UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15 (d) of the
Securities Exchange Act of 1934

For the quarterly period ended March 28, 1997

Commission File Number: 1-9249

GRACO INC.

(Exact name of Registrant as specified in its charter)

Minnesota	41-0285640
(State of incorporation)	(I.R.S. Employer Identification Number)

4050 Olson Memorial Highway Golden Valley, Minnesota	55422
(Address of principal executive offices)	(Zip Code)

(612) 623-6000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

17,124,485 common shares were outstanding as of April 30, 1997.

GRACO INC. AND SUBSIDIARIES

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PART I

GRACO INC. AND SUBSIDIARIES

Item I. CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	Thirteen Weeks Ended	
	March 28, 1997	March 29, 1996
	(In thousands except per share amounts)	
Net Sales	$92,099	$90,153
Cost of products sold	47,566	45,316
Gross Profit	44,533	44,837
Product development	4,825	4,229
Selling	21,633	19,850
General and administrative	8,555	11,675
Operating Profit	9,520	9,083
Interest expense	(207)	(232)
Other income (expense), net	368	(566)
Earnings Before Income Taxes	9,681	8,285
Income taxes	3,500	2,700
Net Earnings	$6,181	$5,585
Net Earnings Per Common and Common Equivalent Share	$.35	$.32
Cash Dividend Per Common Share	$.14	$.12

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 28, 1997	December 27, 1996
ASSETS	(In thousands)	
Current Assets:		
Cash and cash equivalents	$1,378	$6,535
Accounts receivable, less allowances of $4,614 and $4,700	81,061	83,474
Inventories	47,609	41,531
Deferred income taxes	12,107	11,633
Other current assets	1,653	1,321
Total current assets	143,808	144,494
Property, Plant and Equipment:		
Cost	185,782	183,085
Accumulated depreciation	(89,138)	(88,913)
	96,644	94,172
Other Assets	8,624	9,148
	$249,076	$247,814
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Notes payable to banks	$7,302	$3,813
Current portion of long-term debt	1,827	1,845
Trade accounts payable	13,132	13,854
Salaries, wages & commissions	10,753	14,808
Accrued insurance liabilities	11,624	10,925
Income taxes payable	7,622	4,647
Other current liabilities	23,325	30,718
Total current liabilities	75,585	80,610
Long-term Debt, less current portion	7,618	8,075
Retirement Benefits and Deferred Compensation	33,271	33,079
Shareholders' Equity:		
Common stock	17,218	17,047
Additional paid-in capital	24,873	22,254
Retained earnings	88,994	85,232
Other, net	1,517	1,517
Total Stockholder's Equity	132,602	126,050
	$249,076	$247,814

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Thirteen Weeks	
	March 28, 1997	March 29, 1996
CASH FLOWS FROM OPERATING ACTIVITIES:	(In thousands)	
Net Earnings	$6,181	$5,585
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	3,548	3,299
Deferred income taxes	(481)	(605)
Change in:		
Accounts receivable	(61)	52
Inventories	(6,688)	(3,355)
Trade accounts payable	(419)	(367)
Retirement benefits and deferred compensation	571	89
Other accrued liabilities	(7,029)	887
Other	(1,453)	(1,084)
	(5,831)	4,501
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property, plant and equipment additions	(6,340)	(4,485)
Proceeds from sale of property, plant, and equipment	1,578	5
	(4,762)	(4,480)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowing on notes payable and lines of credit	5,335	1,937
Payments on notes payable and lines of credit	(1,528)	(1,662)
Payments on long-term debt	(326)	-
Common stock issued	2,790	2,271
Retirement of common and preferred stock	-	(446)
Cash dividends paid	(2,420)	(2,126)
	3,851	(26)
Effect of exchange rate changes on cash	1,585	465
Net increase (decrease) in cash and cash equivalents	(5,157)	460
Cash and cash equivalents:		
Beginning of year	6,535	1,643
End of period	$1,378	$2,103

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The consolidated balance sheet of Graco Inc. and Subsidiaries (the Company) as of March 28, 1997 and the related statements of earnings and cash flows for the thirteen weeks ended March 28, 1997, and March 29, 1996, have been prepared by the Company without being audited.

   In the opinion of management, these consolidated statements reflect all adjustments necessary to present fairly the financial position of Graco Inc. and Subsidiaries as of March 28, 1997, and the results of operations and cash flows for all periods presented.

   Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. Therefore, these statements should be read in conjunction with the financial statements and notes thereto included in the Company's 1996 Form 10-K.

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

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

	March 28, 1997	Dec. 28, 1996
Finished products and components	$44,595	$38,707
Products and components in various stages of completion	28,289	24,691
Raw materials	12,334	15,192
	85,218	78,590
Reduction to LIFO cost	(37,609)	(37,059)
	$47,609	$41,531

3. Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share," was issued in February 1997 and requires adoption for annual periods ending after December 15, 1997. Earnings per Share determined in accordance with SFAS No. 128 are not materially different than the current disclosure under APB Opinion No. 15.

Item 2. GRACO INC. AND SUBSIDIARIES

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

Results of Operations

Net earnings in the first quarter increased 11% over the same period last year. The earnings improvement was driven by reduced operating expenses, a gain on the sale of the Company's Franklin Park, Illinois facility and higher sales. A reduced gross margin rate, foreign currency translation losses and a higher effective tax rate had a negative impact on earnings for the quarter.

The following table sets forth items from the Company's Consolidated Statements of Earnings as percentages of net sales:

	First Quarter (13 weeks) Ended	
	1996	1997
Net Sales	100.0%	100.0%
Cost of Products Sold	51.6	50.3
Product Development	5.2	4.7
Selling	23.6	22.0
General and Administrative	9.3	12.9
Operating Profit	10.3	10.1
Interest Expense	(.2)	(.3)
Other Income(Expense), Net	.4	(.6)
Earnings Before Income Taxes	10.5	9.2
Income Taxes	3.8	3.0
Net Earnings	6.7%	6.2%

Net Sales

Net sales in the first quarter of $92.1 million were 2 percent higher than last year. The increased sales level was achieved despite a negative currency impact, which reduced sales by 2 percent.

Industrial/Automotive Division sales improved 6 percent to $50.2 million, driven by strong demand for industrial products across all three geographic regions, the Americas, Europe and Asia Pacific. Contractor Division sales of $31.3 million were 4 percent lower than last year due in part to the introduction of an upgraded product line in North America. The late quarter introduction held down sales early in the quarter as customers anticipated the new product release. Additionally, a new pricing structure in the Contractor Division was implemented in 1997 which is expected to result in a seasonal change in demand, versus price promotions in 1996 which forced more activity into the first quarter. Lubrication Division sales increased 6 percent to $10.6 million, reflecting a healthy North American economy, an increased key distributor base and the benefit of new product introductions late in 1996.

Geographically, sales in the Americas increased 1 percent to $62.6 million primarily due to strong Industrial activity, partially offset by the soft start in the Contractor Division and sluggish automotive system's activity. European sales of $16.9 million were 7 percent higher than last year (including a 5 percent decline due to exchange rates). Asia Pacific sales of $12.6 million were 1 percent higher than last year (including a 8 percent decline due to exchange rates). The growth in Europe and Asia Pacific was attributable primarily to strong automotive system's activity and improved results in the Contractor Division.

Gross Profit

Gross profit as a percentage of net sales declined to 48.4 percent in the first quarter, compared with 49.7 percent for the same period last year. The decrease was primarily the result of a shift in the product mix within the Contractor Division to an upgraded product line which generates a lower margin than other products. The strengthening of the U.S. dollar also reduced the gross margin as a greater proportion of the Company's sales are denominated in currencies other than the U.S. dollar than are costs.

Operating Expenses

Operating expenses in the first quarter of $35.0 million decreased 2 percent from the first quarter of 1996. Product development expense increased 14 percent over 1996, reflecting the Company's commitment to expanding sales through the development of new products. Selling expenses were 9 percent higher than the same period last year, largely due to increased information systems development costs and distributor training programs, as well as the increased sales level. General and administrative costs declined 27 percent, as the first quarter of 1996 included expenses related to the relocation of the Company's Franklin Park, Illinois operations to Minneapolis.

Other Income (Expense)

Other income was $.4 million in the first quarter, compared with $.6 million of expense for the same period last year. The first quarter of 1997 was favorably impacted by a gain from the sale of the Company's Franklin Park, Illinois facility, which was partially offset by foreign currency translation losses.

Income Taxes

The effective income tax rate increased to 36 percent in the quarter compared with 33 percent last year. The higher rate in 1997 was principally due to higher effective rates on foreign earnings.

Liquidity and Capital Resources

The Company used $5.8 million of cash flow for operating activities in the first quarter of 1997 compared with generating cash from operations of $4.5 million in the first quarter of last year. Significant uses of operating cash flow in 1997 resulted from the reduction in other accrued liabilities, most significantly the reserve established in the prior year for the relocation of the Company's Franklin Park, Illinois operations. Operating cash flow was also used to fund an increase in inventory levels which was driven by higher engineered systems activity in the foreign operations and anticipated demand for the upgraded product line in the Contractor Division. Available cash and borrowing on lines of credit of $5.3 million were used to fund short-term operating needs, finance capital expenditures of $6.3 million and pay dividends of $2.4 million. The Company has unused lines of credit available at March 28, 1997 totaling $69.6 million. The available credit facilities and internally-generated funds provide the Company with the financial flexibility to meet liquidity needs.

Outlook

The Company is cautiously optimistic about the level of activity during the first quarter. Incoming orders in the first quarter exceeded sales by $7.3 million, increasing backlog to $26.4 million. The Company also expects to introduce a number of new products in 1997 and believes that the continued investments in product development, marketing and manufacturing should have a positive impact on the Company in 1997 and the long-term ability to grow profitably.

SAFE HARBOR CAUTIONARY STATEMENT

The information in this 10Q contains "forward-looking statements" about the Company's expectations of the future, which are subject to certain risk factors that could cause actual results to differ materially from those expectations. These factors include economic conditions in the United States and other major world economies, currency exchange fluctuations, and additional factors identified in Exhibit 99 to the Company's Report on Form 10-K for fiscal year 1996.

PART II

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

1997 Corporate and Business Unit Annual Bonus Plan	Exhibit 10
Statement on Computation of Per Share Earnings	Exhibit 11
Financial Data Schedule	Exhibit 27

(b) No reports on Form 8-K have been filed during the quarter for which this report is filed.

SIGNATURES

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

GRACO INC.

Date: May 9, 1997

By: /s/ James A. Graner
James A. Graner
Vice President and Controller
("duly authorized officer")

Date: May 9, 1997

By: /s/ Mark W. Sheahan
Mark W. Sheahan
Treasurer
(Principal Financial Officer)

GRACO INC.

1997 CORPORATE

&

BUSINESS UNIT

ANNUAL BONUS PLAN

Effective January 1, 1997
Human Resources

1997 EXECUTIVE CORPORATE & SBU BONUS PLAN

Objectives

- - To create shareholder value through achievement of annual financial objectives.

- - To motivate and retain those key executives and managers who work in positions where they can impact the Company's annual financial objectives.

Plan Design

The Plan links the size of each individual's award to specific financial objectives. These objectives are tailored for the Corporation and for each Business Unit. These objectives are:

- Corporation
  - Corporate Sales and/or Net Earnings objectives

- Business Units
  - Sales and/or Contribution Growth objectives

Eligibility Requirements

Only those positions which carry clear managerial responsibility for directly contributing to Graco's Corporate Sales and/or Net Earnings objective and Business Unit Sales and/or Contribution Growth objectives are eligible to be included in this Plan.

Only those individuals in eligible positions who have demonstrated and are maintaining a performance level that meets the supervisor's normal expectations for that position are eligible for annual participation in this Plan as well as the receipt of any annual Bonus Payments.

Participation

The top executive in each organizational unit may nominate managers for participation in this Plan when the established position and individual eligibility requirements have been met.

The Management Organization and Compensation Committee of the Graco Inc. Board of Directors has sole authority to approve the participation of the Chief Executive Officer in the Plan.

The Chief Executive Officer of Graco Inc. has sole authority to select and approve all other Plan participants.

Bonus Maximum

Taken in conjunction with base salary market comparisons, bonus maximum for all positions will be:

- Commensurate with the position's ability to impact the annual Corporate Sales and/or Net Earnings objective and Business Unit Sales and/or Contribution Growth objectives.

- Consistent with total compensation levels prevalent for similar positions in the market place.

Based on these criteria, bonus maximums ranging from 10% to 80% have been established for each individual.

Bonus Payment

The determination of a participant's annual Bonus Payment will be calculated by adding the bonus results attained for Corporate Sales and/or Net Earnings performance (expressed in percent) to the bonus results attained for any applicable Business Unit's Sales and/or Contribution Growth performance (expressed in percent). These bonus results are then multiplied by the participant's Maximum Bonus Percentage and then multiplied by the participant's Base Salary for the Plan Year, to determine the total Bonus Payment.

Example:

Annual Corporate Performance Results	+	Annual Business Unit Performance Results (if applicable)	x	Participant's Maximum Bonus Salary	x	Participant's Annual Base Salary	=	Bonus
%		%		$		$		$

Administration

The following rules have been established to insure equitable administration of Graco's Annual Bonus Plan (the Plan):

1. The Plan will be administered by the Management Organization and Compensation Committee of the Board of Directors. The Committee may cancel the Plan and interpret the Plan.

2. The Management Organization and Compensation Committee shall establish the Annual Corporate Bonus Plan financial objectives. Within the basic framework of the Plan, the Chief Executive Officer may establish the annual bonus plan financial objectives for individual Business Units. The CEO may also establish deadlines for filing administrative forms and adopt other administrative rules.

   The CEO has established the Bonus Administrative Committee consisting of the President, the Vice President, Human Resources, and the Compensation Manager. This Committee is responsible for making approval recommendations on all Annual Bonus Program administrative matters, such as participation award payments, performance measures, and performance results. All requests for adjustments or exceptions are to be formally submitted to this Committee for review through the Compensation Manager.

3. Key executives and managers selected to participate in the Plan after its annual effective date (January 1st) may be included on a pro-rata basis.

4. Participation in the Plan one year does not necessarily assure participation in subsequent years. Eligibility requirements for both the position and individual performance must be met continually.

5. Participation continues during any paid time off such as short-term disability (up to six months). Participation ceases with retirement, death, or long-term disability (over six months). In the event participation ceases due to retirement, death, or long term disability, the Participant will be eligible for a Bonus Payment, calculated using the Maximum Bonus Percent and Base Salary up to the time of retirement, death, or long-term disability and the annual performance results for the year in which retirement, death, or long-term disability occurs.

6. A participant who transfers to a position not eligible for inclusion in the Plan will be eligible for a pro-rata award based on the actual time employed in the eligible position during the year. The pro-rated award will be paid as described in Administrative Rule #11.

7. A participant who resigns or is terminated effective during the Plan Year is ineligible for a bonus.

   Participants must maintain satisfactory performance throughout the Plan year in order to be eligible to receive a bonus award payment.

   In addition, a participant whose employment termination has been requested due to performance or otherwise for cause will be ineligible for a bonus payment even though the participant is still employed at year-end.

8. Corporate Sales and Net Eearnings calculations will include such effects as those created by foreign exchange gain/loss translation and income tax rate changes.

9. Corporate Sales and/or Net Earnings calculations will be based on actual exchange rates, not plan rates.

10. Acquisitions and divestitures not included in the annual business plan for the Plan Year will be excluded from the Corporate Sales and/or Net Earnings calculations.

11. Significant changes in historical FASB accounting practices or income tax rates will be included in corporate earnings calculations at the discretion of the Management Organization and Compensation Committee of the Board of Directors.

12. Payments will be made by March 15th of the year following each successive Corporate and Business Unit performance year.

1997

Corporate Performance Results and Awards

for 100% Corporate Participants

1997 Corporate Net Earnings Results	Percent of Maximum Bonus Award Earned
$30,000	0.00%
$34,000	18.75%
$38,000	37.50%
$41,500	56.25%
$45,000	75.00%

1997 Corporate Sales Results	Percent of Maximum Bonus Award Earned
$400,000	0.00%
$410,000	6.25%
$420,000	12.50%
$430,000	18.75%
$440,000	25.00%

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Note: Calculations exclude acquisitions and divestitures which were not included in 1997 Annual Business Plan.

EXHIBIT 11

GRACO INC. AND SUBSIDIARIES

COMPUTATION OF NET EARNINGS PER COMMON SHARE

(Unaudited)

	Thirteen Weeks Ended	
	March 28, 1997	March 29, 1996
	(In thousands except per share amounts)	
Net earnings applicable to common stock:		
Net earnings	$6,181	$5,585
Average number of common and common equivalent shares outstanding:		
Average number of common shares outstanding	17,106	17,315
Dilutive effect of stock options computed on the treasury stock method	397	238
	17,503	17,553
Net earnings per common and common equivalent share	$.35	$.32

Primary and fully diluted earnings per share are substantially the same.

This schedule contains summary financial information extracted from Graco Inc. and subsidiaries consolidated statements of earnings and consolidated balance sheets for the quarterly period ending March 28, 1997 and is qualified in its entirety by reference to such financial statements.

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GRACO INC.
1,000
U.S. DOLLARS

3-MOS
DEC-26-1997
DEC-28-1996
MAR-28-1997
1
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81,061
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92,099
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6,181
.35
.35