GRACO INC
Form DEF 14A
March 09, 2009
GRACO INC.

88 Eleventh Avenue N.E.

Minneapolis, MN 55413

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

Dear Shareholder:

Please join us on Friday, April 24, 2009, at 1:00 p.m. Central Time for Graco Inc.'s Annual Meeting of Shareholders at the George Aristides Riverside Center, which is located at 1150 Sibley Street N.E., Minneapolis, Minnesota.

At this meeting, shareholders will consider the following matters:

1. Election of three directors to serve for three-year terms.

2. Ratification of the selection of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year 2009.

3. Transaction of such other business as may properly come before the meeting.

Shareholders of record at the close of business on February 23, 2009 are entitled to vote at this meeting or any adjournment.

We encourage you to join us and participate in the meeting. If you are unable to do so, you have the option to vote in one of three ways:

1. Request a paper proxy card to complete and return;

2. Call the toll-free telephone number shown on your proxy card; or

3. To vote via the Internet, visit the website shown on your Notice Regarding the Availability of Proxy Materials and on your proxy card.

Have your Notice Regarding the Availability of Proxy Materials or your proxy card in front of you when voting by telephone or the Internet; they contain important information that is required to access the system. If you do not vote by telephone, Internet, returning a proxy card or voting your shares in person at the meeting, you will lose your right to vote on matters that are important to you as a shareholder. Accordingly, please vote your shares in one of the three ways outlined above. This will not prevent you from voting in person if you decide to attend the meeting.

Sincerely,

/s/PATRICK J. MCHALE Patrick J. McHale President and Chief Executive Officer	/s/KAREN PARK GALLIVAN Karen Park Gallivan Secretary

March 9, 2009
Minneapolis, Minnesota

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YOUR VOTE IS IMPORTANT

We urge you to visit **www.proxyvote.com** and vote your shares. Have your Notice Regarding the Availability of Proxy Materials in front of you when you access the website, as it contains important information, including a unique shareholder control number, that is required to access the system. If you do not wish to take advantage of Internet voting, please request a paper proxy card according to the instructions on your Notice Regarding the Availability of Proxy Materials. You may mark, date and sign the proxy card, and return it as soon as possible in the envelope that will be provided, or you may vote by calling the toll-free phone number, 1-800-690-6903, listed on your proxy card. If you attend the meeting, you may still revoke your proxy and vote in person if you wish. Visit **www.proxyvote.com** to access the proxy materials, the 2008 Annual Report and the Annual Report on Form 10-K.

GENERAL REQUESTS FOR 2008 GRACO INC. ANNUAL REPORT ON FORM 10-K

The 2008 Graco Inc. Annual Report on Form 10-K, including the Financial Statements and the Financial Statement Schedule, is available to the public at www.graco.com. A copy may also be obtained free of charge by calling (612) 623-6609 or writing:

Investor Relations
Graco Inc.
P.O. Box 1441
Minneapolis, Minnesota
55440-1441

GRACO INC.

88 Eleventh Avenue N.E.

Minneapolis, MN 55413

PROXY STATEMENT

FOR ANNUAL MEETING OF SHAREHOLDERS

TO BE HELD APRIL 24, 2009

Your proxy is solicited by the Board of Directors of Graco Inc. in connection with our Annual Meeting of Shareholders to be held on April 24, 2009 and any adjournments of that meeting (the “Meeting”).

We have provided you with access to our proxy materials on the Internet. We are providing a Notice Regarding the Availability of Proxy Materials (the “Notice”) to our shareholders of record and our beneficial owners. All shareholders will have the ability to access the proxy materials free of charge on the website identified in the Notice or request email or paper copies of the proxy materials. The Notice contains instructions on how to access the proxy materials through the Internet or request electronic or paper copies. If your shares are held by a broker, bank, broker-dealer or similar organization, you are the beneficial owner of shares held in “street name” and the notice will be forwarded to you by that organization. As the beneficial owner, you have the right to direct the organization holding your shares how to vote the shares.

The costs of the solicitation, including the cost of preparing and mailing the Notice, Notice of Annual Meeting of Shareholders, and this Proxy Statement, will be paid by us. Solicitation will be primarily through Internet availability of this Proxy Statement to all shareholders entitled to vote at the Meeting. Proxies may be solicited by our officers personally, but at no compensation in addition to their regular compensation as officers. We may reimburse brokers, banks and others holding shares in their names for third parties, for the cost of forwarding proxy material to, and obtaining proxies from, third parties. The Notice will be mailed to shareholders on or about March 11, 2009, and the proxy materials will be available at that time on www.proxyvote.com.

Proxies may be revoked at any time prior to being voted by giving written notice of revocation to our Secretary. All properly executed proxies received by management will be voted in the manner set forth in this Proxy Statement or as otherwise specified by the shareholder giving the proxy.

Shares voted as abstentions on any matter (or a "withhold vote for" as to directors) will be counted as shares that are present and entitled to vote for purposes of determining the presence of a quorum at the Meeting, and as unvoted (although present and entitled to vote) for purposes of determining the approval of each matter as to which the shareholder has abstained. If a broker submits a proxy which indicates that the broker does not have discretionary authority as to certain shares to vote on one or more matters, those shares will be counted as shares that are present and entitled to vote for purposes of determining the presence of a quorum at the Meeting, but will not be considered as present and entitled to vote with respect to such matters.

Except for the election of directors, which are elected by a plurality of the votes cast, each matter requires the approval of the greater of a majority of the shares present at the Meeting and entitled to vote or a majority of the voting power of the minimum number of shares necessary to constitute a quorum.

Only shareholders of record as of the close of business on February 23, 2009 may vote at the Meeting or at any adjournment. As of that date, there were issued and outstanding 59,558,400 common shares of our Company, the only class of securities entitled to vote at the Meeting. Each share registered to a shareholder of record is entitled to one vote. Cumulative voting is not permitted.

PROPOSAL 1

ELECTION OF DIRECTORS

NOMINEES AND OTHER DIRECTORS

The number of directors of our Company is set at a maximum of nine; there are currently nine directors. The directors are divided into three classes, each class being as equal in number as reasonably possible. Vacancies may be filled by a majority vote of the directors then in office, though less than a quorum, and directors so chosen are subject to election by the shareholders at the next annual meeting of shareholders. Directors elected at an annual meeting of shareholders to succeed directors whose terms expire are elected for three-year terms. Our Board policy states a director shall retire from the Board effective as of the date of the annual shareholder meeting next following his or her 72nd birthday, unless our Board waives this requirement. At the Meeting, three persons will be nominated for election to our Board of Directors.

Upon recommendation of the Governance Committee, which acts as the nominating committee of the Board, the Board has nominated William J. Carroll, Jack W. Eugster and R. William Van Sant, for three-year terms expiring in the year 2012. Messrs. Carroll, Eugster and Van Sant, whose current terms expire at the Meeting, have previously been elected by the shareholders as directors of our Company.

Unless otherwise instructed not to vote for the election of directors, proxies will be voted to elect the nominees. A director nominee must receive the vote of a plurality of the voting power of shares present at the Meeting in order to be elected. Unless the Board reduces the number of directors, your proxy will be voted to elect the replacement nominee designated by the Board in the event that a nominee is unable or unwilling to serve.

The following information is given as of February 23, 2009, with respect to the three nominees for election and the other six directors whose terms of office will continue after the Meeting. Except as noted below, each of the nominees and directors has held the same position, or another executive position with the same employer, for the past five years.

Nominees for election at this Meeting to terms expiring in 2012:

William J. Carroll

Mr. Carroll, 64, has been appointed Chief Executive Officer of Hybra-Drive Systems, LLC, a power train designer and manufacturer, effective March 1, 2009. From May 2006 until March 2009, he was a principal of Highland Jebco

LLC, which provides advisory and consulting services to the automotive parts industry. He was the Director of Economic and Community Development for the city of Toledo, Ohio, a position he held from September 2004 until January 2006. From September 2003 to March 2004, Mr. Carroll was the President and Chief Operating Officer of Dana Corporation. Dana Corporation engineers, manufactures and distributes components and systems for vehicular and industrial manufacturers worldwide. From 1997 to March 2004, Mr. Carroll was the President – Automotive Systems Group of Dana Corporation. Mr. Carroll has been a director of Graco since June 1999.

Jack W. Eugster

Mr. Eugster, 63, was the Chairman, President and Chief Executive Officer of Musicland Stores, Inc., a retail music and home video company, from 1980 until his retirement in January 2001. Mr. Eugster has been a director of Graco since February 2004, and is also a director of Donaldson Company, Inc. and Black Hills Corporation.

R. William Van Sant

Mr. Van Sant, 70, is an operating partner of Stone Arch Capital, LLC, a private equity firm. He assumed this position in January 2008. From August 2006 through December 2007, he was the President and Chief Executive Officer of Paladin Brands Holding, Inc., a Dover Corporation company, which manufactures attachments for construction equipment. From 2003 until August 2006, Mr. Van Sant was Chairman of Paladin Brands, LLC, and from 2003 until November 2005, Mr. Van Sant was Chairman and Chief Executive Officer of Paladin. He was an Operating Partner with Norwest Equity Partners, a private equity firm, from 2001 through 2006. Mr. Van Sant has been a director of Graco since February 2004 and is also a director of H.B. Fuller Company.

Directors whose terms continue until 2010:

J. Kevin Gilligan

Mr. Gilligan, 54, has been appointed Chief Executive Officer of Capella Education Company, an on-line education provider. He is expected to assume responsibilities for this position by March 5, 2009. Mr. Gilligan was the President and Chief Executive Officer of United Subcontractors, Inc., a national construction services company, from October 2004 until February 2009. He was President and Chief Executive Officer, Automation and Control Solutions, Honeywell International, Inc., a diversified technology and manufacturing company, from 2001 until January 2004. Mr. Gilligan has been a director of Graco since February 2001.

Mark H. Rauenhorst

Mr. Rauenhorst, 56, is the Chairman and Chief Executive Officer of Opus Corporation, which is engaged in design, construction and real estate development activities. He assumed this position in June 2007. He served as President and Chief Executive Officer of Opus Corporation from and after 1999 and 2000, respectively. Beginning in 1996, he was

President and Chief Executive Officer of Opus Northwest LLC. Mr. Rauenhorst has been a director of Graco since September 2000 and is also a director of Opus Corporation.

William G. Van Dyke

Mr. Van Dyke, 63, was Chairman of the Board of Donaldson Company, Inc., a diversified manufacturer of air and liquid filtration products, from August 2004 until his retirement in August 2005. He was Chief Executive Officer and President of Donaldson Company, Inc. from 1996 to August 2004. Mr. Van Dyke has been a director of Graco since May 1995 and is also a director of Polaris Industries, Inc. and Alliant Techsystems Inc.

Directors whose terms continue until 2011:

Patrick J. McHale

Mr. McHale, 47, is President and Chief Executive Officer of Graco Inc., a position he has held since June 2007. He served as Vice President and General Manager, Lubrication Equipment Division of Graco from June 2003 until June 2007. He was Vice President of Manufacturing and Distribution Operations from April 2001 until June 2003. He served as Vice President, Contractor Equipment Division from February 2000 to March 2001. Prior to becoming Vice President, Lubrication Equipment Division in September 1999, he held various manufacturing management positions in Minneapolis, Minnesota; Plymouth, Michigan; and Sioux Falls, South Dakota. Mr. McHale joined the company in December 1989.

Lee R. Mitau

Mr. Mitau, 60, is the Executive Vice President and General Counsel of U.S. Bancorp, a regional bank holding company. He assumed this position in 1995. Mr. Mitau has been a director of Graco since May 1990. He served as Chairman of the Board of the Company from May 2002 until April 2006 and has been serving as the Chairman of the Board of the Company since June 2007. He also serves as Chairman of the Board of H.B. Fuller Company.

Marti Morfitt

Ms. Morfitt, 51, is a principal of River Rock Partners, Inc., a business and cultural transformation consulting firm. She assumed this position in 2008. Ms. Morfitt is the former President and Chief Executive Officer of CNS, Inc., a manufacturer and marketer of consumer products, including the Breathe Right® nasal strip. She held this position from 2001 through March 2007. Ms. Morfitt left her position at CNS, Inc. effective March 2007 as a result of the acquisition of CNS, Inc. by GlaxoSmithKline plc in December 2006. Ms. Morfitt has been a director of Graco since October 1995 and is also a director of Thermage Inc., Life Time Fitness, Inc. and lululemon athletica inc.

The Board of Directors, upon recommendation of the Governance Committee, recommends that shareholders vote FOR all nominees for election at the Meeting to terms expiring in 2012.

DIRECTOR INDEPENDENCE

Our Board of Directors has determined that Mr. Carroll, Mr. Eugster, Mr. Gilligan, Mr. Mitau, Ms. Morfitt, Mr. Rauenhorst, Mr. Van Dyke and Mr. Van Sant are independent directors. The independent directors constitute a majority of the Board, and the only director who is not independent is Mr. McHale, the Company's President and Chief Executive Officer. In making its determination regarding the independence of the directors, our Board noted that each independent director meets the standards for independence set out in Section 303A.02 of the New York Stock Exchange corporate governance rules, and that there is no material business relationship between our Company and any independent director, including any business entity with which any independent director is affiliated.

In making its determination, our Board reviewed information provided by each of the directors and information gathered by our management, and determined that none of the directors, other than Mr. Mitau, have any relationship with the Company other than as a director and/or shareholder. Some of our nonemployee directors are or were during the previous three fiscal years a non-management director of another company that did business with us during these years, and/or a non-executive director of one or more charitable organizations to which our Company's charitable foundation made a contribution during those years. The Board specifically considered that Mr. Mitau serves as Executive Vice President and General Counsel of U.S. Bancorp, to which our Company paid approximately $2,300,000 in 2008 for interest expense, trust services, revolver and credit line services and banking services including but not limited to fees for cash management and credit card processing. The Board determined that neither the nature of the relationship between U.S. Bancorp, on the one hand, and our Company, on the other hand, nor the amount of payments, was material to either of the entities. Moreover, our Board concluded that Mr. Mitau does not have a material interest in the foregoing transactions because he was not directly involved in the transactions, he does not derive any special benefit related to the transactions, and the transactions with U.S. Bancorp were the result of a competitive bidding process and arm's-length negotiations.

MEETINGS OF THE BOARD OF DIRECTORS

During 2008, our Board of Directors met six times. Attendance of our directors at all Board and Committee meetings averaged 94.2 percent. During 2008, every director attended at least 75 percent of the aggregate number of meetings of the Board and all committees of the Board on which he or she served. Our Corporate Governance Guidelines require that each director make all reasonable efforts to attend the Company's Annual Meeting of Shareholders. In 2008, all of the directors attended the Annual Meeting of Shareholders. Each regularly scheduled meeting of the Board includes an executive session of only non-management directors. Mr. Mitau, Chairman of the Board, presides at the executive sessions.

COMMITTEES OF THE BOARD OF DIRECTORS

The Board of Directors has an Audit Committee, a Governance Committee, and a Management Organization and Compensation Committee. Membership as of February 23, 2009, the record date, was as follows:

Audit	Governance	Management Organization and Compensation
R. William Van Sant, Chair	Lee R. Mitau, Chair	Jack W. Eugster, Chair
William J. Carroll	William J. Carroll	J. Kevin Gilligan
Jack W. Eugster	Marti Morfitt	Lee R. Mitau
J. Kevin Gilligan	William G. Van Dyke	Marti Morfitt
Mark H. Rauenhorst	R. William Van Sant	Mark H. Rauenhorst
William G. Van Dyke		

Audit Committee (8 meetings in fiscal 2008)

The Audit Committee is composed entirely of directors who meet the independence requirements of Rule 10A-3(b) under the Securities Exchange Act of 1934. All of the Audit Committee members are, in the judgment of the Board, financially literate. Our Board has determined that Mr. Carroll, Mr. Van Dyke and Mr. Van Sant are audit committee financial experts.

The Audit Committee assists the Board in its oversight of the integrity of our financial statements, our compliance with legal and regulatory requirements, the qualification and independence of the independent auditor, and the performance of the internal audit function and independent auditors.

The responsibilities of the Audit Committee are set forth in a written charter. The Audit Committee has reviewed and reassessed the adequacy of its charter and concluded that the charter satisfactorily states the responsibilities of the Audit Committee. The Audit Committee Charter was most recently approved by the Board on February 13, 2009.

Governance Committee (3 meetings in fiscal 2008)

The Governance Committee has the following functions:

- Sets criteria for the selection of prospective Board members, identifies and recruits suitable candidates, and presents director nominees to the Board;

- Periodically evaluates our Company's shareholder value protections, board structure, and business continuity provisions, and recommends any changes to the Board; and

- Recommends to the Board requirements for Board membership, including minimum qualifications and retirement policies; the appropriate number of directors; the compensation, benefits and retirement programs for directors; the committee structure, charters, chairs and membership; the number and schedule of Board meetings; a set of Corporate Governance Guidelines; and the appropriate person(s) to hold the positions of Chair of the Board and Chief Executive Officer.

The responsibilities of the Governance Committee are fully set forth in its written charter, which was most recently approved by the Board on February 17, 2006.

Management Organization and Compensation Committee (4 meetings in fiscal 2008)

The Management Organization and Compensation Committee has the following functions:

- Develops our Company's philosophy and structure for executive compensation;

- Determines the compensation of the Chief Executive Officer and approves the compensation of the executive officers;

- Reviews and discusses with management, and recommends to the Board the inclusion of, the Compensation Discussion and Analysis in our Company's annual proxy statement;

- Reviews the performance of the Chief Executive Officer based on individual goals and objectives, and communicates to the CEO its assessment of the CEO's performance on an annual basis;

- Administers our Company's stock option and other stock-based compensation plans; and

- Reviews and makes recommendations on executive management organization and succession plans.

The responsibilities of the Management Organization and Compensation Committee are fully set forth in its written charter, which was most recently approved by the Board on February 16, 2007.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

None of the members of the Board who served on the Management Organization and Compensation Committee during 2008 has ever been an officer or employee of our Company or any of its subsidiaries.

DIRECTOR QUALIFICATIONS AND SELECTION PROCESS

Qualification Standards

Graco will only consider as candidates for director individuals who possess a high level of ethics, integrity and values, and who are committed to representing the long-term interests of our shareholders. Such candidates must be able to make a significant contribution to the governance of our Company by virtue of their business and financial expertise, educational and professional background, and current or recent experience as a chief executive officer or other senior leader of a public company or other major organization. The business discipline that may be sought at any given time will vary depending on the needs and strategic direction of our Company, and the disciplines represented by incumbent directors. In evaluating candidates for nomination as a director of Graco, the Governance Committee will also consider other criteria, including geographical representation, independence, practical wisdom, mature judgment and the ability of the candidate to represent the interests of all shareholders and not those of a special interest group. One or more of our directors is required to possess the education or experience required to qualify as an audit committee financial expert as defined in the applicable rules of the Securities and Exchange Commission.

Once elected, all directors are subject to the standards set forth in our Corporate Governance Guidelines which include, among others, the requirement to resign from the Board effective as of the date of the annual shareholder meeting next following the director's 72^{nd} birthday, unless the Board waives such requirement, and the requirement to tender the director's resignation if his or her employment status significantly changes.

Nominee Selection Process

The selection process for director candidates reflects guidelines established from time to time by the Governance Committee. A shareholder seeking to recommend a prospective candidate for the Governance Committee's consideration should submit such recommendation in writing and addressed to the Governance Committee in care of the Secretary of the Company at our Company's corporate headquarters. Our by-laws provide that timely notice must be received by the Secretary not less than 90 days prior to the anniversary of the date of our Annual Meeting of Shareholders. The nominations must set forth (i) the name, age, business and residential addresses and principal occupation or employment of each nominee proposed in such notice; (ii) the name and address of the shareholder giving the notice, as it appears in our Company's stock register; (iii) the number of shares of capital stock of our Company which are beneficially owned by each such nominee and by such shareholder; and (iv) such other information concerning each such nominee as would be required under the rules of the Securities and Exchange Commission in a proxy statement soliciting proxies for the election of such nominee. Such notice must also include a signed consent of each such nominee to serve as a director of our Company, if elected. Shareholder nominees will be evaluated in the same manner as nominees from other sources.

COMMUNICATIONS WITH THE BOARD

Our Board of Directors welcomes the submission of any comments or concerns from shareholders or other interested parties. These communications will be delivered directly to the Vice President, General Counsel and Secretary. If a communication does not relate in any way to Board matters, he or she will deal with the communication as appropriate. If the communication does relate to any matter of relevance to our Board, he or she will relay the message to the Chairman of the Governance Committee, who will determine whether to relay the communication to the entire Board or to the non-management directors. The Vice President, General Counsel and Secretary will keep a log of all communications addressed to the Board that her or she receives. If you wish to submit any comments or express any concerns to our Board, you may use one of the following methods:

- Write to the Board at the following address:

  Board of Directors

  Graco Inc.

  c/o Karen Park Gallivan, Vice President, General Counsel and Secretary

  P.O. Box 1441

  Minneapolis, Minnesota 55440-1441

- Email the Board at boardofdirectors@graco.com

CORPORATE GOVERNANCE DOCUMENTS

The charters of the Audit, Governance, and Management Organization and Compensation Committees, as well as our Company's Corporate Governance Guidelines and Code of Ethics and Business Conduct, are available on the Company's website at www.graco.com and may be found by selecting the "Investor Relations" tab and then clicking on "Corporate Governance". Any shareholder may obtain paper copies of these documents by submitting a written request to: Graco Inc., P.O. Box 1441, Minneapolis, Minnesota 55440-1441, Attention: Corporate Secretary, or by sending an email to boardofdirectors@graco.com.

AUDIT COMMITTEE REPORT

Report of the Audit Committee

The Audit Committee has reviewed and discussed the audited financial statements of our Company for the fiscal year ended December 26, 2008 ("the financial statements") with both the Company's management and its independent registered public accounting firm, Deloitte & Touche LLP ("Deloitte"). The Audit Committee has discussed with Deloitte the matters required by the Statement on Auditing Standards No. 61, as amended, as adopted by the Public Company Accounting Oversight Board. Our management has represented to the Audit Committee that the financial statements were prepared in accordance with accounting principles generally accepted in the United States of America.

The Audit Committee has received from Deloitte the written disclosure and the letter required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant's communications with the Audit Committee concerning independence, and the Audit Committee has discussed with Deloitte their independence. The Audit Committee has also received written material addressing Deloitte's internal quality control procedures and other matters, as required by the New York Stock Exchange listing standards. The Audit Committee has considered the effect of non-audit fees on the independence of Deloitte and has concluded that such non-audit services are compatible with the independence of Deloitte.

Based on these reviews and discussions, the Audit Committee recommended to our Board of Directors that the financial statements for the fiscal year ended December 26, 2008, be included in the Company's 2008 Annual Report on Form 10-K for filing with the Securities and Exchange Commission.

The Members of the Audit Committee
Mr. R. William Van Sant, Chair
Mr. William J. Carroll
Mr. Jack W. Eugster
Mr. J. Kevin Gilligan
Mr. Mark H. Rauenhorst
Mr. William G. Van Dyke

Independent Registered Public Accounting Firm Fees and Services

The following table sets forth the aggregate audit fees incurred by Graco Inc. and its subsidiaries from our Company's independent registered public accounting firm, Deloitte & Touche, the member firms of Deloitte Touche Tohmatsu, and their respective affiliates (collectively "Deloitte"), and the fees paid to Deloitte for services in the other fee categories during the fiscal years ended December 26, 2008 and December 28, 2007. The Audit Committee has considered the scope and fee arrangements for all services provided by Deloitte to our Company, taking into account whether the provision of non-audit services is compatible with maintaining Deloitte's independence. The Audit Committee pre-approved 100 percent of the services described below.

	Fiscal Year Ended 12/26/08	Fiscal Year Ended 12/28/07
Audit Fees(1)	$790,000	$792,000
Audit-Related Fees	—	—
Tax Fees(2)	44,000	47,000
Total	$834,000	$839,000

(1) Includes fees for the review of purchase accounting of $15,000 in 2008. Also includes fees of $5,000 for a consent in 2007.
(2) Includes fees for tax compliance services of $21,000 and $34,000, and tax advice of $23,000 and $13,000, in 2008 and 2007, respectively.

Pre-Approval Policies

The Audit Committee's policy on approval of services performed by the independent registered public accounting firm is to pre-approve all audit and permissible non-audit services to be provided by the independent registered public accounting firm during the fiscal year. The Audit Committee reviews each non-audit service to be provided and assesses the impact of the service on the firm's independence.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

Executive Compensation Philosophy

The Management Organization and Compensation Committee (for purposes of this Executive Compensation section, the "Committee") is responsible for establishing our executive compensation philosophy. The Committee believes that our total compensation program should:

- Globally source, attract and retain highly qualified executives;
- Motivate executives to improve our financial position and increase shareholder value;
- Provide total compensation that is competitive with other manufacturing companies of comparable sales volume and financial performance, and that may adjust above or below the market median as a result of our financial performance;
- Align pay to balance the achievement of our short- and long-term objectives;
- Maintain a strong link between pay and performance by placing a substantial portion of the total pay at risk;
- Promote collaboration and teamwork across our organization; and
- Provide a total compensation package that includes both fixed and variable, cash and non-cash, and short-term and long-term components.

The Committee applies these philosophies in selecting compensation elements. Additionally, the Committee reviews competitive market and/or trend data, peer company performance and market data, internal equity among executive officers, individual and company performance, cost, and named executive officer tally sheets (as described below) when determining levels of compensation.

Executive Officer Compensation Processes

The Committee uses the following resources, processes and procedures to help it effectively perform its responsibilities:

- Executive sessions without management present to discuss various compensation matters, including the compensation of our President and Chief Executive Officer (“CEO”);
- An independent executive compensation consultant who advises the Committee from time to time on compensation matters;
- An annual review of all executive compensation and, when appropriate, benefit programs for competitiveness, reasonableness and cost-effectiveness;
- Program design and competitive market data for each component of total compensation using an industry peer group and a larger group of similarly sized manufacturing companies; and
- An annual review of each named executive officer’s tally sheet before setting the annual compensation program for the next performance year.

Executive Compensation Consultant

The Committee has the authority under its charter to engage the services of outside consultants, to determine the scope of the consultants’ services, and to terminate such consultants’ engagement. In 2008, the Committee continued its engagement of Hewitt Associates (“Hewitt”) as its independent outside executive compensation consultant to advise the Committee on certain matters related to executive compensation including:

- A competitive compensation review of the CEO and other executive officer positions; and
- Executive compensation trend data.

Hewitt periodically conducts a manufacturing peer group financial performance review and a named executive officer compensation market analysis of our twenty peer companies. This peer analysis was last completed in 2006 and was used by the Committee when determining 2007 compensation for the CEO and other executive officers. As a cost savings measure, a decision was made by the Committee not to engage Hewitt to perform a peer market analysis in 2008. Benchmarking data used to set compensation for 2009 was limited to the Hewitt Survey as described below. At its February 2009 meeting, the Committee agreed to retain an executive compensation consultant in 2009 to review our list of peer companies and make a recommendation as to changes, if any, for future benchmarking.

The Governance Committee of our Board of Directors engaged Hewitt in late 2007 to conduct a market review and analysis of board of director compensation. Additionally, a Hewitt affiliate in Shanghai, China provided consulting services related to market pricing for certain positions of our subsidiary, Graco Fluid Equipment (Shanghai) Co., Ltd. Other than in connection with these services which cost approximately $15,000, and advising the Committee on executive compensation as described above, Hewitt did not receive any other compensation from us in 2008.

Role of Management in Executive Compensation Decisions

Our management is involved in the following executive compensation processes:

- The Vice President of Human Resources (“Vice President HR”) and Compensation Manager develop and oversee the creation of written background and supporting materials for distribution to the Committee prior to its meetings;
- The CEO, Vice President HR, Vice President, General Counsel and Secretary, and Compensation Manager all attend the Committee’s meetings, but leave during the executive officer performance review discussion (except for the CEO who only leaves for the discussion of his performance review) and the non-employee director executive sessions;
- The CEO, Vice President HR, and Compensation Manager review executive officer compensation competitive analyses (excluding the CEO) and annually present and make recommendations to the Committee relating to bonus and long-term incentive plan designs and changes, if warranted;
- The CEO annually recommends to the Committee base salary adjustments and long-term incentive awards in the form of stock-based grants for all executive officers, excluding the CEO; and
- Immediately following the Committee’s executive sessions, the Chair of the Committee provides the Vice President HR with a summary of the executive session decisions, actions and underlying rationale for implementation as appropriate.

Benchmarking

The Committee annually reviews general market benchmarking data, consisting of total compensation and each of its three elements: base salary, annual incentives, and long-term incentives. The Committee targets base salaries at the median of manufacturers with similar sales volume. In determining 2008 and 2009 executive compensation, the Committee used a survey compiled by Hewitt to review the competitiveness of each element of total compensation for the Company's named executive officers (the "Hewitt Survey"). The Committee selected the Hewitt Survey because it provides standard survey data that is based exclusively on U.S. manufacturing companies and is regressed using applicable revenues. Hewitt uses a statistical technique known as regression analysis to model the relationship between variables. In this case, it enables Hewitt to estimate market levels of compensation that relate closely to a company's revenue size and to adjust compensation data based on differences in revenue size of companies in their database. The data is not regressed based on any other comparative financial performance.

Survey benchmark positions were selected by the Committee to determine salary range midpoints based on market medians. The named executive officer benchmark positions include those of CEO, CFO, top manufacturing executive, business unit executive, and regional general manager. For the corporate benchmark positions, the data gathered from the Hewitt Survey reflected manufacturing companies with similar levels of revenue. Individual midpoints were created for our CEO, CFO, and Vice President and General Manager of Europe based on median market data. A single midpoint was also established among our four U.S. business unit executives, our Asia Pacific region executive, who is a U.S. expatriate, and our top manufacturing executive (the "Business Unit Benchmark"). The individual revenues of the four business units were averaged and this average revenue was used when establishing median market data for the Business Unit Benchmark. This method was established to provide better internal equity and flexibility in position rotations. The midpoint for our Vice President and General Manager of Europe was established by the Committee reviewing Hewitt market data based on Belgian companies (the "Hewitt Belgian Survey") for a regional general manager with revenues comparable to our European operations.

In addition, the Committee periodically requests that Hewitt conduct a peer group comparison of named executive officer positions (the "Peer Group Survey"). This data is reviewed to ensure that our compensation practices are generally in alignment with views on competitive pay for named executive officers in our industry. Target levels of short- and long-term incentive compensation may be adjusted above or below median commensurate with our financial performance compared to our peer group, which was comprised of the twenty companies listed below at the time of the last Peer Group Survey in 2006. The peer companies selected are based on industry, size, and location.

Graco's 2006 Peer Group Survey companies included:

Actuant Corporation	MTS Systems Corporation
A.O. Smith Corporation	Nordson Corporation
Arctic Cat Inc.	Pentair Inc.
Briggs & Stratton Corporation	Regal-Beloit Corporation
CIRCOR International Inc.	Robbins & Myers Inc.
Donaldson Company, Inc.	Roper Industries Inc.
Flowserve Corporation	Tecumseh Products Company
Franklin Electric Co., Inc.	Tennant Company
Gardner Denver Inc.	The Toro Company
IDEX Corporation	Watts Water Technologies Inc.

Hewitt's 2006 executive compensation summary report that was used for determining 2007 compensation included an analysis of the foregoing peer companies. The Committee did not engage Hewitt to conduct the Peer Group Survey for the 2008 and 2009 compensation adjustment review.

Components of the Executive Compensation Programs

The primary components of the Company's executive compensation and benefit programs are:

- Total compensation elements
  - Base salary;
  - Annual cash incentive;
  - Stock-based awards;
- Benefits and perquisites; and
- Severance and change of control agreements.

When the Committee reviews competitive market data for each of the benchmark executive positions the Committee reviews total compensation in addition to reviewing each component (base pay, annual cash incentive and stock-based awards). The Committee examines tally sheets for our named executive officers showing their current total compensation and potential accumulation of wealth. Specifically, the tally sheets reviewed by the Committee in September 2008 provided 2007 actual and 2008 target annual compensation, retirement balances as of December 31, 2007 projected to normal retirement age or the age at which the benefit is not subject to reduction, deferred compensation balances, and the projected value of stock awards based on assumptions regarding stock price appreciation. After analysis of market and tally sheet data and discussion among the Committee members, the Committee reviews the dollar allocation among each of the three components. Although the Committee has not established specific ratios for each of the compensation components, it strives to maintain a reasonable and competitive balance between the fixed and variable elements. The compensation program is designed to reward recent results and motivate long-term performance through the use of the three total compensation elements. The Committee believes the compensation mix and amount paid to each of our named executive officers is reasonable and appropriate.

Base Salary

The Committee provides base salaries to executives to attract and retain talent, provide competitive compensation for the performance of the executives' basic job duties and recognize individual contributions to our financial performance. Base salaries may be adjusted at the discretion of the Committee. The Committee generally targets base salary levels at the median of the benchmarked positions in the Hewitt Survey and the Hewitt Belgian Survey. Adjusting base salaries to achieve or approach median is consistent with the Committee's philosophy of providing competitive base salaries.

In December of each year, the CEO provides the Committee with an evaluation of each executive officer's performance, other than his own, covering the prior twelve months and his recommendation for base salary adjustments. The base salary adjustments are based on several considerations, which include scope and complexity of the individual's role, salary comparison to market data, market projection for executive base salary adjustments, individual performance, experience, internal pay relationships, and retention. Evaluation of the individual performance for each executive officer is based on established annual goals that vary for each role. Annual goals are not weighted and may change from year to year. Additionally, executive officers are evaluated on Graco's core values, which include quality, continuous improvement, fact-based decision making, results orientation, and customer focus. The Committee reviews the competitive market data and base salary adjustments recommended by the CEO. All executive officer base salaries for the next calendar year are approved by the Committee at its December meeting and become effective January 1.

In addition, an executive session is held at the Committee's December meeting to determine the base salary adjustment for the CEO. Management does not provide a CEO base salary adjustment recommendation to the Committee. During this session the Committee considers input from the Board members on the CEO's performance over the past year. It also considers the CEO's expertise, market knowledge, decision-making skills, and other leadership capabilities. Additionally, the Committee evaluates the CEO's performance against annual objectives established at the beginning of the year. The Committee also reviews the CEO's base salary in comparison to the Hewitt Survey market data for CEOs of manufacturing companies with similar sales volume, and our Peer Group Survey, in the years when it is conducted. Following the discussion, the Committee approves the CEO's base salary for the next calendar year, which becomes effective January 1.

On January 1, 2008, Mr. McHale received a 24 percent increase in base salary, bringing his base salary to $620,000. The Committee increased his base salary because it was below the competitive market median data and Mr. McHale had demonstrated strong leadership in his new role as CEO. Mr. McHale's base salary as of July 1, 2007 was significantly below the median market data, reflecting his tenure and experience as a CEO immediately following his promotion at that time. The other named executive officers received increases on January 1 ranging from 3 percent to 5 percent, except for Mr. Paulis. The adjustments were based on criteria including scope and complexity of the individual's role, salary comparison to the Hewitt Survey and Hewitt Belgian Survey market data, market projection for executive base salary adjustments, individual performance, experience, internal pay relationships, and retention considerations. The increases these executives received were in line with the market projection for executive base salary adjustments published by Mercer, Hewitt, World at Work, and The Conference Board (the "Market Projection Surveys"). Mr. Paulis, who is employed by Graco N.V., our wholly owned subsidiary, received a 15 percent increase because Graco N.V. had strong financial results in 2007 and, based on the Hewitt Belgian Survey market data, his base salary had lagged the competitive market data following his September 2005 appointment to his current role.

In December 2007, Mr. Graner announced his intention to retire from his positions as the Chief Financial Officer and Treasurer. Mr. Graner's retirement was to become effective upon the appointment of his successor. In May 2008, however, Mr. Graner agreed to defer his retirement and, accordingly, the Committee approved a market adjustment for him which increased his base salary to $325,000 effective June 1, 2008. He received this increase in light of his intention to continue as CFO and because his base salary was below the competitive market median data.

Mr. Paulis received an annual cost of living index increase of 4.3% on July 1, 2008, which increased his base salary to €225,474. This is an inflationary increase mandated by the Metal sector of which Graco N.V. is a member. In July 2008, the Belgium Federal Governmental Services reclassified Graco N.V. to the Metal Trade sector, which changed the timing of the cost of living index increase for 2009 from July to January.

In December 2008, Mr. McHale received a 3.5 percent increase in base salary, bringing his base salary to $641,700 effective January 1, 2009. He received this increase because he has demonstrated strong leadership in his role as CEO. The other named executive officers received increases ranging from 3.5 percent to 6 percent, except for Mr. Paulis. Mr. Paulis received an 8 percent increase in base salary, which included a 3.5 percent merit increase and a 4.5 percent cost of living index increase. The increases given to the other named executive officers were in line with the Market Projection Surveys. The base salary increases, approved for the foregoing named executive officers, became effective January 1, 2009 and were based on the criteria identified above.

Annual Cash Incentive

At the beginning of each year, the Committee establishes an annual incentive opportunity for the CEO and the other designated executive officers. A separate bonus plan (the “Executive Officer Annual Incentive Bonus Plan”) has been created for those most highly paid and designated by the Committee, including the CEO, to qualify the participant’s annual cash incentive as performance-based compensation to ensure deductibility under Section 162(m) of the Internal Revenue Code. A separate annual incentive plan (the “Executive Officer Bonus Plan”) applies to the other designated executive officers. The Executive Officer Annual Incentive Bonus Plan and the Executive Officer Bonus Plan, together, are referred to as the “Annual Incentive Plans”. The Annual Incentive Plans are designed to motivate our executives to increase our sales, earnings and other financial metrics by offering an incentive that rewards year-over-year growth. Potential payout under the Annual Incentive Plans is expressed as a percentage of base salary. The Committee reviews market data for the annual incentive element before determining the relationship between performance targets and the bonus payout range. Specific financial performance thresholds must be attained in order to earn an incentive. If specified performance levels are not achieved or exceeded, there is no payout. The annual incentives, to the extent earned, are paid in cash in March following the calendar year-end and are based upon the Committee’s determination of actual performance against pre-established targets.

At its meeting in February 2008, the Committee approved participation of the CEO and other executive officers in their respective Annual Incentive Plans for 2008. Mr. McHale was the only person designated as a participant in the Executive Officer Annual Incentive Bonus Plan. The maximum payout levels for 2008 were 150 percent of base salary for the CEO and 105 percent of the base salaries for the other executive officers who report to the CEO and serve on the executive management team (the “Management Executives”). The target payout levels for 2008 were 100 percent of base salary for the CEO and 70 percent of the base salaries for the Management Executives.

The Committee established two financial measures for these plans, consisting of net sales and earnings per share (“EPS”) growth over the prior year**.** Starting in 2008, the EPS metric replaced the net earnings metric because the Committee believes EPS more closely aligns management with shareholders’ interests, it is a visible metric that is easy to communicate, and it is a commonly used profit metric. Net sales and EPS growth were selected as the metrics against which to measure the officers' performance for the Annual Incentive Plans because the Committee desires to motivate the officers to achieve profitable business growth consistent with our long-term financial objectives. Potential annual incentive payouts are typically based on various levels of growth over the previous year. In setting these growth percentages, the Committee selects amounts approximately equal to various multiples of forecasted real U.S. Gross Domestic Product ("GDP") growth.

The 2008 incentive award payouts were based upon the achievement of specified levels of growth in net sales and EPS. The target sales growth was approximately two times forecasted GDP growth and the maximum sales growth was approximately four times forecasted GDP growth. The target EPS growth was approximately three times forecasted GDP growth and the maximum EPS growth was approximately six times forecasted GDP growth. The threshold, target and maximum sales growth targets established for 2008 were growth of 0 percent, 4 percent and 8 percent over the prior year, respectively. The threshold, target and maximum EPS growth targets established were growth of -5 percent, 6 percent and 12 percent over the prior year, respectively.

Net sales of $817.3 million in 2008 represents a decrease in net sales of approximately 3 percent versus 2007, and EPS of $1.99 in 2008 represents a decrease in EPS of approximately 14 percent versus 2007, which, together, led to a determination that no bonuses would be paid out under the Annual Incentive Plans. The Committee has the authority to make adjustments to the Executive Officer Bonus Plan payout award based on unanticipated or special circumstances, but no such adjustment was made.

At its February 2009 meeting, the Committee approved net sales and EPS as the 2009 performance metrics. Both metrics will be set with reference to forecasted GDP percent growth. Given the unprecedented global economic downturn, the Committee approved lower threshold, lower target and higher maximum performance levels for both metrics. In addition, threshold bonus payouts as a percentage of base salary will change from 0 percent to 25 percent of target bonus to better align our annual incentive program design with common market practices provided by Hewitt. If the threshold is not achieved in 2009, the payout provided for under the Annual Incentive Plans will be zero. In 2009, Mr. McHale will participate in the Executive Officer Annual Incentive Bonus Plan with a threshold payout of 25 percent, a target payout of 100 percent, and a maximum payout of 150 percent of base salary to be paid. Management Executives will participate in the Executive Officer Bonus Plan with a threshold payout of 25 percent, a target payout of 70 percent, and a maximum payout of 105 percent of base salary to be paid.

CEO Awards

Under this program, individual discretionary awards, in an aggregate amount not to exceed $400,000, may be made each year to recognize the significant contributions of selected employees, including executive officers. The CEO, based on input from his management team, determines the recipients of these monetary awards. The Committee, upon the recommendation of Mr. McHale, approved an award to Mr. Paulis in the amount of $30,000 at its February 15, 2008 meeting for significant contributions made by him during the 2007 fiscal year.

Stock-based Awards

The Company's executive long-term incentive program rewards our executive officers through stock-based awards for performance over a period of time, typically exceeding three years. Stock-based awards are structured to align the financial interests of the executive officers with those of our shareholders. The Committee believes that equity-based compensation ensures the executives have a continuing stake in our long-term success.

In December 2007, the Committee granted a long-term incentive award to some of our named executive officers in the form of restricted stock. These shares will cliff vest in three years and are not subject to accelerated vesting upon retirement. The Committee determined that it was in the best interest of our Company to award restricted stock to motivate executive officers reporting to our CEO to contribute to our growth and to continue their service with our Company following a change in the Company's chief executive officer. Messrs. Johnson and Paulis were granted 4,000 shares each, and Mr. Rescorla was granted 2,500 shares. The number of shares granted to each named executive officer was determined by the Committee based on its consideration of the named executive officer's individual responsibilities and ability to significantly impact key company initiatives. Mr. Graner did not receive a restricted stock award in 2007 due to his retirement plans and the forfeiture impact such retirement would have on the award.

The 2008 stock-based awards consisted of stock options granted to executive officers under the Graco Inc. Amended and Restated Stock Incentive Plan (2006) (the "Stock Incentive Plan"). The stock option awards are designed to promote the growth of our stock price by offering officers a financial stake in the Company. As is the case with our shareholders, the options create value for executives only to the extent Graco's stock price increases. The Committee believes executive officers having a financial stake will be motivated to put forth sustained effort on behalf of the Company's shareholders to support the continued growth of the Company's share price. The stock option awards also promote the interests of the Company and its shareholders through the attraction and retention of experienced and capable leaders.

The Committee typically grants stock-based awards to each executive officer at its regularly scheduled February meeting. The Board sets the February meeting date several months in advance. Under the terms of the Stock Incentive Plan, the Committee must approve all stock option grants to officers. In February 2008, executive officers were awarded non-qualified stock options with an exercise price equal to the fair market value of our common stock on the grant date, defined in the Stock Incentive Plan as the closing price of the stock on the day immediately preceding the grant date. Each option has a 10-year term and becomes exercisable in equal installments over four years, beginning with the first anniversary of the grant date. Additionally, our plan prohibits the repricing of stock options.

The number of shares covered by the stock options granted in 2008 to each executive officer was determined by reviewing competitive long-term incentive market data for each of the benchmarked executive officer positions in addition to considering Hewitt's modified Black-Scholes value at the time of the grant. Hewitt's modified Black-Scholes value model assumes a ten year option life and recognizes option specific terms, vesting schedules, forfeiture provisions, stock prices, volatility, and dividend yield. The Committee granted the same number of shares to each of the Management Executives, except for the CEO and the CFO, given its determination that each of such officers have an approximately equal impact on our performance. The Committee considers, except in the case of the award to the CEO, the recommendation of the CEO for such awards. Other factors considered by the Committee in determining the number of stock options granted to each executive officer include the number of shares granted in previous years, our previous year's financial performance, the dilutive effect on our shareholders, and the allocation of overall share usage attributed to executive officers.

As a result of the market analysis and Black-Scholes value computed by Hewitt in January 2008, the Committee increased the number of shares of stock options granted to Mr. McHale and the other Management Executives in 2008. In February 2008, Mr. McHale was granted an option for 150,000 shares. Mr. Graner was granted an option for 39,000 shares. Messrs. Johnson, Paulis, and Rescorla were each granted an option for 30,000 shares. Each executive officer had significantly impacted our financial results in 2007. The grant date fair market value of the options awarded was $8.38 per share.

In February 2009, the Committee granted Mr. McHale a stock option for 225,000 shares. Each of the other Management Executives was granted an option for 47,000 shares. The Committee granted options for the same number of shares to each of the other Management Executives due to their overall contributions to our performance in 2008. The grant date fair market value of the options awarded was $5.24 per share.

Upon recommendation of the Governance Committee, the Board approved a stock holding policy for the CEO, effective February 12, 2009, by which the CEO is required to retain, until twelve months following retirement or other termination of employment, an amount equal to 50% of the outstanding net shares delivered to the CEO pursuant to awards granted under the Company's equity programs, including, but not limited to, the exercise of Company stock options. "Net shares" are those shares that remain after shares are sold or netted to pay the exercise price of stock options, withholding taxes and other transaction costs. The foregoing Policy applies to all outstanding equity awards to the CEO whether granted before or after the effective date of the Policy. The foregoing Policy requirement shall be waived by the Company upon the effective date of (a) the CEO's "Disability", (b) the death of the CEO, or (c) a "Change of Control", as those terms are defined in that certain Key Employee Agreement between the Company and the CEO dated December 10, 2007, as amended from time to time. The Board has delegated authority to the Company's Governance Committee to determine whether and to what extent special circumstances may warrant the grant by the Committee of an exception, hardship or otherwise, to the foregoing holding requirements.

Benefits and Perquisites

In an effort to attract and retain talented employees, we offer retirement, health and welfare programs competitive within our local markets (the "Benefit Programs"). The only Benefit Programs offered to our U.S. executive officers, either exclusively or with terms different from those offered to other eligible employees, include the following:

- Supplemental Retirement Benefit. This unfunded supplemental retirement benefit arrangement provided certain U.S. executives with a benefit of $10,000 per year payable for ten (10) years in monthly installments commencing upon retirement. If an eligible participant elected to retire and receive this benefit prior to reaching age sixty five (65), the benefit amount would be reduced by one-half of one percent (0.5 percent) for each month by which the participant's retirement precedes his or her sixty-fifth (65th) birthday. Mr. Graner was the only active executive officer eligible for this benefit in 2008. At its December 4, 2008 meeting, the Committee approved a present value lump sum payout of the future benefit amount payable to Mr. Graner in 2009 to avoid the ongoing administrative and legal expense associated with the maintenance of a single participant. The payout amount was $75,598. Upon payout, all other benefit obligations to Mr. Graner under the agreement ceased.

- Restoration Plan. Since the Internal Revenue Code limits the pension benefits that can be accrued under a tax-qualified defined benefit pension plan, we have established the Graco Inc. Restoration Plan. This plan is a nonqualified excess benefit plan designed to provide retirement benefits to eligible participants in the United States as a replacement for those retirement benefits reduced under the Graco Employee Retirement Plan by operation of Section 415 and Section 401(a)(17) of the Code.

- Supplemental Long-term Disability Program. Each U.S. executive officer is enrolled in an individual executive long-term disability plan under which Graco pays the premiums. Each plan provides the executive with a monthly disability benefit of up to $21,800 in the event of long-term disability.

- Other Perquisites. We provide few other perquisites to our executive officers. We reimburse our U.S. Management Executives for certain financial planning expenses to encourage the executives to maximize the value of their compensation and benefit programs. In 2008, the maximum amount reimbursable for financial planning was $10,000 for the CEO and $7,000 for all other U.S. Management Executives. In order to motivate the executives to receive appropriate preventative medical care to support their continued health and productivity, we offer executive officers in the United States an executive physical examination program through the Mayo Clinic. This program provides a physical examination every three years for executives under age 40, every other year for executives from age 40 through 49, and every year for executives age 50 and older. •Executives may be reimbursed and/or receive a tax gross-up for certain limited spousal travel and entertainment events. Mr. Paulis, our named executive officer employed by Graco N.V., is also eligible for benefits and perquisites consistent with those offered to other Graco N.V. management employees.

Severance and Change of Control Arrangements

We have entered into key employee agreements with the CEO and each of the named executive officers, the terms of which are described below under "Change of Control and Post Termination Payments." The Committee believes it is in the best interests of our Company and its shareholders to design compensation programs that assist our Company in attracting and retaining qualified executive officers, assure our Company will have the continued dedication of our Company's executive officers in the event of a pending, threatened or actual change of control, provide certainty about the consequences of terminating certain executive officers' employment, protect our Company by obtaining non-compete covenants from certain executive officers that continue after their termination of employment not involving a change of control and to obtain a release of any claims from those former executive officers. Accordingly, the agreements generally provide for certain benefits if the executive officer's employment or executive officer's service is terminated involuntarily by our Company without cause prior to a change of control or if, within two years after a change of control, the executive officer's employment or service is terminated involuntarily by the Company without cause or the executive officer resigns for good reason. The current form of key employee agreement was approved by the Committee in December 2007 after reviewing the key employee agreements previously in effect and current market practices related to severance arrangements and benefit levels related thereto. In particular, the Committee reviewed Hewitt's most recent "Executive Severance Arrangements Not Related to a Change in Control" and "Executive Change of Control Arrangements" surveys regarding the form and amount of benefits and severance terms provided by companies to their executive officers. Additionally, the Committee reviewed information collected from publicly available information about severance practices at companies in Graco's peer group.

The Committee believes it is imperative to diminish any potential distraction of the executive officers by the personal uncertainties and risks created by a pending or threatened change of control. By offering an agreement that will financially protect the executive officer in the event his or her employment or service is involuntarily terminated or terminated by the executive officer for good reason following a change of control, the Committee believes each executive officer's full attention and dedication to our Company will be enhanced to assist in the evaluation of a proposed change of control, and complete a change of control transaction and facilitate an orderly transition in the event of a change of control. In the event of a change of control of our Company, the agreements provide benefits only if the executive officer's employment or service is terminated involuntarily without cause or if the executive officer resigns for good reason, including by reason of material demotion, decrease in compensation, relocation or increased travel, within two years after the change of control. The Committee believes this "double-trigger" approach is most consistent with the objectives described above. The Committee believes a termination by an executive officer for good reason may be conceptually the same as termination by our Company without cause, and that a potential acquirer would otherwise have an incentive to constructively terminate the executive's employment to avoid paying severance benefits. Thus, the key employee agreements provide severance benefits in the case of resignation for good reason following a change of control.

The Committee believes it is important to attract and retain our executive officers by agreeing to provide certain benefits if the executive officer's employment or service is terminated without cause prior to a change of control. In addition, the Committee believes these benefits are appropriate to compensate these executive officers for agreeing not to work with competitors for a specified period of time following termination of employment, and that compensation enhances the enforceability of these non-compete covenants. The Committee also believes we benefit from obtaining a release of any claims from these former executive officers and the severance payments provide consideration for obtaining the release.

Our equity awards for executive officers and certain key managers provide for accelerated vesting, or lapse of restrictions, upon a change of control. The Committee believes that acceleration upon a change of control is appropriate to minimize the risk that executive officers might favor a transaction based on the likely impact on the executive officer's equity awards, to increase the likelihood that the employees will remain with us after becoming aware of a pending or threatened change of control, and due to the increased likelihood that employees may be terminated by a successor through no fault of their own.

Tax Implications of Executive Compensation

Section 162(m) of the Internal Revenue Code places a limit of $1 million in compensation per year on the amount we may deduct with respect to each of our named executive officers. This limitation does not apply to compensation that qualifies as “performance-based compensation.” Annual cash incentives meeting certain conditions and stock option awards constitute performance-based compensation and will generally be fully deductible. The Committee believes all compensation paid to the executive officers for fiscal year 2008 will be deductible for federal income tax purposes. However, the Committee reserves the flexibility to approve elements of compensation for specific officers in the future that may not be fully deductible when the Committee deems the compensation appropriate in light of its philosophies.

Report of the Management Organization and Compensation Committee

The Management Organization and Compensation Committee of the Company has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management, and based on such review and discussions, the Management Organization and Compensation Committee recommended to the Board that the Compensation Discussion and Analysis be included in this Proxy Statement.

The Members of the Management Organization and Compensation Committee

Mr. Jack W. Eugster, Chair
Mr. J. Kevin Gilligan
Mr. Lee R. Mitau
Ms. Marti Morfitt
Mr. Mark H. Rauenhorst

Summary Compensation Table

The table below summarizes the total compensation paid to or earned by our chief executive officer ("CEO"), our chief financial officer ("CFO") and our three other most highly compensated executive officers (collectively with our CEO and CFO, the "Named Executive Officers" or "NEOs"; individually a "Named Executive Officer" or "NEO"), based on total compensation (excluding changes in pension value and nonqualified deferred compensation earnings) during the fiscal year ended December 26, 2008[1].

Name and Principal Position	Year	Salary[2] ($)	Bonus[3] ($)	Stock Awards[4] ($)	Option Awards[5] ($)	Non-Equity Incentive Plan Compensation[6] ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings[7] ($)	All Other Compensation[8] ($)	Total ($)
Patrick J. McHale President and Chief Executive Officer	2008	620,000	—	—	687,520	—	230,000	17,593	1,555,113
	2007	370,393	—	—	347,547	216,021	91,000	11,643	1,036,604
James A. Graner Chief Financial Officer and Treasurer	2008	297,077	—	—	362,485	—	167,000	20,232	846,794
	2007	330,750	—	—	335,735	111,146	356,000	18,125	1,151,756
	2006	238,500	—	—	373,034	242,692	283,000	26,026	1,163,252
Simon J. W. Paulis[9] Vice President and General Manager, Europe	2008	340,747	—	52,173	492,514	—	78,308	95,834	1,059,576
	2007	254,681	30,000	4,348	236,112	108,853	67,645	85,498	787,137
Dale D. Johnson	2008	299,164	—	52,173	386,063	—	222,000	22,583	981,983
	2007	289,047	—	4,348	271,965	130,755	185,000	19,117	900,232

Vice President and General Manager, Contractor Equipment Division	2006	277,930	—	—	199,461	288,254	97,000	17,988	880,633
Charles L.	2008	254,268	—	32,608	304,806	—	133,000	13,659	738,341
Rescorla	2007	245,670	—	2,717	368,054	111,133	117,000	16,335	860,909
Vice President, Manufacturing and Distribution Operations	2006	236,221	10,000	—	416,769	244,996	82,000	26,283	1,016,269

(1) Also includes information with respect to the fiscal years ended December 29, 2006 and December 28, 2007 for those NEOs serving in such capacity during those fiscal years.

(2) The salary amounts reflect regular base salary earned in the year and accrued vacation payments including any base salary deferred. Mr. Graner's salary amount for 2007 included an accrued vacation payment as a result of his intention to retire at the time.

(3) Bonus includes any discretionary bonuses or awards made under the CEO Award Program.

(4) The amounts reported in the Stock Awards Column are the same as the compensation cost recognized pursuant to SFAS No.123(R) in our Company's financial statements for restricted stock grants made under the Stock Incentive Plan, unreduced by the estimated service-based forfeitures. Information concerning these amounts may be found in Item 8, Financial Statements and Supplementary Data, and Note H to the Consolidated Financial Statements in our Company's 2008 Annual Report on Form 10-K.

(5) The amounts reported in the Option Awards Column are the same as the compensation cost recognized pursuant to SFAS No.123(R) in our Company's financial statements for option grants made under the Stock Incentive Plan, unreduced by the estimated service-based forfeitures. Information concerning these amounts may be found in Item 8, Financial Statements and Supplementary Data, and Note H to the Consolidated Financial Statements in the Company's 2008 Annual Report on Form 10-K. The option awards reflected in the calculation of this cost are identified in the Supplemental Table to the Options Awards Column found on page 21 immediately following this Summary Compensation Table.

(6) The amounts represent awards earned under the Executive Officer Annual Incentive Bonus Plan or the Executive Officer Bonus Plan, as applicable, including any amount that was deferred. The Executive Officer Annual Incentive Bonus Plan has a 100 percent of base salary target payout and a 150 percent of base salary maximum payout. The Executive Officer Bonus Plan has a 70 percent of base salary target payout and a 105 percent of base salary maximum payout. See narrative preceding the Grants of Plan-Based Awards table found on page 22. At its February 13, 2009 meeting, the Committee certified that

there was no payout for the Executive Officer Annual Incentive Bonus Plan or the Executive Officer Bonus Plan for 2008.

(7) The amount shown in the Change in Pension Value and Nonqualified Deferred Compensation Earnings column reflects the aggregate change in the actuarial present value of the NEO's accumulated benefit under the qualified Graco Employee Retirement Plan, nonqualified excess benefits plan known as the Graco Inc. Restoration Plan, and the Supplemental Executive Retirement Plan ("SERP") as follows: Mr. McHale: $49,000 (qualified pension) and $181,000 (nonqualified restoration); Mr. Graner: $47,000 (qualified pension), $115,000 (nonqualified restoration), and $5,000 (SERP); Mr. Johnson: $101,000 (qualified pension) and $121,000 (nonqualified restoration); and Mr. Rescorla: $63,000 (qualified pension) and $70,000 (nonqualified restoration). The amount shown for Mr. Paulis reflects the change in present value of $76,485 attributable to the fully insured pension through Swiss Life N.V. and the change in present value of $1,823 attributable to the sector pension plan.

(8) The amounts shown in the All Other Compensation column for 2008 reflect the following for Messrs. McHale, Graner, Johnson, and Rescorla:

	Mr. McHale	Mr. Graner	Mr. Johnson	Mr. Rescorla
Employee Investment Plan Matching Contribution	$6,900	$6,882	$6,900	$6,817
Tax Gross-up Payments on Travel Expenses	$1,052	–	$770	–
Other Perquisites	$9,641	$13,350	$14,913	$6,842
Total	$17,593	$20,232	$22,583	$13,659

The Other Perquisites consist of company-provided incremental cost for long term disability coverage, financial planning, spousal travel, and executive physical. None of these individual perquisite categories exceeded the greater of $25,000 or 10 percent of the total perquisite amount.

The amount shown in the All Other Compensation column for 2008 reflect the following for Mr. Paulis:

Insurance Premium for Pension, Medical, and Life	$59,264
Incremental Cost for Long Term Disability Coverage	$ 9,483
Metal Trade Sector Retirement Contribution	$ 1,591
Other Perquisites	$25,496
Total	$95,834

The “other” perquisites for Mr. Paulis consist of company-provided spousal travel, car related expenses, and miscellaneous expenses. None of these individual perquisite categories exceeded the greater of $25,000 or 10 percent of the total perquisite amount. Benefits provided to Belgium employees are very different than those provided to employees based in the United States; however, Mr. Paulis receives similar benefits to those provided to all other Belgium management employees.

(9) Amounts for Mr. Paulis reflect an average exchange rate of 1.472 dollar-to-euro for 2008.

Supplemental Table to the Option Awards Column for Fiscal Year Ended December 26, 2008

Name	Grant Date	Shares Granted (#)	Expense Recorded in 2008 ($)
Patrick J. McHale	2/20/2004	27,000	6,670
	2/18/2005	22,500	46,640
	2/17/2006	22,500	71,796