GRACO INC
Form DEF 14A
March 10, 2004

GRACO INC.
88 Eleventh Avenue N.E.
Minneapolis, MN 55413

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

Dear Shareholder:

Please join us on Friday, April 23, 2004, at 1:00 p.m. for Graco 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 and two directors to serve for two year terms.

2. Ratification of the selection of Deloitte & Touche LLP as independent auditors for the fiscal year 2004.

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

Shareholders of record at the close of business on February 23, 2004, 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. Mark, sign, date and return the enclosed Proxy Card;

2. Call the toll-free telephone number shown on your Proxy Card; or

3. Visit the website shown on your Proxy Card to vote via the internet.

Have your Proxy Card in front of you when voting by telephone or via the internet as it contains important information which is required to access the system.

If you do not vote by telephone, internet, returning your Proxy Card or by 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/David A. Roberts
David A. Roberts
President and Chief Executive Officer

/s/Robert M. Mattison
Robert M. Mattison
Secretary

March 10, 2004
Minneapolis, Minnesota

YOUR VOTE IS IMPORTANT

We urge you to call our transfer agent any time toll-free at **1-800-560-1965 or visit the website at www.eproxy.com/ggg** and vote your shares. Have your Proxy Card in front of you when you make your call or 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 the telephone or internet voting, please mark, date and sign the Proxy Card and return it in the accompanying envelope as soon as possible. If you attend the meeting, you may still revoke your proxy and vote in person if you wish.

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The 2003 Graco Inc. Annual Report on Form 10-K, including the Financial Statements and the Financial Statement Schedule, is available on our website at www.graco.com. A copy can be obtained free of charge by calling (612) 623-6659, requesting a copy from our web site or writing:

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

NOTE: Vote by telephone call 1-800-560-1965
Vote by internet at www.eproxy.com/ggg

GRACO INC.
88 Eleventh Avenue N.E.
Minneapolis, MN 55413

PROXY STATEMENT
FOR ANNUAL MEETING OF SHAREHOLDERS
TO BE HELD APRIL 23, 2004

Your proxy, represented by the accompanying Proxy Card, is solicited by the Board of Directors of Graco Inc. (Graco or the Company) in connection with the Annual Meeting of Shareholders of the Company to be held on April 23, 2004, (the Meeting) and any adjournments of that meeting.

The costs of the solicitation, including the cost of preparing and mailing the Notice of Meeting and this Proxy Statement, will be paid by the Company. Solicitation will be primarily by mailing this Proxy Statement to all shareholders entitled to vote at the meeting. Proxies may be solicited by officers of the Company personally, but at no compensation in addition to their regular compensation as officers. The Company 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 Proxy Statement and accompanying Proxy Card will be mailed to shareholders on or about March 10, 2004.

Proxies may be revoked at any time prior to being voted by giving written notice of revocation to the Secretary of the Company. 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.

Only shareholders of record as of the close of business on February 23, 2004, may vote at the Meeting or at any adjournment. As of that date, there were issued and outstanding 45,912,519 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.

PROPOSAL 1

Election of Directors

NOMINEES AND OTHER DIRECTORS

The number of directors of the Company is currently set at a maximum of 12 members. 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. Board policy states that no director may continue to serve on the Board after the last day of the month of his/her seventieth (70th) birthday. At the Meeting, five persons are nominated to be elected to the Company s Board of Directors.

Upon recommendation of the Governance Committee, which acts as the nominating committee of the Board, the Board has nominated William G. Van Dyke, Mark H. Rauenhorst and J. Kevin Gilligan for three year terms expiring in the year 2007. These individuals, whose current terms expire at the Meeting, have previously been elected as directors of the Company by the shareholders.

Upon recommendation of the Governance Committee, the Board has nominated Jack W. Eugster and R. William Van Sant to terms expiring in the year 2006. These individuals were elected by the Board of Directors on February 20, 2004, to fill vacancies. Non-management directors recommended Mr. Eugster and Mr. Van Sant to the Governance Committee.

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 majority of the voting power of shares present at the Meeting in order to be elected. Unless the Board reduces the number of directors, the enclosed 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, 2004 with respect to nominees for election and the six directors whose terms of office will continue after the Annual 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 2007:

William G. Van Dyke

Mr. Van Dyke, 58, is Chairman, Chief Executive Officer and President of Donaldson Company, Inc., a diversified manufacturer of air and liquid filtration products. Mr. Van Dyke has been a director of Graco since 1995. Mr. Van Dyke has been designated by the Board as the Audit Committee Financial Expert. Mr. Van Dyke is also a director of Donaldson Company, Inc. and Alliant TechSystems.

Mark H. Rauenhorst

Mr. Rauenhorst, 51, is the President and Chief Executive Officer of Opus Corporation, which is engaged in design, construction and real estate development activities, positions he assumed in 1999 and 2000 respectively. Beginning in 1996, he was President and CEO of Opus Northwest L.L.C. Mr. Rauenhorst has been a director of Graco since September, 2000 and is a director of Opus Corporation and ConAgra Foods, Inc.

J. Kevin Gilligan

Mr. Gilligan, 49, was President and Chief Executive Officer, Automation and Control Solutions, Honeywell International, Inc., a diversified technology and manufacturing company, from 2001 through 2003. In 1997 he became President, Solutions and Services Business, Home and Building Control of Honeywell Inc. Mr. Gilligan has been a director of Graco since February, 2001.

Nominees for election at this meeting to terms expiring in 2006:

Jack W. Eugster

Mr. Eugster, 58, has been the Non-Executive Chairman, ShopKo Stores, Inc., a multi-outlet discount retailer, since 2001. He was the Chairman, President and Chief Executive Officer of Musicland Stores Corporation, a retail music and home video company, from 1986 until his retirement in 2001. Mr. Eugster has been a director of Graco since February 20, 2004, and is also a director of Donaldson Co. Inc. and ShopKo Stores, Inc.

R. William Van Sant

Mr. Van Sant, 65, has been an Operating Partner with Norwest Equity Partners, a leading private equity firm, since 2001. He was Chairman and Chief Executive Officer of Nortrax, Inc., a multi-outlet John Deere dealership, from 1999 to 2001. Mr. Van Sant has been a director of Graco since February 20, 2004, and is also a director of H. B. Fuller Company and Amcast Industrial Corporation.

Directors whose terms continue until 2005:

Lee R. Mitau

Mr. Mitau, 55, is Chairman of the Board, a position he has held since May 7, 2002. He is the Executive Vice President and General Counsel of U.S. Bancorp, a regional bank holding company. Mr. Mitau has been a director of Graco since 1990 and is a director of H.B. Fuller Company.

James H. Moar

Mr. Moar, 55, became the Chief Operating Officer of Identix Incorporated in April 2003. Identix is a multi-biometric security technology company, offering fingerprint and facial technologies and products that empower the identification of individuals. He was Chief Operating Officer of Tennant Company from 1998 to June 2002. Mr. Moar has been a director of Graco since May, 2001.

Martha A.M. Morfitt

Ms. Morfitt, 46, is President and Chief Executive Officer of CNS Inc., a manufacturer and marketer of consumer products, including the Breathe Right® nasal strip. From 1998 to 2001, she was Chief Operating Officer of CNS Inc. Ms. Morfitt has been a director of Graco since 1995 and is a director of CNS Inc.

David A. Roberts

David A. Roberts, 56, is President and Chief Executive Officer of the Company, a position he has held since June 25, 2001. Prior to joining Graco, from 1996 to June 2001 he was Group Vice President of the Marmon Group, where he had responsibility for a group of manufacturing companies with products including grocery store refrigeration, retail store fixtures and fast food restaurant equipment. Mr. Roberts has been a director of Graco since June, 2001 and is a director of Franklin Electric Company. (See section entitled Certain Business Relationships on page 16.)

Directors whose terms continue until 2006:

Robert G. Bohn

Mr. Bohn, 49, is Chairman, President and Chief Executive Officer, Oshkosh Truck Corporation, Oshkosh, Wisconsin, a designer, manufacturer and marketer of a broad range of specialty commercial, fire and emergency apparatus and military trucks. Mr. Bohn has been a director of Graco since June, 1999 and is a director of Oshkosh Truck Corporation.

William J. Carroll

Mr. Carroll, 59, is retiring from Dana Corporation, Toledo, Ohio, effective March 1, 2004. Dana Corporation is engaged in the engineering, manufacturing and distribution of components and systems for vehicular and industrial manufacturers worldwide. From September 2003 to March 2004, Mr. Carroll was the acting President and Chief Operating Officer, Dana Corporation. From 1997 to March 2004, Mr. Carroll was the President Automotive Systems, Dana Corporation. Mr. Carroll has been a director of Graco since June, 1999.

DIRECTOR INDEPENDENCE

The Board of Directors has determined that all of the directors of the Company, except Mr. Roberts, are independent directors. In making this determination, the Board noted that each independent director meets the standards for independence set out in Section 303A.02(b) of the New York Stock Exchange Corporate Governance Rules, and that there is no material business relationship between the Company and any business entity with which any independent director is affiliated.

MEETINGS OF THE BOARD OF DIRECTORS

During 2003, the Board of Directors met 5 times. Attendance of the Company s directors at all Board and Committee meetings averaged 91.1 percent. During 2003, every current director except Mr. Carroll 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. The Company s Corporate Governance Guidelines require each director to make all reasonable efforts to attend the Company s Annual Meeting of Shareholders; in 2003, 9 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, the 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, 2004, the record date, was as follows:

Audit	Governance	Management Organization and Compensation
W. G. Van Dyke, Chair	L. R. Mitau, Chair	M. A.M. Morfitt, Chair
W. J. Carroll	R. G. Bohn	R. G. Bohn
J.W. Eugster	J. H. Moar	W. J. Carroll
J. K. Gilligan	M. A.M. Morfitt	J. W. Eugster
J. H. Moar	W. G. Van Dyke	J. K. Gilligan
M. H. Rauenhorst	R. W. Van Sant	L. R. Mitau
R. W. Van Sant		M. H. Rauenhorst

Audit Committee (5 meetings in fiscal 2003)

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, and all of which are, in the judgement of the Board, financially literate.

The Audit Committee assists the Board in its oversight of the integrity of the Company s financial statements; the Company s 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. A revised Audit Committee Charter was approved by the Board on February 20, 2004. The charter is set forth in Appendix A to this Proxy Statement. The charter is also available on the Company s website at www.graco.com.

Governance Committee (4 meetings in fiscal 2003)

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;

Recommends to the Board requirements for Board membership, including minimum qualifications and retirement policies;

Recommends to the Board the appropriate number of directors;

Recommends to the Board the compensation, benefits and retirement programs for directors;

Recommends to the Board the committee structure, committee charters, committee chairs and membership;

Recommends to the Board the number and schedule of Board meetings;

Recommends to the Board a set of Corporate Governance Guidelines;

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

Recommends to the Board 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 approved by the Board on February 20, 2004. The charter is available on the Company s website at www.graco.com.

Management Organization and Compensation Committee (2 meetings in fiscal 2003)

The Management Organization and Compensation Committee has the following functions:

Develops the Company's philosophy and structure for executive compensation;

Determines the compensation of the Chief Executive Officer and reviews compensation for the executive officers;

Prepares the report on executive compensation for the Company's proxy statement;

Reviews the individual performance of the Chief Executive Officer based on goals and objectives, and communicates to the CEO regarding performance on an annual basis;

Administers the 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 approved by the Board on February 20, 2004. The charter is available on the Company s website at www.graco.com.

NOMINATING PROCESS

The Governance Committee acts as the nominating committee for the Board of Directors, having the responsibility for identifying director candidates and recommending nominees to the Board. Shareholders may nominate candidates for election to the Board. Recommendations should be made in writing and addressed to the Governance Committee in care of the Secretary of the Company at the Company s corporate headquarters. The Company s 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 the 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 the Company s stock register; (iii) the number of shares of capital stock of the 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 the Company, if elected.

The Governance Committee will recommend for nomination as directors individuals who, in the judgment of the Board, will be able to make a significant contribution to the governance of the Company by virtue of their experience, background, current position with other organizations and/or expertise in a particular business discipline. The business discipline that may be sought at any given time will vary depending on the needs and strategic direction of the Company, and the disciplines represented by incumbent directors. The Board will endeavor to at all times have at least one director, who shall serve on the Audit Committee, who shall be independent and qualify as an Audit Committee Financial Expert as defined in the applicable rules of the Securities and Exchange Commission.

The Governance Committee identifies nominees for director a number of ways, including recommendations from Committee members or other directors, research to identify candidates, and nominees recommended by shareholders. If appropriate, a recruiting firm may be used. At its meetings, the Committee discusses the number of new directors that may be needed and any particular expertise that may be desirable at the time. The Committee will then discuss and evaluate each nominee, taking into account the nominee s experience, background, current occupation, and particular expertise, assessing the nominee s ability to make a significant contribution to the governance of the Company, expertise in a desired area, probable willingness to serve, ability to make the significant time commitment necessary to be a director of the Company, and other relevant factors. Shareholder nominees will be evaluated in the same manner as nominees from other sources.

COMMUNICATIONS WITH THE BOARD

The Board of Directors welcomes the submission of any comments or concerns from shareholders and any interested parties. These communications will go 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 the 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. If you wish to submit any comments or express any concerns to the Board, you may use one of the following methods:

Write to the Board at the following address:
Board of Directors
Graco Inc.
c/o Robert M. Mattison, Vice President, General Counsel and Secretary
88 11th Ave. NE
Minneapolis, MN 55413

Email the Board at boardofdirectors@graco.com

AUDIT COMMITTEE REPORT

Report of the Audit Committee

The Audit Committee has reviewed and discussed the audited financial statements of the Company for the fiscal year ended December 26, 2003 (the financial statements) with both the Company s management and its independent auditors, Deloitte & Touche LLP (Deloitte). The Audit Committee has discussed with Deloitte the matters required by Statement of Auditing Standards No. 61, Communication with Audit Committees. 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 Independence Standards Board Standard No. 1, Independence Discussion with Audit Committees, and the Audit Committee has discussed with Deloitte their independence. 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 the Board of Directors that the financial statements be included in the Company s Annual Report on Form 10-K for filing with the Securities and Exchange Commission.

The Members of the Audit Committee
Mr. William G. Van Dyke, Chair
Mr. William J. Carroll
Mr. J. Kevin Gilligan
Mr. James H. Moar
Mr. Mark H. Rauenhorst

Principal Accountant Fees and Services

The following table sets forth the aggregate audit fees incurred by Graco Inc. and its subsidiaries from the Company s principal accounting firm, Deloitte, the member firms of Deloitte Touche Tohmatsu, and their respective affiliates (collectively Deloitte & Touche), and fees paid to Deloitte & Touche for services in the other fee categories during the fiscal years ended December 26, 2003 and December 27, 2002. The Audit Committee has considered the scope and fee arrangements for all services provided by Deloitte & Touche, taking into account whether the provision of non-audit services is compatible with maintaining Deloitte & Touche s independence. The Audit Committee pre-approved 100% of the services described below.

	2003	2002
Audit Fees	$422,000	$410,000
Audit Related Fees[1]	8,000	7,000
Tax Fees[2]	41,000	84,000
Other Fees[3]	60,000	70,000
Total	$531,000	$571,000

(1) Includes fees for employee benefit plan audits of $7,000 and $6,000 and accounting services of $1,000 and $1,000 in 2003 and 2002, respectively.

(2) Includes fees for tax compliance services of $31,000 and $58,000 and tax advice of $10,000 and $26,000 in 2003 and 2002, respectively.
(3) Includes fees for individual employee benefit statement preparation of $58,000 and $57,000 and other services of $2,000 and $13,000 in 2003 and 2002, respectively.

Pre-Approval Policies

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

Audit Committee Financial Expert

The Board has identified William G. Van Dyke as an Audit Committee Financial Expert.

EXECUTIVE COMPENSATION

Report of the Management Organization and Compensation Committee

Overview

The Management Organization and Compensation Committee is responsible for developing the Company s philosophy and structure for executive compensation. Consistent with this philosophy, on an annual basis the Committee determines the compensation of the Chief Executive Officer and reviews the compensation of the other executive officers.

Compensation plans that provide for grants or awards of Company stock to executive officers are approved by the Board of Directors and the shareholders of the Company. In 1993, the Internal Revenue Code (the Code) was amended to include a deductibility limit for remuneration to certain executive officers [Section 162(m) of the Code]. Qualified performance-based compensation is not subject to this deductibility limit. The Graco Inc. Stock Incentive Plan, which permits grants of stock options and stock appreciation rights to executive officers, meets the requirements of Section 162(m) in all respects.

In order to qualify annual incentive awards to the Chief Executive Officer and other executive officers as performance-based compensation under Section 162(m) of the Code, the Company has an Executive Officer Annual Incentive Bonus Plan. This Plan meets the requirements of Section 162(m) in all respects.

Executive Compensation Philosophy and Structure

It is the Company s philosophy to set its executive compensation structure at a level competitive with durable goods manufacturers of comparable sales volume and geographic scope. The salary ranges within this compensation structure are determined by consulting a variety of independent third-party executive compensation surveys and resources.

Executive compensation is delivered through:

- base salaries that recognize the experience and performance of individual executives;
- performance-driven incentives that:
  - enhance shareholder value;
  - balance annual and long-term corporate objectives; and
  - provide meaningful amounts of Company stock; and
- competitive benefits.

<u>Components of Executive Compensation</u>

Base Salary ranges are established using salary and trend data for durable goods manufacturers of comparable sales volume and geographic scope using a variety of independent third-party executive compensation surveys and resources. Executive positions will be individually benchmarked against these survey sources not less than every other year and multiple surveys will be used to establish a competitive salary range for each position. The target for base salary ranges will be the median of the defined marketplace.

The actual base salary of each executive officer within the range is determined by the executive s performance, which is evaluated annually by the Chief Executive Officer and reviewed by the Committee. Other factors that may influence the level of individual executive base pay may include current position in salary range, internal pay relationships, and retention considerations.

The **Executive Officer Annual Incentive Bonus Plan** (the Executive Bonus Plan) was available in 2003 to the Chief Executive Officer and any other executive designated by the Committee. The Committee is authorized to establish financial growth targets for each participant that are directly and specifically tied to one or more financial measures. On or before the 90th day of the Company s fiscal year, the Committee identifies the participants, establishes the Targeted Bonus Maximum Percentages for each participant, establishes the applicable Financial Measures and the Company Performance Target(s) for each Financial Measure, as these terms are defined in the Executive Bonus Plan. At the close of the fiscal year, the Committee certifies whether or not the Company Performance Target(s) have been attained. Using a variety of independent third-party executive compensation surveys and resources, the Committee establishes competitive payout levels for achievement of the Executive Bonus Plan metrics. In 2003, the Committee established payouts for Mr. Roberts, the sole Executive Bonus Plan participant, from 0 to 90% of base salary paid.

The **Annual Bonus Plan** covers executive officers and select managers that do not participate in the Executive Bonus Plan. The Annual Bonus Plan, available in 2003 to 10 executive officers and 34 managers, is structured to encourage growth in both sales and net earnings by the Company. The Plan determines individual payout amounts for executive officers by measuring Company performance against corporate sales and net earnings growth targets, which are established by the Committee in the first quarter of each year to be competitive with durable goods manufacturers of comparable sales volume and geographic scope. In addition, the Chief Executive Officer has been given the authority to establish divisional and regional growth targets for the executive officers and select managers assigned to specific divisions and regions. Overall performance for determining the payout amounts for the divisional and regional executive officers and select managers is measured against divisional, regional and corporate targets.

The Annual Bonus Plan payout for each executive officer assigned to a specific operation, division or region was determined by evaluating performance against the established targets for that operation, division or region, and corporate sales and net earning results against the corporate targets. The bonus payout for the executive officers in charge of corporate staff functions was determined using corporate sales and net earnings results. For 2003, corporate sales results led to an award of the maximum payout attributable to sales, which was 50% of the total payout. Corporate net earnings results led to an award of the maximum payout attributable to net earnings, which was 50% of the total payout. In 2003, the Committee established a range of payouts for executive officer positions under the Annual Bonus Plan from 0 to 70% of base salary paid.

CEO Awards. Under this program, a total of $89,000 in individual discretionary awards were granted to recognize significant contributions of selected executive officers and other management employees. In 2003, CEO Awards were granted to 10 employees.

The **Executive Long Term Stock Incentive Program** is structured to align the interests of executive officers with those of all Graco shareholders. The Long Term Stock Incentive Program for 2003 consisted of stock options granted to executive officers under the Graco Inc. Stock Incentive Plan. The number of stock options granted to each executive officer was determined using competitive data for comparably sized durable good manufacturers, as reflected in independent third party long term incentive surveys. Stock option grants were targeted at the median of this market. These options were non-incentive stock options with a 10-year duration and a vesting schedule of 25 percent after each of years one, two, three, and four.

Executive Benefits are offered to all executive officers who are eligible to participate in the employee benefit programs available to all Graco employees and target the median practice of the external market.

Compensation of the Chief Executive Officer

On an annual basis, the Committee is responsible for reviewing the individual performance of the Chief Executive Officer, and determining appropriate adjustments in base pay and award opportunities under the Executive Bonus Plan and the Stock Incentive Plan.

In 2003, Mr. Roberts served as Chief Executive Officer of the Company. The Committee, using salary survey data, established Mr. Roberts base salary at $485,000 per year. These data were based on comparably sized durable goods manufacturing companies, as published in independent third party executive compensation surveys. Mr. Roberts earned the maximum bonus award available under the Executive Bonus Plan of $436,500, which is equal to 90% of his base salary. The 2003 bonus award was based upon the achievement of specified levels of net sales and net earnings of the Company. Sales of $535 million in 2003 represent an increase in sales of 10% from 2002, which led to the maximum payout attributable to sales, which was 50% of the total payout. Net earnings of $87 million in 2003 represent an increase in net earnings of 15% from net earnings in 2002, which led to the maximum payout attributable to net earnings, which was 50% of the total payout.

Review of the 2003 performance of the Chief Executive Officer was conducted by the Committee. Based on this review, the Committee increased Mr. Roberts base salary from $485,000 to $510,000 effective January 1, 2004. For 2004, Mr. Roberts will participate in the Executive Bonus Plan, with a minimum payout of 0% of base salary and a maximum payout of 100% of base salary.

The Members of the Management Organization and Compensation Committee
Ms. Martha A.M. Morfitt, Chair
Mr. Robert G. Bohn
Mr. William J. Carroll
Mr. J. Kevin Gilligan
Mr. Lee R. Mitau
Mr. Mark Rauenhorst

Comparative Stock Performance Graph

The graph below compares the cumulative total shareholder return on the common stock of the Company for the last five fiscal years with the cumulative total return of the S&P 500 Index and of the Dow Jones Factory Equipment Index over the same period (assuming the value of investment in Graco common stock and each index was 100 on December 24, 1998, and all dividends were reinvested).

Five Year* Cumulative Total Shareholder Return

*Fiscal Year Ended Last Friday in December

Summary Compensation Table

The following table shows both annual and long-term compensation awarded to or earned by the Chief Executive Officer and the four most highly compensated executive officers of the Company whose total annual salary and bonus for 2003 exceeded $100,000.

		Annual Compensation			Long Term Compensation Awards		
(a)	**(b)**	**(c)**	**(d)**	**(e)**	**(f)**	**(g)**	**(h)**
Name and Principal Position	**Year**	**Salary ($)[1,2]**	**Bonus ($)[1,3]**	**Other Annual Compen-sation ($)**	**Restricted Stock Award(s) ($)[4]**	**Securities Underlying Options/ SARs (#)**	**All Other Compen-sation ($)[5]**
David A. Roberts	2003	486,290	436,500	0	0	72,000	6,000
President and Chief	2002	451,269	329,144	0	0	60,000	5,767
Executive Officer	2001	224,514	38,175	0	115,800	75,000	0
Dale D. Johnson	2003	254,366	177,800	0	0	18,000	6,000
Vice President,	2002	241,846	142,560	0	109,125	15,000	6,000
Contractor Equipment Division	2001	252,469	57,975	0	0	30,000	5,100
Charles L. Rescorla	2003	208,435	145,600	0	0	18,000	6,000
Vice President,	2002	196,502	108,316	0	109,125	15,000	5,553
Manufacturing/ Distribution Operations	2001	185,170	21,671	0	0	15,000	5,100

			Annual Compensation		Long Term Compensation Awards		
and Information Systems							
Patrick J. McHale	2003	198,177	127,870	0	0	15,000	6,000
Vice President,	2002	180,156	112,241	0	109,125	11,250	6,000
Lubrication Equipment Division	2001	170,093	56,529	0	0	11,250	5,100
Robert M. Mattison	2003	191,874	133,770	0	0	10,000	4,301
Vice President, General	2002	182,414	103,538	0	65,475	7,500	6,000
Counsel and Secretary	2001	175,314	23,152	0	0	7,500	5,100

(1) Deferred compensation is included in Salary and Bonus in the year earned.

(2) In addition to base salary, the reported figure includes amounts attributable to the imputed value of the group term life insurance benefit for each of the named executive officers.

(3) Bonus includes any awards under the Executive Bonus Plan, the Annual Bonus Plan and the CEO Award Program (formerly known as the Chairman s Award Program) described in the Management Organization and Compensation Committee Report. CEO Award Program awards of $12,000 were made to Mr. McHale in 2003 and $15,000 to Mr. Rescorla in 2002.

(4) Restricted stock grants were made to Mr. Johnson, Mr. Rescorla, Mr. McHale and Mr. Mattison on May 7, 2002, in the amount shown on the table. The restrictions will lapse on May 7, 2005. A restricted stock grant was made to Mr. Roberts on June 25, 2001, in the amount shown on the table. The restrictions will lapse on June 25, 2004.

(5) The compensation reported includes the Company contributions under the Graco Employee Investment Plan (excluding employee contributions). For 2003, the Company contribution accrued under the Graco Employee Investment Plan for each named executive officer was as follows: $6,000 for Mr. Roberts, $6,000 for Mr. Johnson, $6,000 for Mr. Rescorla, $6,000 for Mr. McHale and $4,301 for Mr. Mattison. The Company contribution under the Graco Employee Investment Plan is a dollar for dollar match up to the first 3% of employee contributions.

Option Grants Table (Last Fiscal Year)

The following table shows the stock options granted to the named executive officers during 2003, their exercise price and their grant date present value.

		Individual Grant			Grant Date Value[2]
(a)	**(b)**	**(c)**	**(d)**	**(e)**	**(f)**
Name	**Number of Securities Underlying Options Granted (#)[1]**	**% of Total Options Granted to Employees in Fiscal Year**	**Exercise or Base Price ($/Sh)**	**Expiration Date**	**Grant Date Present Value ($)**
David A. Roberts	72,000	29%	26.01	2/20/13	587,520
Dale D. Johnson	18,000	7%	26.01	2/20/13	146,880
Charles L. Rescorla	18,000	7%	26.01	2/20/13	146,880
Patrick J. McHale	15,000	6%	26.01	2/20/13	122,400
Robert M. Mattison	10,000	4%	26.01	2/20/13	81,600

(1) Non-incentive stock options were granted on February 20, 2003, in the amount shown on the table. The options become exercisable in equal installments over four years, beginning with the first anniversary date of the grant.

(2) The Black-Scholes option pricing model has been used to determine the grant date present value. Annual volatility was calculated using monthly returns for 36 months prior to the grant date, the interest rate was set using U.S. Treasury securities of similar duration to the option period as of the grant date, and dividend yield was established as the yield on the grant date. A 10% discount for nontransferability and 3% discount to reflect the possibility of forfeiture over a two-year period were applied. For grants expiring on February 20, 2013, the assumptions used in the model were annual volatility of 25.24%, interest rate of 3.96%, dividend yield of 1.24%, and time to exercise of 10 years.

Aggregated Option Exercises in Last Fiscal Year And Fiscal Year-End Option Values

The following table shows the value of outstanding in-the-money options at the end of the fiscal year 2003 for the named executive officers.

(a) Name	(b) Shares Acquired on Exercise (#)	(c) Value Realized ($)[1]	(d) Number of Securities Underlying Unexercised Options at FY-End (#) Exercisable/ Unexercisable	(e) Value of Unexercised In-the-Money Options at FY-End ($)[2] Exercisable/ Unexercisable
David A. Roberts	0	0	52,000/154,500	908,775/2,293,455
Dale D. Johnson	34,500	751,331	41,250/72,375	978,150/1,495,883
Charles L. Rescorla	35,437	1,112,266	47,814/45,186	1,238,710/801,541
Patrick J. McHale	28,296	575,431	0/33,279	0/553,550
Robert M. Mattison	11,250	196,763	26,251/28,749	668,420/535,369

(1) Value realized is the difference between the sale price of the Company s common stock on the date of exercise and the option exercise price multiplied by the number of shares received.

(2) Value at fiscal year-end is the difference between $40.05, the closing price of the Company s common stock on December 26, 2003, and the option price multiplied by the number of shares subject to option.