

GRACO INC  
Form DEF 14A  
March 11, 2015  
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**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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- (1) Amount Previously Paid:
  
- (2) Form, Schedule or Registration Statement No.:
  
- (3) Filing Party:
  
- (4) Date Filed:

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GRACO INC.

88 Eleventh Avenue N.E.

Minneapolis, MN 55413

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

Dear Shareholder:

The 2015 Annual Meeting of Shareholders of Graco Inc. will be held on April 24, 2015, beginning at 1:00 p.m. Central Time. **We are pleased to inform you that this year's meeting will be our first completely virtual meeting of shareholders.** You may attend the meeting and vote your shares electronically during the meeting via live webcast by visiting [www.virtualshareholdermeeting.com/GGG2015](http://www.virtualshareholdermeeting.com/GGG2015). You will need the 12-digit control number that is printed in the box marked by the arrow on your Notice Regarding the Availability of Proxy Materials to enter the annual meeting. We recommend that you log in at least fifteen minutes before the meeting to ensure you are logged in when the meeting starts.

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 2015.
3. An advisory, non-binding resolution to approve our executive compensation.
4. Approval of the Graco Inc. 2015 Stock Incentive Plan.
5. Transaction of such other business as may properly come before the meeting.

Shareholders of record at the close of business on February 23, 2015, are entitled to vote at this meeting or any adjournment.

We encourage you to join us via the Internet and vote at the meeting. Regardless of whether you plan on joining the meeting, we encourage you to vote by Internet, or by requesting a paper copy and voting by telephone or by 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 online during 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. Instructions on how to vote while participating in the meeting live via the Internet are posted at [www.virtualshareholdermeeting.com/GGG2015](http://www.virtualshareholdermeeting.com/GGG2015).

Sincerely,

Patrick J. McHale  
President and Chief Executive Officer  
March 11, 2015

Karen Park Gallivan  
Secretary

Minneapolis, Minnesota

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**GENERAL REQUESTS FOR GRACO INC. 2014 ANNUAL REPORT ON FORM 10-K**

The Graco Inc. 2014 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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GRACO INC.

88 Eleventh Avenue N.E.

Minneapolis, MN 55413

**PROXY STATEMENT**

**FOR ANNUAL MEETING OF SHAREHOLDERS**

**TO BE HELD APRIL 24, 2015**

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, 2015 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 11, 2015, 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 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 approval of the Graco Inc. 2015 Stock Incentive Plan 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 in an uncontested election is a majority of votes cast, where the number of votes cast for a nominee exceeds the number of votes cast against a nominee. In a contested election, the vote required for the election of directors is a plurality of votes cast. In the event an incumbent director does not receive a sufficient number of the votes cast for re-election, our Corporate Governance Guidelines require that the director promptly offer to tender his or her resignation to the Board. The Governance Committee will make a recommendation to the Board on whether to accept or reject the offer. The Board, taking into account the recommendation of the Governance Committee, will decide whether to accept or reject the offer, and will publicly disclose its decision and the rationale behind it within 90 days after the date of the election. The vote required to ratify the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year 2015 and the vote to approve the Graco Inc. 2015 Stock Incentive Plan is 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. An abstention will have no effect on the election of directors or the vote on our executive compensation, but will have the effect of a vote against the ratification of the appointment of Deloitte and Touche LLP and a vote against approval of the Graco Inc. 2015 Stock Incentive Plan.

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Only shareholders of record as of the close of business on February 23, 2015 may vote at the Meeting. As of that date, there were 58,889,076 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.

## **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, 24 hours a day, seven days a week, prior to 11:59 p.m., Eastern Time, on April 23, 2015. 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, 24 hours a day, seven days a week, prior to 11:59 p.m., Eastern Time, on April 23, 2015. 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 to be received no later than April 23, 2015.

4. **Vote Online During the Meeting.**

You may vote online during the Meeting through the link [www.virtualshareholdermeeting.com/GGG2015](http://www.virtualshareholdermeeting.com/GGG2015). The 12-digit control number provided on your Notice or proxy card is necessary to access this site.

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**

On September 5, 2014, one of our directors, William G. Van Dyke, passed away. Mr. Van Dyke was an invaluable member of our Board. He helped shape the Company's strategic vision, and served with distinction on our Board and numerous other boards in the Twin Cities. He will be deeply missed.

## **Nominees and Continuing Directors**

The following information is given with respect to the three nominees for election at the Meeting and the other five 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.

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**Nominees for election at the Meeting to terms expiring in 2018:**

**William J. Carroll**

Mr. Carroll, 70, 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, 69, was President and Chief Executive Officer of Musicland Stores Corporation, a retail music and home video company, from 1980 until his retirement in January 2001. He also served as Chairman of Musicland Stores from 1986 until his retirement. 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., and from 2000 until 2007, he was a director of Golf Galaxy, Inc. From 1991 until 2005, Mr. Eugster served as a director of ShopKo Stores, Inc., and was Chairman of the Board from 2001 until 2005. 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, 76, has been a Senior Operating Partner at Tenex Capital Management, L.P., a private equity firm, since December 2013, and a Special Advisor at Yukon Partners II, LLC, a provider of mezzanine financing for middle-market private equity transactions, since July 2014. From September 2012 until December 2013, he was a Senior Advisor at Tenex. He also serves as the Chairman or as a director of several portfolio companies of Tenex. In addition to actively advising private equity funds and their portfolio companies, Mr. Van Sant may from time to time take ownership interests in the funds and portfolio companies he advises. 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 an 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.

**Directors whose terms continue until 2016:**

**Eric P. Etchart**

Mr. Etchart, 58, is Senior Vice President, Business Development of The Manitowoc Company, Inc., a manufacturer of cranes and foodservice equipment. He assumed this role in January 2015. Mr. Etchart served as President of Manitowoc Cranes and Senior Vice President of The Manitowoc Company, Inc. from 2007 until January of 2015. 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 over thirty years of global manufacturing experience, as well

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as extensive knowledge of and expertise in finance and marketing. Mr. Etchart, a French-national with over twenty years of experience in management positions outside of the U.S., including positions in China, Singapore, Italy, 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.

### **J. Kevin Gilligan**

Mr. Gilligan, 60, is Chairman and Chief Executive Officer of Capella Education Company, an online education provider. He has served as Chief Executive Officer of Capella Education since March 2009, and as Chairman since February 2010. 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-five 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.

### **Directors whose terms continue until 2017:**

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

Mr. McHale, 53, 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 over twenty-five 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, 66, was Executive Vice President and General Counsel of U.S. Bancorp, the fifth-largest commercial bank in the United States by assets, from 1995 until his retirement in March 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-four 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, 57, 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. 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

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strategic and product marketing guidance. With nineteen 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.

## **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 tender the director's resignation if his or her employment status significantly changes, and 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 director has current, substantial engagement in business activities that require skills relevant to Graco's business and useful to the Board. In August 2014, Mr. Van Sant reached age 76. At its September 2014 meeting, the Board considered whether Mr. Van Sant had current, substantial engagement in business activities that require skills relevant to our Company's business and useful to the Board. The Board once again unanimously determined that it would waive the mandated retirement of Mr. Van Sant, which waiver shall be reviewed annually, because Mr. Van Sant's current and substantial engagement with private equity firms and their portfolio companies requires skills relevant to Graco's business and useful to the Board.

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 has retained an independent search firm as a resource to assist with future candidate sourcing and succession planning.

## **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.

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

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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 and any beneficial owner on whose behalf the nomination is made, as they appear in our Company's stock register; (iii) the number of shares of capital stock of our Company which are beneficially owned by, or any other direct or indirect interest in the capital stock of our Company held by, each such nominee and 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 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 have any relationship with our Company other than as a director and shareholder.

## **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, in the wake of difficult or volatile economic times such as those experienced during the economic recession of the late 2000's, 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.

## **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. 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 2014, our Board of Directors met five times. Every current 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 2014, 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.

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**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, 2015, the record date, was as follows:

<u>Audit</u>	<u>Governance</u>	<u>Management Organization and Compensation</u>
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	R. William Van Sant	Lee R. Mitau
R. William Van Sant		Martha A. Morfitt

**Audit Committee** (8 meetings in fiscal year 2014)

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 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** (3 meetings in fiscal year 2014)

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** (3 meetings in fiscal year 2014)

The Management Organization and Compensation Committee is composed entirely of directors who meet the independence requirements of the New York Stock Exchange. 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

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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 September 20, 2013.

**COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION**

None of the members of the Board who served on the Management Organization and Compensation Committee during 2014 has ever been an officer or employee of our Company or any of its subsidiaries.

**DIRECTOR COMPENSATION**

<b>Non-Employee Director Compensation<sup>(1)</sup></b>	<b>Amount</b>
Annual Equity Grant	\$115,000 <sup>(2)</sup>
Annual Board Retainer	\$50,500
Annual Chair Retainer	\$75,000
Board Meeting Fees	\$1,500 per in-person meeting/\$750 telephonic
Committee Meeting Fees	\$1,200 per in-person meeting/\$600 telephonic
Annual Committee Chair Retainer:	
Audit Committee	\$15,000
Compensation Committee	\$10,000
Governance Committee	\$7,500

(1) Effective May 1, 2014, except for annual equity grant, which became effective February 13, 2014.

(2) Approximate economic value of annual equity grant based on Black-Scholes value per share on the date immediately prior to the date of grant.

Effective May 1, 2014, the annual retainer paid to each non-employee director of Graco, except the non-employee Chairman, was increased from \$38,000 to \$50,500. The non-employee Chairman continues to be paid at the rate of \$75,000 per annum. Effective May 1, 2014, the annual retainer for the Chair of the Governance Committee was increased from \$5,000 to \$7,500, the annual retainer for the Chair of the Management Organization and Compensation Committee was increased from \$7,500 to \$10,000, and the annual retainer for the Chair of the Audit Committee was increased from \$10,000 to \$15,000. The non-employee directors receive 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.

Non-employee directors receive an annual option grant. In 2014, non-employee directors received an annual option grant of 4,646 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 \$24.75 per share on April 23, 2014, and an economic value of approximately \$115,000. 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 2014. Options granted to non-employee directors are issued under the Graco Inc. 2010 Stock Incentive Plan and will, if approved by our shareholders, be granted under the Graco Inc. 2015 Stock Incentive Plan going forward. The options 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 plans. The

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plans define 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.

Our Board's philosophy is to target retainer and meeting fee compensation at a level approximately comparable to the median of the market, and to target equity compensation in the form of stock options at a level approximately comparable to the 75<sup>th</sup> percentile of the market, in order to attract and retain capable board members, to encourage above-market Company performance, and to strengthen the link between our director compensation program and the interests 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 2014 meeting. The peer companies selected for the comparison matched the peer group identified for executive compensation on page 21 of the Compensation Discussion and Analysis section of the Proxy Statement for the 2014 Annual Meeting of Shareholders. In reviewing the peer group comparison, the Governance Committee concluded that the current base retainer and the retainers for the Governance Committee Chair, the Management Organization and Compensation Committee Chair, and the Audit Committee Chair fell below the median of the peer group. The Governance Committee also concluded that the current economic value of its equity compensation fell below the 75<sup>th</sup> percentile of the peer group. As a result, the Board of Directors, upon recommendation of the Governance Committee, determined that, effective May 1, 2014, the annual base retainer for non-employee directors (excluding the Chairman) would increase from \$38,000 to the peer group median of \$50,500, the Governance Committee Chair annual retainer would increase from \$5,000 to the peer group median of \$7,500, the Management Organization and Compensation Committee Chair annual retainer would increase from \$7,500 to the peer group median of \$10,000, and the Audit Committee Chair annual retainer would increase from \$10,000 to the peer group median of \$15,000. The Board of Directors, upon recommendation of the Governance Committee, also determined that the economic value of the annual option grant for non-employee directors and the initial option grant for non-employee directors first joining the Board would increase from \$102,000 to \$115,000, which is approximately at the 75<sup>th</sup> percentile of the peer group.

Our Governance Committee requested that the Graco Compensation Department conduct a peer group comparison of director compensation and present such data at its February 2015 meeting. The peer companies used for the 2015 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 approximately at the 75<sup>th</sup> percentile of the peer group, so no changes were proposed for 2015.

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. The annual retainer calculation is set at the rate then in effect for the non-Chairman annual retainer and does 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 and Ms. Morfitt upon their respective retirements. Mr. Van



Dyke's retirement benefit of \$252,500 was paid to his estate in one lump sum, which amount was equal to the total amount of the payments that would have been made had he retired on the date of his death and survived to the date of the final payment.

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The following table summarizes the total compensation paid to or earned by our non-employee directors for their service during the fiscal year ended December 26, 2014:

Name	Fees Earned or		Change in Pension Value and Nonqualified Deferred		Total
	Paid in Cash <sup>(1)</sup>	Stock Awards <sup>(2)</sup>	Option Awards <sup>(3)</sup>	Compensation Earnings <sup>(4, 5)</sup>	
	(\$)	(\$)	(\$)	(\$)	(\$)
William J. Carroll	58,475	19,492	112,227		190,194
Eric P. Etchart	46,625	15,308	112,227		174,160
Jack W. Eugster	13,875	59,325	112,227		185,427
J. Kevin Gilligan		63,433	112,227		175,660
Lee R. Mitau		95,767	112,227	59,000	266,994
Martha A. Morfitt		59,223	112,227	59,000	230,450
William G. Van Dyke	40,908		112,227	59,000	212,135
R. William Van Sant		64,633	112,227		