

GRACO INC  
Form PRE 14A  
March 01, 2013  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**SCHEDULE 14A INFORMATION**

**Proxy Statement Pursuant to Section 14(a) of the**

**Securities Exchange Act of 1934**

**(Amendment No. )**

Filed by the Registrant ☒

Filed by a Party other than the Registrant ☐

Check the appropriate box:

☒ Preliminary Proxy Statement

☐ **Confidential, for Use of the Commission Only** (as permitted by Rule 14a-6(e)(2))

☐ Definitive Proxy Statement

☐ Definitive Additional Materials

☐ Soliciting Material under Rule 14a-12

**Graco Inc.**

(Name of registrant as specified in its charter)

(Name of person(s) filing proxy statement, if other than the registrant)

Payment of Filing Fee (Check the appropriate box):

☒ No fee required.

☐ Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

(1) Title of each class of securities to which transaction applies:

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- (2) Aggregate number of securities to which transaction applies:
  
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- (4) Proposed maximum aggregate value of transaction:
  
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- (1) Amount Previously Paid:
  
- (2) Form, Schedule or Registration Statement No.:
  
- (3) Filing Party:
  
- (4) Date Filed:

**Table of Contents**

GRACO INC.

88 Eleventh Avenue N.E.

Minneapolis, MN 55413

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

Dear Shareholder:

Please join us on Friday, April 26, 2013, at 1:00 p.m. Central Time for Graco Inc.'s Annual Meeting of Shareholders at the George Aristides Riverside Center, 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 appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year 2013.
3. An advisory, non-binding resolution to approve our executive compensation.
4. Amendment of the Restated Articles of Incorporation to adopt majority voting for the election of directors.
5. Transaction of such other business as may properly come before the meeting.

Shareholders of record at the close of business on February 25, 2013, are entitled to vote at this meeting or any adjournment.

We encourage you to join us and vote at the meeting. Regardless of whether you plan on attending the meeting, we encourage you to vote by Internet, or by requesting a paper copy and voting by telephone or returning your proxy card by mail, as described in further detail later in this Proxy Statement.

If you do not vote by Internet, telephone, 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 methods identified above. This will not prevent you from voting in person if you decide to attend the meeting.

Sincerely,

Patrick J. McHale  
President and Chief Executive Officer

Karen Park Gallivan  
Secretary

March [ ], 2013  
Minneapolis, Minnesota



**Table of Contents**

**TABLE OF CONTENTS**

<u>VOTING METHODS</u>	5
<u>BOARD OF DIRECTORS</u>	5
<u>Nominees and Continuing Directors</u>	5
<u>Qualification Standards</u>	8
<u>Qualifications of Current Directors</u>	8
<u>Board Diversity</u>	8
<u>Nominee Selection Process</u>	8
<u>DIRECTOR INDEPENDENCE</u>	9
<u>BOARD LEADERSHIP STRUCTURE</u>	9
<u>BOARD OVERSIGHT OF RISK</u>	10
<u>MEETINGS OF THE BOARD OF DIRECTORS</u>	10
<u>COMMITTEES OF THE BOARD OF DIRECTORS</u>	10
<u>Audit Committee</u>	10
<u>Governance Committee</u>	10
<u>Management Organization and Compensation Committee</u>	11
<u>COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION</u>	11
<u>DIRECTOR COMPENSATION</u>	11
<u>Director Compensation Table for Fiscal Year Ended December 28, 2012</u>	13
<u>COMMUNICATIONS WITH THE BOARD</u>	14
<u>CORPORATE GOVERNANCE DOCUMENTS</u>	14
<u>AUDIT COMMITTEE REPORT</u>	14
<u>Report of the Audit Committee</u>	14
<u>Independent Registered Public Accounting Firm Fees and Services</u>	15
<u>Pre-Approval Policies</u>	15
<u>EXECUTIVE COMPENSATION</u>	16
<u>Compensation Discussion and Analysis</u>	16
<u>Report of the Management Organization and Compensation Committee</u>	28
<u>Summary Compensation Table</u>	28
<u>Grants of Plan-Based Awards in 2012</u>	30
<u>Outstanding Equity Awards at Fiscal Year Ended December 28, 2012</u>	31
<u>Option Exercises and Stock Vested in 2012</u>	32
<u>Change of Control and Post-Termination Payments</u>	32
<u>Potential Payments Upon Termination or Following a Change of Control at December 28, 2012</u>	34
<u>Retirement Benefits</u>	35
<u>Pension Benefits at Fiscal Year Ended December 28, 2012</u>	37
<u>Nonqualified Deferred Compensation</u>	38
<u>Nonqualified Deferred Compensation at Fiscal Year Ended December 28, 2012</u>	39
<u>CEO Succession Planning</u>	39
<u>EQUITY COMPENSATION PLAN INFORMATION</u>	40
<u>BENEFICIAL OWNERSHIP OF SHARES</u>	40
<u>Director and Executive Officer Beneficial Ownership</u>	40
<u>Principal Shareholder Beneficial Ownership</u>	41
<u>Section 16(a) Beneficial Ownership Reporting Compliance</u>	42
<u>RELATED PERSON TRANSACTION APPROVAL POLICY</u>	42
<u>PROPOSAL 1: ELECTION OF DIRECTORS</u>	42
<u>PROPOSAL 2: RATIFICATION OF THE APPOINTMENT OF INDEPENDENT</u>	
<u>REGISTERED PUBLIC ACCOUNTING FIRM</u>	43
<u>PROPOSAL 3: ADVISORY VOTE ON OUR EXECUTIVE COMPENSATION</u>	43
<u>PROPOSAL 4: AMENDMENT OF RESTATED ARTICLES OF INCORPORATION</u>	
<u>TO ADOPT MAJORITY VOTING FOR THE ELECTION OF DIRECTORS</u>	44
<u>SHAREHOLDER PROPOSALS FOR THE ANNUAL MEETING IN THE YEAR 2014</u>	44
<u>OTHER MATTERS</u>	45
<u>APPENDIX A</u>	A-1



**Table of Contents**

**GENERAL REQUESTS FOR GRACO INC. 2012 ANNUAL REPORT ON FORM 10-K**

The Graco Inc. 2012 Annual Report on Form 10-K, including the Financial Statements and the Financial Statement Schedule, is available to the public at [www.graco.com](http://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

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**Table of Contents**

GRACO INC.

88 Eleventh Avenue N.E.

Minneapolis, MN 55413

**PROXY STATEMENT**

**FOR ANNUAL MEETING OF SHAREHOLDERS**

**TO BE HELD APRIL 26, 2013**

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 26, 2013 and any adjournments of that meeting (the Meeting). Throughout this Proxy Statement, we may refer to Graco Inc. as us, we, Graco, our Company or the Company.

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 13, 2013, and the proxy materials will be available at that time on [www.proxyvote.com](http://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. The election of directors, the advisory vote on our executive compensation and the vote to amend the Restated Articles of Incorporation to adopt majority voting for the election of directors will be considered proposals on which your broker does not have discretionary authority to vote. Thus, if your shares are held in street name and you do not provide instructions as to how your shares are to be voted on these matters, your broker or other nominee may not be able to vote your shares in these matters. Accordingly, we urge you to provide instructions to your broker or nominee so that your votes may be counted on these matters. You should vote your shares by following the instructions provided on the voting instruction card that you receive from your broker.

The vote required for the election of directors is a plurality of votes cast. The vote required to ratify the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year 2013 and the vote to amend the Restated Articles of Incorporation to adopt majority voting for the election of directors require 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. The vote on our executive compensation is advisory and non-binding. However, the Board will consider shareholders to have approved our executive compensation if the number of the votes cast for that proposal exceeds the number of votes cast against that proposal.

Only shareholders of record as of the close of business on February 25, 2013 may vote at the Meeting. As of that date, there were 60,939,904 issued and outstanding common shares of the 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.





## **Table of Contents**

### **VOTING METHODS**

Registered shareholders may vote by using any one of the following methods:

1. **Vote by Internet.**

You may visit [www.proxyvote.com](http://www.proxyvote.com) to vote your shares on the Internet. Have your Notice or proxy card (if you have requested one) in front of you when you access the website, as they include information, including a unique shareholder control number, that is required to access the system.

2. **Vote by Telephone.**

You may request a paper proxy card by following the instructions on your Notice for requesting a copy of materials. After you receive your paper proxy card, you may call the toll-free phone number, 1-800-690-6903, listed on your proxy card to vote your shares. Have your proxy card or Notice in front of you when calling, as they include information, including a unique shareholder control number, which is required to access the system.

3. **Vote by Mail.**

You may request a paper proxy card by following the instructions on your Notice for requesting a copy of materials. After you receive your paper proxy card, you may mark, date, and sign the proxy card, and return it as soon as possible in the envelope provided.

4. **Vote in Person at the Annual Meeting.**

You may vote in person at the Annual Meeting to be held at the George Aristides Riverside Center, 1150 Sibley Street N.E., Minneapolis, Minnesota, on Friday, April 26, 2013, at 1:00 p.m. Central Time.

If you own your shares through a broker, bank, broker-dealer or similar organization, you may vote by the methods made available to you through your broker. Follow the instructions describing the available processes for voting your stock that are provided to you by your broker.

### **BOARD OF DIRECTORS**

#### **Nominees and Continuing Directors**

The following information is given with respect to the three nominees for election at the Meeting and the other six directors whose terms of office will continue after the Meeting, and includes a description of the particular experience, qualifications, attributes or skills that led the Board to conclude that each of the nominees and directors should serve as members of the Board. 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 2016:**

##### **Eric P. Etchart**

Mr. Etchart, 56, is President of the Manitowoc Cranes Group, a business segment of The Manitowoc Company, Inc., and a Senior Vice President of The Manitowoc Company, Inc., a manufacturer of cranes and foodservice equipment. He has held these positions since 2007. From 2001 to 2007, Mr. Etchart was Executive Vice President, Asia Pacific and President, Zhang Jia Gang Company of the Manitowoc Crane Group, in Shanghai, China. Prior to that, Mr. Etchart held various management positions at Potain S.A., until it was acquired by Manitowoc in 2001, and PPM Cranes S.A. Mr. Etchart has been a director of Graco since December 2010. Among other qualifications, Mr. Etchart brings to our Board thirty years of global manufacturing experience, as well as extensive knowledge of and expertise in finance and marketing. Mr. Etchart, a French-national with twenty-six years of experience in management positions outside of the U.S., including positions in China, Singapore, Italy,

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France and the Middle East, is particularly well-suited to provide an international perspective to the Board as we develop our business in global markets.

## **Table of Contents**

### **J. Kevin Gilligan**

Mr. Gilligan, 58, is Chairman and Chief Executive Officer of Capella Education Company, an online education provider, a position he has held since March 2009. Mr. Gilligan was President and Chief Executive Officer of United Subcontractors, Inc., a national construction services company, from October 2004 until February 2009. United Subcontractors voluntarily filed for Chapter 11 bankruptcy on March 31, 2009 and emerged from the bankruptcy proceedings on June 30, 2009. Mr. Gilligan 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 and is also a director of Capella Education Company. From 2004 until 2009, Mr. Gilligan was a director of ADC Telecommunications, Inc., and served as lead director from 2008 until 2009. Among other qualifications, Mr. Gilligan brings to our Board over twenty-six years of global operational experience as well as comprehensive knowledge of the construction industry, one of the key industries that Graco serves. Mr. Gilligan's additional public company experience as both an executive and as a director provides additional depth to our Board's leadership capabilities.

### **William G. Van Dyke**

Mr. Van Dyke, 67, was Chairman of the Board of Donaldson Company, Inc., a diversified global manufacturer of air and liquid filtration products, from 1996 until his retirement in August 2005. From 1996 until August 2004, he was also Chief Executive Officer and President of Donaldson Company. 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. From 2005 until 2006, he served as a director of Black Hills Corporation. Mr. Van Dyke brings to our Board visionary, disciplined leadership developed over his distinguished career as Chairman and CEO of Donaldson Company. In addition, the Board values his experience as a director of two other public manufacturing companies. He was selected by our Board not only for his financial, accounting and operational expertise, but also because of his knowledge of industrial product markets and manufacturing processes. Mr. Van Dyke has over seventeen years of experience serving Graco on its Board, and has been designated by our Board as an audit committee financial expert.

### **Directors whose terms continue until 2014:**

#### **Patrick J. McHale**

Mr. McHale, 51, 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, 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 and has been a director since June 2007. Mr. McHale has twenty-three years of progressive experience in various manufacturing, sales and marketing roles while at Graco. He has extensive manufacturing experience and in-depth knowledge of financial and managerial accounting practices at Graco.

#### **Lee R. Mitau**

Mr. Mitau, 64, was Executive Vice President and General Counsel of U.S. Bancorp, the fifth-largest commercial bank in the United States, from 1995 until his retirement on March 1, 2013. 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 Chairman of the Board of the Company since June 2007. He also serves as Chairman of the Board of H.B. Fuller Company, a position he has held since 2006. Among other qualifications, Mr. Mitau brings to our Board extensive public company legal and governance expertise developed in his roles as an executive, a director and as the former chair of the corporate and securities practice of a global law firm. In addition, he is an expert in corporate finance and mergers and acquisitions. With over twenty-two years on our Board, Mr. Mitau has developed an in-depth knowledge of our business. His long history with our Company, combined with his leadership and corporate governance skills, makes him particularly well-qualified to be our Chairman and Chair of our Governance Committee.

#### **Martha A. Morfitt**

Ms. Morfitt, 55, is President and Chief Executive Officer of River Rock Partners, Inc., a business and cultural transformation consulting firm. She assumed this position in 2008. Ms. Morfitt formerly served as Chief Executive Officer of Airborne, Inc., a manufacturer of dietary supplements, from 2009 through March 2012. Ms. Morfitt left her position at Airborne effective March 30, 2012 as a result of the acquisition of Airborne by Schiff Nutrition Group on March 30, 2012.



## **Table of Contents**

She also served as President and Chief Executive Officer of CNS, Inc., a manufacturer and marketer of consumer products, from 2001 through March 2007. Ms. Morfitt left her position at CNS effective March 2007 as a result of the acquisition of CNS by GlaxoSmithKline plc in December 2006. Ms. Morfitt has been a director of Graco since October 1995 and is also a director of Life Time Fitness, Inc. and lululemon athletica inc. From 1998 until 2007, she served as a director of CNS; from 2005 until 2006, she served as a director of Intrawest Corporation; and from 2007 until 2010, she served as a director of Solta Medical, Inc. f/k/a Thermage, Inc. Among other qualifications, Ms. Morfitt brings a wealth of global marketing and leadership skills to our Board. Her experience as CEO at River Rock Partners, Airborne and CNS, as well as her experience as a Vice President at Pillsbury Company, allow her to provide our Company with significant strategic and product marketing guidance. With seventeen years on our Board, Ms. Morfitt's considerable knowledge of our business makes her well-suited to provide advice with respect to our strategic plans and marketing programs.

### **Directors whose terms continue until 2015:**

#### **William J. Carroll**

Mr. Carroll, 68, was Chief Executive Officer of Limo-Reid, Inc. d/b/a NRG Dynamix, a power train designer and manufacturer, from March 2009 until June 2011. 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 from September 2004 until January 2006. From September 2003 to March 2004, Mr. Carroll was 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 President Automotive Systems Group of Dana Corporation. Mr. Carroll has been a director of Graco since June 1999. Mr. Carroll brings to our Board a seasoned perspective and comprehensive breadth of expertise on the automotive industry, a key market served by Graco, as well as considerable skill in financial, accounting and manufacturing oversight. Our Board recognizes this skill through its designation of Mr. Carroll as one of our audit committee financial experts and by his appointment as Chair of the Audit Committee.

#### **Jack W. Eugster**

Mr. Eugster, 67, was Chairman, President and Chief Executive Officer of Musicland Stores Corporation, 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 Black Hills Corporation and Life Time Fitness, Inc. From 1993 to November 2012, Mr. Eugster served as a director of Donaldson Company, Inc.; from 2000 until 2007, he was a director of Golf Galaxy, Inc.; and from 1991 until late 2005, he served as a director of ShopKo Stores, Inc. Among other qualifications, Mr. Eugster brings to our Board more than forty years of public company experience, including extensive experience as an executive and as a director. He has extensive knowledge of and expertise in finance and marketing, and is able to devote considerable attention to Company matters. Our Board recognizes this experience and expertise by his appointment as Chair of the Management Organization and Compensation Committee.

#### **R. William Van Sant**

Mr. Van Sant, 74, has been a Senior Advisor at Tenex Capital Management, L.P., a private equity firm, since September 2012. He also serves as Chairman of the Board of Quintec and as a director of Rush-Overland, two portfolio companies of Tenex. From January 2008 until February 2013, he was an operating partner of Stone Arch Capital, LLC, a private equity firm. From August 2006 through December 2007, he was President and Chief Executive Officer of Paladin Brands Holding, Inc., which manufactures attachments for construction equipment. From 2003 until August 2006, Mr. Van Sant was Chairman, and from 2003 until November 2005, Mr. Van Sant was Chairman and Chief Executive Officer, of Paladin Brands, LLC. 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. Among other qualifications, Mr. Van Sant is an expert in management, finance and manufacturing operations, experience he has acquired over many years as executive and/or director of various manufacturing companies, including those listed above as well as Nortrax, Inc., Lukens Inc., Blount, Inc., and Cessna Aircraft Company. He also held roles of increasing responsibility over a nearly thirty year career at John Deere Company. Mr. Van Sant's strong leadership experience and seasoned business valuation skills make him a key contributor to our Board on strategy and growth topics, particularly with respect to mergers and acquisitions. He has been designated by our Board as an audit committee financial expert.

## **Table of Contents**

### **Qualification Standards**

Our Company 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 Meeting of Shareholders next following the director's 75<sup>th</sup> birthday, unless the Board waives such requirement, and the requirement to tender the director's resignation if his or her employment status significantly changes.

The Governance Committee is responsible for the identification and recruitment of suitable prospective director candidates and has the sole authority to hire an outside search firm to identify director candidates. The Governance Committee may retain an outside search firm as a resource for future candidate sourcing and succession planning as the Governance Committee deems appropriate.

At its February 2010 meeting, the Governance Committee engaged Spencer Stuart to conduct a search for a new director, with a focus on candidates with strong international sales and marketing experience, an industrial manufacturing background, and at least 20 years of overall business experience culminating in a senior executive role with a mid-to-large market capitalization company. Spencer Stuart presented a list of potential candidates to the Governance Committee at the April 2010 meeting, at which time the Governance Committee narrowed the list of potential candidates. Subsequent to the meeting, several directors interviewed the top two candidates, including Mr. Etchart. At its September 2010 meeting, the Board, upon the recommendation of the Governance Committee, set the number of Board members at nine and appointed Mr. Etchart as a director effective December 2, 2010 to hold office for a term expiring at the 2013 Annual Meeting of Shareholders based on Mr. Etchart's considerable global manufacturing and public company experience, demonstrated strategic and leadership capabilities, and his desire to serve on our Board.

### **Qualifications of Current Directors**

All of our directors meet the qualification standards and expectations described above. In addition to possessing a high level of ethics, integrity and values, excellent judgment and a commitment to representing the long-term interests of our shareholders, each of our directors brings a particular set of skills and experience that enable him or her to make a significant contribution to the governance of our Company.

### **Board Diversity**

In considering whether to recommend an individual for election to our Board, the Governance Committee considers diversity of experience, geographical representation, gender and race, in addition to the other qualifications described in the Qualification Standards section above. The Committee views diversity expansively and considers, among other things, functional areas of business and financial expertise, educational and professional background, and those competencies that it deems appropriate to develop a cohesive Board such as ethics, integrity, values, 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.

Our Board of Directors and each of its committees engage in an annual self-evaluation process. As part of that process, directors, including our President and Chief Executive Officer, provide feedback on, among other things, whether the Board has the right set of skills, experience and expertise. This evaluation encompasses a consideration of diversity as described above.

### **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, addressed to the Governance Committee in care of the Secretary of the Company at our Company's corporate headquarters.





## **Table of Contents**

To nominate a director, our bylaws 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.

## **DIRECTOR INDEPENDENCE**

Our Board of Directors has determined that Mr. Carroll, Mr. Etchart, Mr. Eugster, Mr. Gilligan, Mr. Mitau, Ms. Morfitt, 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 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 independent directors and information gathered by our management, and determined that none of the independent directors, other than Mr. Mitau while he served as Executive Vice President and General Counsel of U.S. Bancorp, have any relationship with our Company other than as a director and/or shareholder. Some of our non-employee 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 served as Executive Vice President and General Counsel of U.S. Bancorp prior to retiring on March 1, 2013. In 2012, our Company paid certain subsidiaries of U.S. Bancorp approximately \$133,000 for transactional deposit services, including those related to cash management, credit card processing and letters of credit; approximately \$885,000 for interest expense; and approximately \$724,000 for service fees related to our revolver and credit lines. The revolver services provided during 2012 were not advisory in nature. Our banking and borrowing relationship with U.S. Bancorp predates Mr. Mitau's service on our Board and Mr. Mitau was never personally involved in any way in the negotiation of our business terms or relationships with the U.S. Bancorp subsidiaries with which we do business. The total amount our Company paid to U.S. Bancorp's subsidiaries in 2012, approximately \$1,742,000, falls significantly below 2% of U.S. Bancorp's 2012 gross revenues, or \$406 million, which is the threshold for determining independence under the New York Stock Exchange's independence standards. The Board determined that neither the nature of the relationship between U.S. Bancorp (including the subsidiaries with which we do business) and our Company nor the amount of payments was material to either Graco or U.S. Bancorp. Moreover, our Board concluded that Mr. Mitau did not have a material interest in the foregoing transactions while at U.S. Bancorp because he was not directly involved in the transactions nor did he derive any special benefit related to the transactions, and the transactions with U.S. Bancorp's subsidiaries were the result of a competitive bidding process and arm's-length negotiations.

## **BOARD LEADERSHIP STRUCTURE**

Our Corporate Governance Guidelines provide for the position of Chairman of the Board of Directors, who may or may not be the same person who serves as our President and Chief Executive Officer. Mr. Mitau has served as our independent Chairman of the Board from May 2002 until April 2006 and again since June 2007. Our Board currently believes that separating the roles of Chairman of the Board and CEO is appropriate for our Company because, during difficult or volatile economic times such as those experienced during the economic recession several years ago, it is desirable to have our CEO focused on the management and operation of our business without the additional responsibilities of Chairman. Moreover, Mr. Mitau has significant public company and governance experience. Our Corporate Governance Guidelines set forth several responsibilities of the Chairman of the Board, including setting agendas for board meetings and presiding at executive sessions of non-employee directors.

**Table of Contents****BOARD OVERSIGHT OF RISK**

Our Board of Directors takes an active role in oversight of our Company's risk by assessing risks inherent in our Company's decisions and key strategies. The Audit Committee specifically discusses policies with respect to risk assessment and risk management as part of its responsibility to oversee our Company's compliance with legal and regulatory requirements.

Our Company engages in an Enterprise Risk Management (ERM) process. The ERM process consists of periodic risk assessments performed by each division, region and functional group during the year. Executive management periodically reviews the divisional, regional and functional risk assessments. These assessments are presented to the Audit Committee each September for approval to ensure completeness, appropriate oversight and review. While our Board leadership structure results from the considerations described above, we believe that the active oversight role played by our Audit Committee, which consists solely of independent directors, provides the appropriate level of independent oversight of risk within our Company.

**MEETINGS OF THE BOARD OF DIRECTORS**

During 2012, our Board of Directors met seven times. Attendance of our directors at all Board and committee meetings averaged 95%. During 2012, every director attended at least 75% 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 2012, all of the directors attended the Annual Meeting of Shareholders. Each regularly scheduled meeting of the Board includes an executive session of only non-employee 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 25, 2013, the record date, was as follows:

Audit	Governance	Management Organization and Compensation
William J. Carroll, Chair	Lee R. Mitau, Chair	Jack W. Eugster, Chair
Eric P. Etchart	William J. Carroll	Eric P. Etchart
Jack W. Eugster	Martha A. Morfitt	J. Kevin Gilligan
J. Kevin Gilligan	William G. Van Dyke	Lee R. Mitau
William G. Van Dyke	R. William Van Sant	Martha A. Morfitt

R. William Van Sant

**Audit Committee** (8 meetings in fiscal year 2012)

The Audit Committee is composed entirely of directors who meet the independence requirements of 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 the 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 18, 2011.

**Governance Committee** (4 meetings in fiscal year 2012)

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

## **Table of Contents**

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 (3 meetings in fiscal year 2012)**

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 18, 2011.

## **COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION**

None of the members of the Board who served on the Management Organization and Compensation Committee during 2012 has ever been an officer or employee of our Company or any of its subsidiaries.

## **DIRECTOR COMPENSATION**

Beginning May 1, 2011, the annual retainer paid to each non-employee director of Graco, except the non-employee Chairman, is \$38,000. The non-employee Chairman is paid at the rate of \$75,000 per annum. We also pay annual retainers of \$5,000 for the Chair of the Governance Committee, \$7,500 for the Chair of the Management Organization and Compensation Committee, and \$10,000 for the Chair of the Audit Committee. The non-employee directors received a meeting fee of \$1,500 for each Board meeting attended. The meeting fee for each of our three Committees is \$1,200 per meeting. The meeting fee for attendance by telephone at any in-person or telephonic Board or Committee meeting is one-half of the fee for in-person attendance. All retainer and meeting fees are paid in arrears.

A non-employee director may elect to receive shares of our common stock instead of cash for all or part of the director's annual retainer (including committee chair retainer) and meeting fees. A director may choose to receive the shares currently or defer receipt until the director leaves the Board, at which time the director may receive the shares in a lump sum or installments. Payments, whether in a lump sum or by installments, will be made in shares of common stock, plus cash in lieu of any fractional share. When our Board declares a dividend, the director's deferred stock account is credited with additional shares of stock in an account held by a trustee in the name of the non-employee director equivalent to the number of shares that could be purchased with the dividends at the current fair market value of the shares.

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Non-employee directors receive an annual option grant. In 2012, non-employee directors received an annual option grant of 5,600 shares on the date of the Company's Annual Meeting of Shareholders. The number of shares granted was based on an estimated Black-Scholes value of \$17.76 per share on April 18, 2012, and an economic value of approximately \$100,000. Upon first joining the Board, non-employee directors are also eligible to receive an initial option grant with an economic value equal to that of the most recent option grant for non-employee directors. There were no first-time non-employee director appointments in

## **Table of Contents**

2012. Options granted to non-employee directors are issued under the Graco Inc. 2010 Stock Incentive Plan, are non-statutory, have a 10-year duration and become exercisable in equal installments over four years, beginning with the first anniversary of the date of the grant. The option exercise price is the fair market value of the stock on the date of grant, as defined in the Plan. The Plan defines "fair market value" as the last sale price of the stock as reported by the New York Stock Exchange on the date immediately prior to the date of grant. At the February 2012 meeting, the Management Organization and Compensation Committee, which administers the Company's equity plans, approved an amendment to all outstanding and future stock option award agreements of the directors to allow the directors to exercise their stock options through net exercises as more fully described on page 25 of this Proxy Statement.

Our Board's philosophy is to target retainer and meeting fee compensation at the median of the market, and target equity compensation in the form of stock options above the median of the market, in order to attract and retain capable board members and to strengthen the link between our director compensation program and the interest of our shareholders in Graco stock performance.

Our Governance Committee requested that the Graco Compensation Department conduct a peer group comparison of director compensation and present such data at its February 2012 meeting. The peer companies used for the 2012 benchmarking study matched the peer group identified for executive compensation on page 20 of the Compensation Discussion and Analysis section of this Proxy Statement. In reviewing the peer group comparison, the Governance Committee concluded that its current retainer and meeting fee compensation, in the aggregate, is approximately at the median of the peer group, and that its equity compensation, in the aggregate, is in the upper quartile of the peer group, so no changes were proposed for 2012.

Our Governance Committee retained Towers Watson to conduct a peer group comparison of director compensation and present such data at its February 2013 meeting. The peer companies selected for the comparison matched the peer group identified for executive compensation on page 20 of the Compensation Discussion and Analysis section of this Proxy Statement. Based on the results of the peer group comparison, Towers Watson recommended that the Governance Committee increase the annual retainer by \$2,000. Rather than increase the annual retainer by \$2,000, the Governance Committee elected to increase the economic value of the annual option grant by \$2,000 to further align the interests of the directors with the interests of the Company's shareholders.

Share ownership guidelines for our directors were adopted effective February 15, 2008. The guidelines require each of our non-employee directors to own a minimum of approximately five times the total value of their annual retainer and meeting fees in Company stock. Shares of common stock directly and beneficially owned, as well as phantom stock shares, are used to calculate each director's ownership level; stock options are not used. Directors have five years from their initial date of appointment to reach the minimum ownership level. All of our directors who have served for at least five years exceed this ownership requirement.

In February 2001, our Board terminated the retirement benefit for non-employee directors, which provided that, upon cessation of service, a non-employee director who has served for five full years or more will receive payments for five years at a rate equal to the director's annual retainer in effect on the director's last day of service on the Board. At the September 18, 2008 Governance Committee meeting, the Committee clarified that the annual retainer calculation shall be set at the rate then in effect for the non-Chairman annual retainer and shall not include Committee Chair retainer fees. Such retirement payments will be prorated and made quarterly. Payments will be made in accordance with this retirement benefit to Mr. Mitau, Ms. Morfitt and Mr. Van Dyke upon their respective retirements.

**Table of Contents****Director Compensation Table for Fiscal Year Ended December 28, 2012**

The following table summarizes the total compensation paid to or earned by the members of our Board of Directors during the fiscal year ended December 28, 2012:

Name	Fees Earned or Paid in Cash <sup>(1)</sup>	Stock Awards <sup>(2)</sup>	Option Awards <sup>(3)</sup>	Change in Pension Value and Nonqualified Deferred Compensation Earnings <sup>(4,5)</sup>	Total
	(\$)	(\$)	(\$)	(\$)	(\$)
William J. Carroll	52,200	17,400	97,158		166,758
Eric P. Etchart	28,403	28,047	97,158		153,608
Jack W. Eugster	11,375	51,975	97,158		160,508
J. Kevin Gilligan					