the Company's Annual Report on Form 10-K for fiscal year 2010 and Item 1A of this Quarterly Report on Form 10-Q for a more comprehensive discussion of these and other risk factors.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes related to market risk from the disclosures made in the Company's 2010 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

As of the end of the fiscal quarter covered by this report, the Company carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures. This evaluation was done under the supervision and with the participation of the Company's President and Chief Executive Officer, the Chief Financial Officer and Treasurer, the Vice President and Controller, and the Vice President, General Counsel and Secretary. Based upon that evaluation, they concluded that the Company's disclosure controls and procedures are effective.

Changes in internal controls

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

PART II OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes to the Company's risk factors from those disclosed in the Company's 2010 Annual Report on Form 10-K, except for the addition of the risk factor described below:

Pending Acquisition — Our pending acquisition of the finishing business operations of Illinois Tool Works Inc. is subject to regulatory approvals and the expected benefits from the acquisition may not be fully realized.

We have entered into a definitive agreement to purchase the finishing business of Illinois Tools Works Inc. (ITW) in a \$650 million cash transaction. We cannot predict whether or when the required regulatory approvals will be obtained or if the closing conditions will be satisfied. If we terminate the agreement before April 1, 2012 due to failure to obtain regulatory approval, we will be required to pay a \$20 million termination fee. The \$450 million revolving credit facility that will be used to finance the transaction has not yet been executed. After the transaction closes, significant changes to our financial condition as a result of global economic changes or difficulties in the integration of the newly acquired businesses may affect our ability to obtain the expected benefits from the transaction or to satisfy the financial covenants included in the terms of the financing arrangements.

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

Issuer Purchases of Equity Securities

On September 18, 2009, the Board of Directors authorized the Company to purchase up to 6,000,000 shares of its outstanding common stock, primarily through open-market transactions. The authorization expires on September 30, 2012.

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

No shares were purchased in the first quarter of 2011. As of April 1, 2011, there were 5,179,638 shares that may yet be purchased under the Board authorization.

Item 6. Exhibits

- 10.1 Chief Executive Officer Restricted Stock Agreement (Performance-Based). Form of agreement used to award performance-based restricted stock to the Chief Executive Officer (incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K filed March 2, 2011).
- 10.2 Note Agreement, dated March 11, 2011, between Graco Inc. and the Purchasers listed on the Purchaser Schedule attached thereto, which includes as exhibits the form of Senior Notes (incorporated by reference to Exhibit 10.1 to the Company's Report on Form 8-K filed March 16, 2011).
- 10.3 Stock Option Agreement. Form of agreement used for award in 2011 of non-qualified stock options to chief executive officer under the Graco Inc. 2010 Stock Incentive Plan.
- 10.4 Stock Option Agreement. Form of agreement used for award in 2011 of non-qualified stock options to executive officers under the Graco Inc. 2010 Stock Incentive Plan.
- 31.1 Certification of President and Chief Executive Officer pursuant to Rule 13a-14(a).
- 31.2 Certification of Chief Financial Officer and Treasurer pursuant to Rule 13a-14(a).
- 32 Certification of President and Chief Executive Officer and Chief Financial Officer and Treasurer pursuant to Section 1350 of Title 18, U.S.C.
- 99.1 Press Release, Reporting First Quarter Earnings, dated April 27, 2011.
- 101 Interactive Data File.

SIGNATURES

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

GRACO INC.

Date: April 27, 2011

By: /s/ Patrick J. McHale

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

Date: April 27, 2011

By: /s/ James A. Graner

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

Date: April 27, 2011

By: /s/ Caroline M. Chambers

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

GRACO INC. 2010 STOCK INCENTIVE PLAN

**CHIEF EXECUTIVE OFFICER
STOCK OPTION AGREEMENT
(Non-Qualified)**

THIS AGREEMENT, made this «DATE» day of «MONTH», «YEAR», by and between Graco Inc., a Minnesota corporation (the “Company”) and «NAME» (“«NAME»” or the “Employee”).

WITNESSETH THAT:

WHEREAS, the Company pursuant to the Graco Inc. 2010 Stock Incentive Plan (the “Plan”) wishes to grant this stock option to Employee;

NOW THEREFORE, in consideration of the premises and of the mutual covenants contained in this Agreement, the parties agree as follows:

1. Grant of Option

The Company grants to Employee, the right and option (the “Option”) to purchase all or any part of an aggregate of «SHARES» shares of Common Stock of the Company, par value USD 1.00 per share, at the price of USD «PRICE» per share on the terms and conditions set forth in this Agreement. The date of grant of the Option is «DATE» (the “Date of Grant”).

2. Duration and Exercisability

- A. No portion of this Option may be exercised by Employee until the first anniversary of the Date of Grant and then only in accordance with the Vesting Schedule set forth below. In no event shall this Option or any portion of this Option be exercisable following the tenth anniversary of the Date of Grant.

Vesting Schedule

<u>Vesting Date</u>	<u>Portion of Option Exercisable</u>
First Anniversary of Date of Grant	25%
Second Anniversary of Date of Grant	50%
Third Anniversary of Date of Grant	75%
Fourth Anniversary of Date of Grant	100%

If Employee does not purchase in any one year the full number of shares of Common Stock of the Company to which he/she is entitled under this Option, he/she may, subject to the terms and conditions of Section 3, purchase such shares of Common Stock in any subsequent year during the term of this Option. This Option shall expire as of the close of trading at the national securities exchange on which the Common Stock is traded (“Exchange”) on the tenth anniversary of the Date of Grant or if the Exchange is closed

on the anniversary date or the Common Stock of the Company is not trading on said anniversary date, such earlier business day on which the Common Stock is trading on the Exchange.

- B. During the lifetime of Employee, the Option shall be exercisable only by him/her and shall not be assignable or transferable by him/her otherwise than by will or the laws of descent and distribution.
- C. Under no circumstances may the Option or any portion of the Option granted by this Agreement be exercised after the term of the Option expires.

3. Effect of Termination of Employment

- A. If Employee's employment terminates for any reason other than Employee's gross and willful misconduct, death, retirement (as defined in Section 3D), or disability (as defined in Section 3D), Employee shall have the right to exercise that portion of the Option exercisable upon the date of termination of employment at any time within the period beginning on the day after termination of employment and ending at the close of trading on the Exchange ninety (90) days later.
 - B. If Employee's employment terminates by reason of Employee's gross and willful misconduct during employment, including, but not limited to, wrongful appropriation of Company funds, serious violations of Company policy, breach of fiduciary duty or the conviction of a felony, the unexercised portion of the Option shall terminate as of the time of the misconduct. If the Company determines subsequent to the termination of Employee's employment for whatever reason, that Employee engaged in conduct during employment that would constitute gross and willful misconduct justifying termination, the Option shall terminate as of the time of such misconduct. Furthermore, if the Option is exercised in whole or in part and the Company thereafter determines that Employee engaged in gross and willful misconduct during employment which would have justified termination at any time prior to the date of such exercise, the Option shall be deemed to have terminated as of the time of the misconduct and the Company may elect to rescind the Option exercise. Gross and willful misconduct shall not include any action or inaction by the Employee contrary to the direction of the Board with respect to any initiative, strategy or action of the Company, which action or inaction the Employee believes is in the best interest of the Company.
 - C. If Employee shall die while employed by the Company or an affiliate and shall not have fully exercised the Option, all shares remaining under the Option shall become immediately exercisable. If Employee shall die within ninety (90) days after a termination of employment which meets the criteria of Section 3A above, only those shares vested as of the date of termination shall be exercisable. The executor or administrator of Employee's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent may exercise such exercisable shares at any time during a period beginning on the day after the date of Employee's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant.
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- D. If Employee's termination of employment is due to retirement or disability, all shares remaining under the Option shall become immediately exercisable. Employee shall be deemed to have retired if the termination of employment occurs for reasons other than the Employee's gross and willful misconduct, death, or disability after Employee (i) has attained age 55 and 10 years of service with the Company or an affiliate, or (ii) has attained age 65. Employee shall be deemed to be disabled if the termination of employment occurs because Employee is unable to work due to an impairment which would qualify as a disability under the Company's long term disability program. Employee may exercise the shares remaining unexercised at any time during a period beginning on the day after the date of Employee's termination of employment and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant. If Employee should die during the period between the date of Employee's retirement or disability and the expiration of the Option, the executor(s) or administrator(s) of the Employee's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent may exercise the unexercised portion of the Option at any time during a period beginning the day after the date of Employee's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant. Notwithstanding anything to the contrary contained in Section 3, if the Employee's employment is terminated by retirement (as defined in this Section 3D) and Employee has not given written notice to the Chair of the Management Organization and Compensation Committee of the Board of Directors (the "Committee"), of Employee's intention to retire not less than six (6) months prior to the date of his retirement, then in such event, for purposes of this Agreement only, said termination of employment shall be deemed to be not a retirement but a termination subject to the provisions of Section 3A, *provided, however*, that in the event that the Committee determines that said termination of employment without six (6) months prior written notice is in the best interests of the Company, such termination shall be deemed to be a retirement and shall be subject to this Section 3D.
- E. If the Option is exercised by the executors, administrators, legatees, or distributees of the estate of a deceased optionee, the Company shall be under no obligation to issue stock hereunder unless and until the Company is satisfied that the person(s) exercising the Option is the duly appointed legal representative of the deceased optionee's estate or the proper legatee or distributee thereof.
- F. For purposes of this Section 3, if the last day of the relevant period is a day upon which the Exchange is not open for trading or the Common Stock is not trading on that day, the relevant period will expire at the close of trading on such earlier business day on which the Exchange is open and the Common Stock is trading.

4. Manner of Exercise

- A. Employee or other proper party may exercise the Option only by delivering within the term of the Option written notice to the Company at its principal office in Minneapolis, Minnesota, stating the number of shares as to which the Option is being exercised and, except as provided in Sections 4B(2) and 4C, accompanied by payment-in-full of the Option price for all shares designated in the notice.
- B. The Employee may, at Employee's election, pay the Option price as follows:
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- (1) by cash or check (bank check, certified check, or personal check)
- (2) by delivering to the Company for cancellation, shares of Common Stock of the Company which have been held by the Employee for not less than six (6) months with a fair market value equal to the Option price.

For purposes of Section 4B(2), the fair market value of the Company's Common Stock shall be the closing price of the Common Stock on the day immediately preceding the date of exercise on the Exchange. If there is not a quotation available for such day, then the closing price on the next preceding day for which such a quotation exists shall be determinative of fair market value. If the shares are not then traded on an exchange, the fair market value shall be the average of the closing bid and asked prices of the Common Stock as reported by the National Association of Securities Dealers Automated Quotation System. If the Common Stock is not then traded on NASDAQ or on an exchange, then the fair market value shall be determined in such manner as the Company shall deem reasonable.

- C. The Employee may, with the consent of the Company, pay the Option price by delivering to the Company a properly executed exercise notice, together with irrevocable instructions to a broker to promptly deliver to the Company from sale or loan proceeds the amount required to pay the exercise price.

5. Payment of Withholding Taxes

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

6. Change of Control

- A. Notwithstanding Section 2A hereof, the entire Option shall become immediately and fully exercisable upon a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:
 - (1) an acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "1934 Act")), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) which, together with other acquisitions by such Person, results in the aggregate beneficial ownership by such Person of 30% or more of either
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- (a) the then outstanding shares of Common Stock of the Company (the “Outstanding Company Common Stock”) or
- (b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the “Outstanding Company Voting Securities”);

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

- (i) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
 - (ii) an acquisition by the Employee or any group that includes the Employee, or
 - (iii) an acquisition by any entity pursuant to a transaction that complies with clauses (a), (b) and (c) of Section 6A(3) below; or
- (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the “Incumbent Board”) cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company’s shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies by or on behalf of a Person other than the Board; or
- (3) Consummation of a reorganization, merger or consolidation of the Company with or into another entity or a statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company (“Business Combination”); excluding, however, such a Business Combination pursuant to which
- (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, a majority of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors (or comparable equity interests), as the case may be, of the surviving or acquiring entity resulting from such Business Combination (including, without limitation, an entity that as a result of such transaction beneficially owns 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company’s assets either
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directly or indirectly) in substantially the same proportions (as compared to the other holders of the Company's common stock and voting securities prior to the Business Combination) as their respective ownership, immediately prior to such Business Combination, of the Outstanding Company Common Stock and Outstanding Company Voting Securities,

- (b) no Person (excluding (i) any employee benefit plan (or related trust) sponsored or maintained by the Company or such entity resulting from such Business Combination or any entity controlled by the Company or the entity resulting from such Business Combination, (ii) any entity beneficially owning 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly and (iii) the Employee and any group that includes the Employee) beneficially owns, directly or indirectly, 30% or more of the then outstanding shares of common stock (or comparable equity interests) of the entity resulting from such Business Combination or the combined voting power of the then outstanding voting securities (or comparable equity interests) of such entity, and
 - (c) immediately after the Business Combination, a majority of the members of the board of directors (or comparable governors) of the entity resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or
- (4) approval by the shareholders of the Company of a complete liquidation or dissolution of the Company.

7. Adjustments; Fundamental Change

- A. If there shall be any change in the number or character of the Common Stock of the Company through merger, consolidation, reorganization, recapitalization, dividend in the form of stock (of whatever amount), stock split or other change in the corporate structure of the Company, and all or any portion of the Option shall then be unexercised and not yet expired, appropriate adjustments in the outstanding Option shall be made by the Company, in order to prevent dilution or enlargement of Employee's Option rights. Such adjustments shall include, where appropriate, changes in the number of shares of Common Stock and the price per share subject to the outstanding Option.
 - B. In the event of a proposed (i) dissolution or liquidation of the Company, (ii) a sale of substantially all of the assets of the Company, (iii) a merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, or (iv) a statutory share exchange involving the capital stock of the Company (each, a "Fundamental Change"), the Committee may, but shall not be obligated to:
 - (1) with respect to a Fundamental Change that involves a merger, consolidation or statutory share exchange, make appropriate provision for the protection of the
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Option by the substitution of options and appropriate voting common stock of the corporation surviving any such merger or consolidation or, if appropriate, the "parent corporation" (as defined in Section 424(e) of the Internal Revenue Code of 1986, as amended from time to time, and any regulations promulgated thereunder, or any successor provision) of the Company or such surviving corporation, in lieu of the Option and shares of Common Stock of the Company, or

- (2) with respect to any Fundamental Change, including, without limitation, a merger, consolidation or statutory share exchange, declare, prior to the occurrence of the Fundamental Change, and provide written notice to the holder of the Option of the declaration, that the Option, whether or not then exercisable, shall be canceled at the time of, or immediately prior to the occurrence of, the Fundamental Change in exchange for payment to the holder of the Option, within 20 days after the Fundamental Change, of cash (or, if the Committee so elects in lieu of solely cash, of such form(s) of consideration, including cash and/or property, singly or in such combination as the Committee shall determine, that the holder of the Option would have received as a result of the Fundamental Change if the holder of the Option had exercised the Option immediately prior to the Fundamental Change) equal to, for each share of Common Stock covered by the canceled Option, the amount, if any, by which the Fair Market Value (as defined in this Section 7B) per share of Common Stock exceeds the exercise price per share of Common Stock covered by the Option. At the time of the declaration provided for in the immediately preceding sentence, the Option shall immediately become exercisable in full and the holder of the Option shall have the right, during the period preceding the time of cancellation of the Option, to exercise the Option as to all or any part of the shares of Common Stock covered thereby in whole or in part, as the case may be. In the event of a declaration pursuant to this Section 7B, the Option, to the extent that it shall not have been exercised prior to the Fundamental Change, shall be canceled at the time of, or immediately prior to, the Fundamental Change, as provided in the declaration. Notwithstanding the foregoing, the holder of the Option shall not be entitled to the payment provided for in this Section 7B if such Option shall have expired or been forfeited. For purposes of this Section 7B only, "Fair Market Value" per share of Common Stock means the fair market value, as determined in good faith by the Committee, of the consideration to be received per share of Common Stock by the shareholders of the Company upon the occurrence of the Fundamental Change, notwithstanding anything to the contrary provided in this Agreement.

8. Miscellaneous

- A. This Option is issued pursuant to the Plan and is subject to its terms. The terms of the Plan are available for inspection during business hours at the principal offices of the Company.
- B. This Agreement shall not confer on Employee any right with respect to continuance of employment by the Company or any of its subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time.
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- C. Neither Employee, the Employee's legal representative, nor the executor(s) or administrator(s) of the Employee's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent shall be, or have any of the rights or privileges of, a shareholder of the Company in respect of any shares of Common Stock receivable upon the exercise of this Option, in whole or in part, unless and until such shares shall have been issued upon exercise of this Option.
- D. The Company shall at all times during the term of the Option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.
- E. The internal law, and not the law of conflicts of the State of Minnesota shall govern all questions concerning the validity, construction and effect of this Agreement, the Plan and any rules and regulations relating to the Plan or this Option.
- F. Employee hereby consents to the transfer to his employer or the Company of information relating to his/her participation in the Plan, including the personal data set forth in this Agreement, between them or to other related parties in the United States or elsewhere, or to any financial institution or other third party engaged by the Company, but solely for the purpose of administering the Plan and this Option. Employee also consents to the storage and processing of such data by such persons for this purpose.

IN WITNESS WHEREOF, the Company, by the Management Organization and Compensation Committee of the Board of Directors, and the Employee have caused this Agreement to be executed and delivered, all as of the day and year first above written.

GRACO INC.
Management Org and Comp Committee

By _____
«NAME»
Its Chairman

EMPLOYEE

By _____
«NAME»

GRACO INC. 2010 STOCK INCENTIVE PLAN
EXECUTIVE OFFICER STOCK OPTION AGREEMENT
(Non-Qualified)

THIS AGREEMENT, made this «DATE» day of «MONTH», «YEAR», by and between Graco Inc., a Minnesota corporation (the “Company”) and «NAME» (the “Employee”).

WITNESSETH THAT:

WHEREAS, the Company pursuant to the Graco Inc. 2010 Stock Incentive Plan (the “Plan”) wishes to grant this stock option to Employee;

NOW THEREFORE, in consideration of the premises and of the mutual covenants contained in this Agreement, the parties agree as follows:

1. Grant of Option

The Company grants to Employee, the right and option (the “Option”) to purchase all or any part of an aggregate of «SHARES» shares of Common Stock of the Company, par value USD 1.00 per share, at the price of USD «PRICE» per share on the terms and conditions set forth in this Agreement. The date of grant of the Option is «DATE» (the “Date of Grant”).

2. Duration and Exercisability

- A. No portion of this Option may be exercised by Employee until the first anniversary of the Date of Grant and then only in accordance with the Vesting Schedule set forth below. In no event shall this Option or any portion of this Option be exercisable following the tenth anniversary of the Date of Grant.

Vesting Schedule

Vesting Date	<u>Portion of Option</u> Exercisable
First Anniversary of Date of Grant	25%
Second Anniversary of Date of Grant	50%
Third Anniversary of Date of Grant	75%
Fourth Anniversary of Date of Grant	100%

If Employee does not purchase in any one year the full number of shares of Common Stock of the Company to which he/she is entitled under this Option, he/she may, subject to the terms and conditions of Section 3, purchase such shares of Common Stock in any subsequent year during the term of this Option. This Option shall expire as of the close of trading at the national securities exchange on which the Common Stock is traded (“Exchange”) on the tenth anniversary of the Date of Grant or if the Exchange is closed on the anniversary date or the Common Stock of the Company is not trading on said

anniversary date, such earlier business day on which the Common Stock is trading on the Exchange.

- B. During the lifetime of Employee, the Option shall be exercisable only by him/her and shall not be assignable or transferable by him/her otherwise than by will or the laws of descent and distribution.
- C. Under no circumstances may the Option or any portion of the Option granted by this Agreement be exercised after the term of the Option expires.

3. Effect of Termination of Employment

- A. If Employee's employment terminates for any reason other than Employee's gross and willful misconduct, death, retirement (as defined in Section 3D), or disability (as defined in Section 3D), Employee shall have the right to exercise that portion of the Option exercisable upon the date of termination of employment at any time within the period beginning on the day after termination of employment and ending at the close of trading on the Exchange ninety (90) days later.
 - B. If Employee's employment terminates by reason of Employee's gross and willful misconduct during employment, including, but not limited to, wrongful appropriation of Company funds, serious violations of Company policy, breach of fiduciary duty or the conviction of a felony, the unexercised portion of the Option shall terminate as of the time of the misconduct. If the Company determines subsequent to the termination of Employee's employment for whatever reason, that Employee engaged in conduct during employment that would constitute gross and willful misconduct justifying termination, the Option shall terminate as of the time of such misconduct. Furthermore, if the Option is exercised in whole or in part and the Company thereafter determines that Employee engaged in gross and willful misconduct during employment which would have justified termination at any time prior to the date of such exercise, the Option shall be deemed to have terminated as of the time of the misconduct and the Company may elect to rescind the Option exercise.
 - C. If Employee shall die while employed by the Company or an affiliate and shall not have fully exercised the Option, all shares remaining under the Option shall become immediately exercisable. If Employee shall die within ninety (90) days after a termination of employment which meets the criteria of Section 3A above, only those shares vested as of the date of termination shall be exercisable. The executor or administrator of Employee's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent may exercise such exercisable shares at any time during a period beginning on the day after the date of Employee's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant.
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- D. If Employee's termination of employment is due to retirement or disability, all shares remaining under the Option shall become immediately exercisable. Employee shall be deemed to have retired if the termination of employment occurs for reasons other than the Employee's gross and willful misconduct, death, or disability after Employee (i) has attained age 55 and 10 years of service with the Company or an affiliate, or (ii) has attained age 65. Employee shall be deemed to be disabled if the termination of employment occurs because Employee is unable to work due to an impairment which would qualify as a disability under the Company's long term disability program. Employee may exercise the shares remaining unexercised at any time during a period beginning on the day after the date of Employee's termination of employment and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant. If Employee should die during the period between the date of Employee's retirement or disability and the expiration of the Option, the executor(s) or administrator(s) of the Employee's estate, or any person(s) to whom the Option was transferred by will or the applicable laws of distribution and descent may exercise the unexercised portion of the Option at any time during a period beginning the day after the date of Employee's death and ending at the close of trading on the Exchange on the tenth anniversary of the Date of Grant.
- E. Notwithstanding anything to the contrary contained in this Section 3, if the Employee's employment is terminated by retirement (as defined in Section 3D) and Employee has not given the Company written notice to his/her immediate supervisor and the Chief Executive Officer, of Employee's intention to retire not less than six (6) months prior to the date of his/her retirement, then in such event, for purposes of this Agreement only, said termination of employment shall be deemed to be not a retirement but a termination subject to the provisions of Section 3A, *provided, however*, that in the event that the Chief Executive Officer determines that said termination of employment without six (6) months prior written notice is in the best interests of the Company, such termination shall be deemed to be a retirement and shall be subject to Section 3D.
- F. If the Option is exercised by the executors, administrators, legatees, or distributees of the estate of a deceased optionee, the Company shall be under no obligation to issue stock hereunder unless and until the Company is satisfied that the person(s) exercising the Option is the duly appointed legal representative of the deceased optionee's estate or the proper legatee or distributee thereof.
- G. For purposes of this Section 3, if the last day of the relevant period is a day upon which the Exchange is not open for trading or the Common Stock is not trading on that day, the relevant period will expire at the close of trading on such earlier business day on which the Exchange is open and the Common Stock is trading.
4. Manner of Exercise
- A. Employee or other proper party may exercise the Option only by delivering within the term of the Option written notice to the Company at its principal office in Minneapolis, Minnesota, stating the number of shares as to which the Option is being exercised and, except as provided in Sections 4B(2) and 4C, accompanied by payment-in-full of the Option price for all shares designated in the notice.
- B. The Employee may, at Employee's election, pay the Option price as follows:
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- (1) by cash or check (bank check, certified check, or personal check)
- (2) by delivering to the Company for cancellation, shares of Common Stock of the Company which have been held by the Employee for not less than six (6) months with a fair market value equal to the Option price.

For purposes of Section 4B(2), the fair market value of the Company's Common Stock shall be the closing price of the Common Stock on the day immediately preceding the date of exercise on the Exchange. If there is not a quotation available for such day, then the closing price on the next preceding day for which such a quotation exists shall be determinative of fair market value. If the shares are not then traded on an exchange, the fair market value shall be the average of the closing bid and asked prices of the Common Stock as reported by the National Association of Securities Dealers Automated Quotation System. If the Common Stock is not then traded on NASDAQ or on an exchange, then the fair market value shall be determined in such manner as the Company shall deem reasonable.

- C. The Employee may, with the consent of the Company, pay the Option price by delivering to the Company a properly executed exercise notice, together with irrevocable instructions to a broker to promptly deliver to the Company from sale or loan proceeds the amount required to pay the exercise price.

5. Payment of Withholding Taxes

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

6. Change of Control

- A. Notwithstanding Section 2A hereof, the entire Option shall become immediately and fully exercisable upon a "Change of Control" and shall remain fully exercisable until either exercised or expiring by its terms. A "Change of Control" means:
 - (1) an acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "1934 Act"), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) which, together with other acquisitions by such Person, results in the aggregate beneficial ownership by such Person of 30% or more of either
 - (a) the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or

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

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

- (i) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
 - (ii) an acquisition by the Employee or any group that includes the Employee, or
 - (iii) an acquisition by any entity pursuant to a transaction that complies with clauses (a), (b) and (c) of Section 6A(3) below; or
 - (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the “Incumbent Board”) cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company’s shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies by or on behalf of a Person other than the Board; or
 - (3) Consummation of a reorganization, merger or consolidation of the Company with or into another entity or a statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company (“Business Combination”); excluding, however, such a Business Combination pursuant to which
 - (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, a majority of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors (or comparable equity interests), as the case may be, of the surviving or acquiring entity resulting from such Business Combination (including, without limitation, an entity that as a result of such transaction beneficially owns 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company’s assets either directly or indirectly) in substantially the same proportions (as compared to the other holders of the Company’s common stock and voting securities prior to the Business Combination) as their respective
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ownership, immediately prior to such Business Combination, of the Outstanding Company Common Stock and Outstanding Company Voting Securities,

- (b) no Person (excluding (i) any employee benefit plan (or related trust) sponsored or maintained by the Company or such entity resulting from such Business Combination or any entity controlled by the Company or the entity resulting from such Business Combination, (ii) any entity beneficially owning 100% of the outstanding shares of common stock and the combined voting power of the then outstanding voting securities (or comparable equity securities) or all or substantially all of the Company's assets either directly or indirectly and (iii) the Employee and any group that includes the Employee) beneficially owns, directly or indirectly, 30% or more of the then outstanding shares of common stock (or comparable equity interests) of the entity resulting from such Business Combination or the combined voting power of the then outstanding voting securities (or comparable equity interests) of such entity, and
- (c) immediately after the Business Combination, a majority of the members of the board of directors (or comparable governors) of the entity resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

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

7. Adjustments: Fundamental Change

- A. If there shall be any change in the number or character of the Common Stock of the Company through merger, consolidation, reorganization, recapitalization, dividend in the form of stock (of whatever amount), stock split or other change in the corporate structure of the Company, and all or any portion of the Option shall then be unexercised and not yet expired, appropriate adjustments in the outstanding Option shall be made by the Company, in order to prevent dilution or enlargement of Employee's Option rights. Such adjustments shall include, where appropriate, changes in the number of shares of Common Stock and the price per share subject to the outstanding Option.
 - B. In the event of a proposed (i) dissolution or liquidation of the Company, (ii) a sale of substantially all of the assets of the Company, (iii) a merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, or (iv) a statutory share exchange involving the capital stock of the Company (each, a "Fundamental Change"), the Management Organization and Compensation Committee of the Board of Directors (the "Committee") may, but shall not be obligated to:
 - (1) with respect to a Fundamental Change that involves a merger, consolidation or statutory share exchange, make appropriate provision for the protection of the Option by the substitution of options and appropriate voting common stock of the corporation surviving any such merger or consolidation or, if appropriate, the
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“parent corporation” (as defined in Section 424(e) of the Internal Revenue Code of 1986, as amended from time to time, and any regulations promulgated thereunder, or any successor provision) of the Company or such surviving corporation, in lieu of the Option and shares of Common Stock of the Company, or

- (2) with respect to any Fundamental Change, including, without limitation, a merger, consolidation or statutory share exchange, declare, prior to the occurrence of the Fundamental Change, and provide written notice to the holder of the Option of the declaration, that the Option, whether or not then exercisable, shall be canceled at the time of, or immediately prior to the occurrence of, the Fundamental Change in exchange for payment to the holder of the Option, within 20 days after the Fundamental Change, of cash (or, if the Committee so elects in lieu of solely cash, of such form(s) of consideration, including cash and/or property, singly or in such combination as the Committee shall determine, that the holder of the Option would have received as a result of the Fundamental Change if the holder of the Option had exercised the Option immediately prior to the Fundamental Change) equal to, for each share of Common Stock covered by the canceled Option, the amount, if any, by which the Fair Market Value (as defined in this Section 7B) per share of Common Stock exceeds the exercise price per share of Common Stock covered by the Option. At the time of the declaration provided for in the immediately preceding sentence, the Option shall immediately become exercisable in full and the holder of the Option shall have the right, during the period preceding the time of cancellation of the Option, to exercise the Option as to all or any part of the shares of Common Stock covered thereby in whole or in part, as the case may be. In the event of a declaration pursuant to this Section 7B, the Option, to the extent that it shall not have been exercised prior to the Fundamental Change, shall be canceled at the time of, or immediately prior to, the Fundamental Change, as provided in the declaration. Notwithstanding the foregoing, the holder of the Option shall not be entitled to the payment provided for in this Section 7B if such Option shall have expired or been forfeited. For purposes of this Section 7B only, “Fair Market Value” per share of Common Stock means the fair market value, as determined in good faith by the Committee, of the consideration to be received per share of Common Stock by the shareholders of the Company upon the occurrence of the Fundamental Change, notwithstanding anything to the contrary provided in this Agreement.

8. Miscellaneous

- A. This Option is issued pursuant to the Plan and is subject to its terms. The terms of the Plan are available for inspection during business hours at the principal offices of the Company.
 - B. This Agreement shall not create an employment relationship between Employee and the Company and shall not confer on Employee any right with respect to continuance of employment by the Company or any of its affiliates or subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time.
 - C. Neither Employee, the Employee’s legal representative, nor the executor(s) or administrator(s) of the Employee’s estate, or any person(s) to whom the Option was
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transferred by will or the applicable laws of distribution and descent shall be, or have any of the rights or privileges of, a shareholder of the Company in respect of any shares of Common Stock receivable upon the exercise of this Option, in whole or in part, unless and until such shares shall have been issued upon exercise of this Option.

- D. This option has been granted to Employee as a purely discretionary benefit and shall not form part of Employee's salary or entitle Employee to receive similar option grants in the future. Benefits received under the Plan shall not be used in calculating severance payments, if any.
- E. The Company shall at all times during the term of the Option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.
- F. The internal law, and not the law of conflicts, of the State of Minnesota, USA, shall govern all questions concerning the validity, construction and effect of this Agreement, the Plan and any rules and regulations relating to the Plan or this Option
- G. Employee hereby consents to the transfer by his/her employer or the Company of information relating to his/her participation in the Plan, including the personal data set forth in this Agreement, between them or to other related parties in the United States or elsewhere, or to any financial institution or other third party engaged by the Company, but solely for the purpose of administering the Plan and this Option. Employee also consents to the storage and processing of such data by such persons for this purpose.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed on the day and year first above written.

GRACO INC.

By _____
«NAME»
President and Chief Executive Officer

EMPLOYEE

«NAME»

CERTIFICATION

I, Patrick J. McHale, certify that:

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

Date: April 27, 2011

/s/ Patrick J. McHale
Patrick J. McHale
President and Chief Executive Officer

CERTIFICATION

I, James A. Graner, certify that:

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

Date: April 27, 2011

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

CERTIFICATION UNDER SECTION 1350

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

Date: April 27, 2011

/s/ Patrick J. McHale

Patrick J. McHale
President and Chief Executive Officer

Date: April 27, 2011

/s/ James A. Graner

James A. Graner
Chief Financial Officer and Treasurer



News Release

FOR IMMEDIATE RELEASE:
April 27, 2011

FOR FURTHER INFORMATION:
James A. Graner (612) 623-6635

**GRACO REPORTS RECORD FIRST QUARTER SALES AND EARNINGS
STRONG SALES GROWTH CONTINUES IN ALL SEGMENTS AND REGIONS**

MINNEAPOLIS, MN (April 27, 2011) — Graco Inc. (NYSE: GGG) today announced results for the first quarter ended April 1, 2011.

Summary

\$ in millions except per share amounts

	Thirteen Weeks Ended		% Change
	April 1, 2011	March 26, 2010	
Net Sales	\$217.7	\$ 164.7	32%
Net Earnings	37.3	20.6	81%
Diluted Net Earnings per Common Share	\$ 0.61	\$ 0.34	79%

- All segments and regions had double-digit percentage revenue growth.
- Gross margin rate of 57 percent was 3 percentage points higher than the rate for the first quarter last year.
- Sales growth and expense leverage drove operating margin improvement in all segments.
- Net earnings were 17 percent of sales, 5 percentage points higher than the first quarter last year.
- Proceeds from the private placement of \$150 million in notes were used to repay revolving line of credit borrowings and invested in cash equivalents.

“Sales momentum picked up in 2010 and continued into the first quarter of 2011,” said Patrick J. McHale, President and Chief Executive Officer. “Revenue gains were strong across all segments and regions. Returns on the investments we made during the recession are significant contributors to current growth. Our good start to 2011 reflects improved economic conditions and solid execution of our core growth strategies, including new products and technology, geographic expansion and new markets.”

Consolidated Results

First quarter sales increased 33 percent in the Americas, 27 percent in Europe and 35 percent in Asia Pacific (31 percent at consistent translation rates). Translation rates did not have a significant impact on the overall sales increase of 32 percent.

Gross profit margin, expressed as a percentage of sales, was 57 percent, up from 54 percent for the first quarter last year. Higher production volume was the major factor in the improvement. Selling price increases also contributed to the increase in margin rates.

Total operating expenses increased \$11 million (19 percent) compared to first quarter last year, including increases of \$8 million in selling and marketing and \$2 million in general and administrative. Increases in payroll (headcount

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and incentives) and product promotion (mostly Contractor segment) were related to higher levels of business activity. As a percentage of sales, operating expenses decreased to 31 percent from 34 percent for the first quarter last year.

The effective income tax rate was 34 percent compared to 34 1/2 percent for the first quarter last year. There was no federal R&D credit included in the 2010 rate.

Segment Results

Certain measurements of segment operations are summarized below:

	Thirteen Weeks		
	Industrial	Contractor	Lubrication
Net sales (in millions)	\$ 122.8	\$ 70.2	\$ 24.6
Net sales percentage change from last year	27%	38%	44%
Operating earnings as a percentage of net sales			
2011	37%	16%	21%
2010	31%	10%	10%

All segments had strong increases in sales and improved operating margins. Industrial segment sales increased 27 percent, with gains of 26 percent in the Americas, 24 percent in Europe and 31 percent in Asia Pacific. Contractor segment sales increased 38 percent, including a gain of 41 percent in the Americas, with substantial increases in both the paint stores and home centers channels. Sales in this segment were up 33 percent in Europe and 38 percent in Asia Pacific. Lubrication segment sales increased 44 percent, with strong percentage gains in all regions.

Higher volume and leveraging of expenses drove continued improvement in operating earnings. Compared to first quarter last year, operating earnings as a percentage of sales increased by more than 5 percentage points in all segments.

Outlook

“We’re optimistic that sales momentum will continue throughout 2011, although we expect that percentage gains will decline due to tougher sales comparisons, particularly in the Contractor segment, where the initial stocking of new handheld products occurred in the second quarter of 2010,” said Patrick J. McHale, President and Chief Executive Officer. “We are excited about the previously announced pending acquisition of the ITW finishing businesses. Financing is committed for the \$650 million transaction and we look forward to complementing Graco’s already strong business model with the premium brands, strong distribution channel and global manufacturing capabilities of those businesses.”

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Cautionary Statement Regarding Forward-Looking Statements

A forward-looking statement is any statement made in this earnings release and other reports that the Company files periodically with the Securities and Exchange Commission, as well as in press releases, analyst briefings, conference calls and the Company's Annual Report to shareholders, which reflects the Company's current thinking on market trends and the Company's future financial performance at the time it is made. All forecasts and projections are forward-looking statements. The Company undertakes no obligation to update these statements in light of new information or future events.

The Company desires to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 by making cautionary statements concerning any forward-looking statements made by or on behalf of the Company. The Company cannot give any assurance that the results forecasted in any forward-looking statement will actually be achieved. Future results could differ materially from those expressed, due to the impact of changes in various factors. These risk factors include, but are not limited to: economic conditions in the United States and other major world economies, currency fluctuations, political instability, changes in laws and regulations, and changes in product demand. In addition, risk factors related to the Company's pending acquisition of the ITW finishing business include: whether and when the required regulatory approvals will be obtained, whether and when the closing conditions will be satisfied and whether and when the transaction will close, the ability to close on committed financing on satisfactory terms, the amount of debt that the Company will incur to complete the transaction, completion of purchase price valuation for acquired assets, whether and when the Company will be able to realize the expected financial results and accretive effect of the transaction, how customers, competitors, suppliers and employees will react to the transaction, and economic changes in global markets. Please refer to Item 1A of, and Exhibit 99 to, the Company's Annual Report on Form 10-K for fiscal year 2010 (and most recent Form 10-Q, if applicable) for a more comprehensive discussion of these and other risk factors. These reports are available on the Company's website at www.graco.com and the Securities and Exchange Commission's website at www.sec.gov.

Conference Call

Graco management will hold a conference call, including slides via webcast, with analysts and institutional investors on Thursday, April 28, 2011, at 11:00 a.m. ET, to discuss Graco's first quarter results.

A real-time Webcast of the conference call will be broadcast live over the Internet. Individuals wanting to listen and view slides can access the call at the Company's website at www.graco.com. Listeners should go to the website at least 15 minutes prior to the live conference call to install any necessary audio software.

For those unable to listen to the live event, a replay will be available soon after the conference call at Graco's website, or by telephone beginning at approximately 2:00 p.m. ET on April 28, 2011, by dialing 800-406-7325, Conference ID #4432429, if calling within the U.S. or Canada. The dial-in number for international participants is 303-590-3030, with the same Conference ID #. The replay by telephone will be available through May 2, 2011.

Graco Inc. supplies technology and expertise for the management of fluids in both industrial and commercial applications. It designs, manufactures and markets systems and equipment to move, measure, control, dispense and spray fluid materials. A recognized leader in its specialties, Minneapolis-based Graco serves customers around the world in the manufacturing, processing, construction and maintenance industries. For additional information about Graco Inc., please visit us at www.graco.com.

GRACO INC. AND SUBSIDIARIES
Consolidated Statement of Earnings (Unaudited)

	Thirteen Weeks Ended	
	April 1, 2011	March 26, 2010
(in thousands, except per share amounts)		
Net Sales	\$217,679	\$164,721
Cost of products sold	93,282	75,426
Gross Profit	124,397	89,295
Product development	9,931	9,474
Selling, marketing and distribution	37,483	29,160
General and administrative	19,914	17,955
Operating Earnings	57,069	32,706
Interest expense	616	1,080
Other expense, net	—	161
Earnings Before Income Taxes	56,453	31,465
Income taxes	19,200	10,900
Net Earnings	\$ 37,253	\$ 20,565
Net Earnings per Common Share		
Basic	\$ 0.62	\$ 0.34
Diluted	\$ 0.61	\$ 0.34
Weighted Average Number of Shares		
Basic	60,270	60,206
Diluted	61,360	60,713

Segment Information (Unaudited)

	Thirteen Weeks Ended	
	April 1, 2011	March 26, 2010
Net Sales		
Industrial	\$ 122,830	\$ 96,792
Contractor	70,205	50,797
Lubrication	24,644	17,132
Total	\$217,679	\$164,721
Operating Earnings		
Industrial	\$ 45,025	\$ 30,474
Contractor	11,115	4,883
Lubrication	5,227	1,707
Unallocated corporate (expense)	(4,298)	(4,358)
Total	\$ 57,069	\$ 32,706

All figures are subject to audit and adjustment at the end of the fiscal year.

The consolidated Balance Sheets, Consolidated Statements of Cash Flows and Management's Discussion and Analysis are available in our Quarterly Report on Form 10-Q on our website at www.graco.com.

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