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 September 28, 2001

Commission File Number: 001-9249

GRACO INC.
(Exact name of Registrant as specified in its charter)

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

88 - 11th Avenue N.E. Minneapolis, Minnesota	55413
(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 ___

31,090,328 common shares were outstanding as of October 31, 2001.

GRACO INC. AND SUBSIDIARIES

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PART I

Item I.

GRACO INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands except per share amounts)

(Unaudited)

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep. 28, 2001	Sep. 29, 2000	Sep. 28, 2001	Sep. 29, 2000
Net Sales	$118,651	$123,100	$359,338	$378,095
Cost of products sold	59,495	60,151	186,915	180,791
Gross Profit	59,156	62,949	178,547	191,180
Product development	4,666	5,324	16,664	15,244
Selling, marketing and distribution	20,285	20,569	61,398	66,743
General and administrative	8,813	8,531	26,106	25,985
Operating Earnings	25,392	28,525	74,379	83,208
Interest expense	261	985	1,066	3,522
Other expense	171	267	985	1,507
Earnings Before Income Taxes	24,960	27,273	72,328	78,179
Income taxes	8,200	9,200	24,200	26,800
Net Earnings	$ 16,760	$ 18,073	$ 48,128	$ 51,379
Basic Net Earnings Per Common Share	$ .54	$ .60	$ 1.56	$ 1.69
Diluted Net Earnings Per Common Share	$ .53	$ .59	$ 1.53	$ 1.66

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands)

(Unaudited)

	Sep. 28, 2001	Dec. 29, 2000
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 10,431	$ 11,071
Accounts receivable, less allowances of $4,200 and $4,700	85,111	85,836
Inventories	37,318	33,079
Deferred income taxes	10,711	11,574
Other current assets	2,338	2,182
Total current assets	145,909	143,742
Property, Plant and Equipment:		
Cost	206,779	186,872
Accumulated depreciation	(110,457)	(102,883)
	96,322	83,989

Other Assets	21,086	10,245
	$263,317	$237,976
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Notes payable to banks	$ 12,440	$ 15,713
Current portion of long-term debt	1,050	1,310
Trade accounts payable	10,768	12,899
Salaries, wages and commissions	9,932	14,532
Accrued insurance liabilities	11,595	10,622
Income taxes payable	8,436	4,642
Other current liabilities	23,967	22,123
Total current liabilities	78,188	81,841
Long-term Debt, less current portion	500	18,050
Retirement Benefits and Deferred Compensation	27,543	27,230
Shareholders' Equity:		
Common stock	31,074	20,274
Additional paid-in capital	50,412	39,954
Retained earnings	75,582	50,233
Other, net	18	394
Total shareholders' equity	157,086	110,855
	$263,317	$237,976

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Thirty-nine Weeks	
	Sep. 28, 2001	Sep. 29, 2000
Cash Flows from Operating Activities:		
Net Earnings	$ 48,128	$ 51,379
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	13,573	11,927
Deferred income taxes	766	200
Loss on sale of fixed assets	156	131
Change in:		
Accounts receivable	1,745	(5,903)
Inventories	(1,506)	3,220
Trade accounts payable	(2,380)	(957)
Salaries, wages and commissions	(4,643)	862
Retirement benefits and deferred compensation	(1,871)	(3,240)
Other accrued liabilities	5,227	5,446
Other	370	(1,047)
	59,565	62,018
Cash Flows from Investing Activities:		
Property, plant and equipment additions	(23,033)	(9,391)
Proceeds from sale of property, plant and equipment	103	162
Acquisition of business, net of cash acquired	(15,949)	-
	(38,879)	(9,229)
Cash Flows from (for) Financing Activities:		
Borrowings on notes payable and lines of credit	148,255	159,264
Payments on notes payable and lines of credit	(151,365)	(161,644)
Borrowings on long-term debt	21,000	26,135
Payments on long-term debt	(38,810)	(62,715)
Common stock issued	11,381	7,028
Retirement of common stock	(3,600)	(18,966)

Cash dividends paid	(9,232)	(8,532)
	(22,371)	(59,430)
Effect of exchange rate changes on cash	1,045	2,216
Net increase (decrease) in cash and cash equivalents	(640)	(4,425)
Cash and cash equivalents:		
Beginning of year	11,071	6,588
End of Period	$ 10,431	$ 2,163

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 September 28, 2001, and the related statements of earnings for the thirteen and thirty-nine weeks ended September 28, 2001 and September 29, 2000, and cash flows for the thirty-nine weeks ended September 28, 2001 and September 29, 2000 have been prepared by the Company without being audited.

   In the opinion of management, these consolidated statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of Graco Inc. and Subsidiaries as of September 28, 2001, 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 2000 Form 10-K.

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

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

	Sep. 28, 2001	Dec. 29, 2000
Finished products and components	$27,111	$26,812
Products and components in various stages of completion	20,596	20,153
Raw materials and purchased components	21,678	19,259
	69,385	66,224
Reduction to LIFO cost	(32,067)	(33,145)
	$37,318	$33,079

3. Other assets consist of the following (in thousands):

	Sep. 28, 2001	Dec. 29, 2000
Identifiable intangibles, net of accumulated amortization of $4,500 and $2,800	$ 7,024	$ 5,576
Goodwill, net of accumulated amortization of $400 in 2001	7,723	-
Prepaid pension	5,560	3,150
Other	779	1,519
	$21,086	$10,245

4. The Company has three reportable segments; Industrial/Automotive, Contractor and Lubrication. The Company does not identify assets by segment. Sales and operating profit by segment for the thirteen and thirty-nine weeks ended September 28, 2001 and September 29, 2000 were as follows (in thousands):

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep. 28, 2001	Sep. 29, 2000	Sep. 28, 2001	Sep. 29, 2000
Net Sales				
Industrial/Automotive	$ 48,583	$ 56,798	$147,681	$169,343
Contractor	58,918	55,759	175,595	176,277
Lubrication	11,150	10,543	36,062	32,475
Consolidated	$118,651	$123,100	$359,338	$378,095
Operating Earnings				
Industrial/Automotive	$ 12,500	$ 14,484	$ 34,007	$ 40,751
Contractor	12,695	12,857	36,852	38,309
Lubrication	2,807	2,437	8,835	7,162
Unallocated Corporate Expenses	(2,610)	(1,253)	(5,315)	(3,014)
Consolidated Operating Earnings	$ 25,392	$ 28,525	$ 74,379	$ 83,208

5. There have been no significant changes to the components of comprehensive income from those noted on the 2000 Form 10-K. Total comprehensive income in 2001 was $17.8 million in the third quarter and $47.8 million year-to-date. In 2000, comprehensive income was $16.9 million for the third quarter and $49.6 million for the nine-month period.

6. The adoption of Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities" on December 30, 2000, resulted in no transition adjustment. See Note A to financial statements included in the Company's 2000 Form 10-K for a description of the Company's use of derivative instruments and hedging activities.

7. On March 19, 2001, the Company purchased ASM Company, Inc. ("ASM") for $16 million cash. ASM manufactures and markets spray tips, guns, poles and other accessories for the professional painter, and had sales of approximately $11 million in 2000.

   The Company used the purchase method to account for the acquisition. Based on the results of an independent appraisal, the purchase price was allocated to net tangible assets of $5 million (net of assumed liabilities totaling $2 million), identifiable intangible assets of $3 million and goodwill of $8 million. Identifiable intangible assets include patents, proprietary technologies, trade names, trademarks, customer list and a non-compete agreement. Intangibles and goodwill are being amortized on a straight-line basis over useful lives ranging from 2 to 10 years.

8. In July 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Goodwill and Other Intangible Assets", which will be effective for the Company at the beginning of fiscal year 2002. Upon adoption of SFAS No. 142, goodwill amortization of approximately $800,000 on an annualized basis will cease. Based on a preliminary assessment, management believes that other provisions of SFAS No. 142 will not have a material impact on the Company's financial position or results of operations, however results of initial goodwill impairment testing required upon adoption are not currently determinable.

9. Upon the acquisition of ASM, the Company began implementing a plan to move ASM operations from California to expanded facilities in Sioux Falls, South Dakota. Estimated incremental costs associated with the plan that would not benefit continuing activities were recognized as liabilities assumed in the acquisition and included in the allocation of acquisition cost.

   During the third quarter of 2001, the Company also announced plans to restructure the operations of its German subsidiary, Graco Verfahrenstechnik (GV), including termination of approximately 50 employees, termination of leases, consolidation of product lines, and relocation of operations to other Company facilities in Belgium and the U.S.

Third quarter general and administrative expense includes a $1.4 million charge to establish a restructuring accrual for incremental costs associated with relocating GV operations. There were no significant payments charged against the accrual during the quarter.

Item 2. GRACO INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

Net earnings are down from prior year due to lower sales. Sales are down due to reduced demand resulting from economic weakness and the adverse impacts of foreign currency exchange rates.

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

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep. 28, 2001	Sep. 29, 2000	Sep. 28, 2001	Sep. 29, 2000
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	50.1	48.9	50.3	49.4
Product development	4.0	4.3	4.6	4.0
Selling, marketing and distribution	17.1	16.7	17.1	17.7
General and administrative	7.4	6.9	7.3	6.9
Operating Earnings	21.4	23.2	20.7	22.0
Interest expense	0.2	0.8	0.3	0.9
Other (income) expense, net	0.2	0.2	0.3	0.4
Earnings Before Income Taxes	21.0	22.2	20.1	20.7
Income taxes	6.9	7.5	6.7	7.1
Net Earnings	14.1%	14.7%	13.4%	13.6%

Net Sales

Sales in the Industrial / Automotive segment were down due to reduced demand resulting from weak economic conditions, particularly in North America. In the Contractor segment, third quarter sales increased compared to prior year on the strength of sales in the home center channel, which increased 21 percent. Year-to-date, Contractor sales were even with last year. Sales in the Lubrication segment exceeded 2000 sales for both the three-month and nine-month periods due mostly to large sales to key customers and increased market share. Price increases have not had a significant impact on sales in 2001.

Sales by geographic area were as follows:

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep. 28, 2001	Sep. 29, 2000	Sep. 28, 2001	Sep. 29,2000
Americas	$ 86,513	$ 89,613	$262,601	$278,655
Europe	20,851	21,355	62,430	64,351
Asia Pacific	11,287	12,132	34,307	35,089
Consolidated	$118,651	$123,100	$359,338	$378,095

Year-to-date translated at consistent exchange rates, Europe would have shown a

2 percent increase in sales compared to last year, and Asia Pacific region would have shown a 5 percent increase over prior year sales. For the third quarter, the impact of changes in foreign exchange rates was not as great as it was in the first two quarters of 2001 due to the strengthening of the U.S. dollar in Europe.

Gross Profit
- ------------

Gross profit percentages of sales for the quarter and year-to-date were down compared to the prior year due to lower sales volume, product mix and the negative impact of changes in exchange rates.

Operating Expenses
- ------------------

Year-to-date product development expenses were up due to spending for significant new product launches in the first part of the year, but are down for the third quarter due to lower product-launch-related expenses and management actions to reduce the product development expense running rate. Selling, marketing and distribution expenses were down from prior year due in part to lower sales-based incentives. In addition, the first half of last year included costs related to the launch of Contractor products in the home center channel.

The Company estimates that costs related to relocating GV and ASM will total approximately $4 million over a twelve month period, including the $1.4 million restructuring charge to general and administrative expense in the third quarter. Excluding the restructuring charge, general and administrative expenses decreased due mostly to reduced information systems spending and lower sales-and-earnings-based incentives.

Year-to-date operations include a $2.5 million pension credit related to the Company's U.S. defined benefit pension plan, compared to a $3.6 million credit in the same period last year. These credits resulted from recognition of investment gains attributable to pension plan assets, and are included in cost of products sold and operating expenses based on salaries and wages.

Interest Expense and Other Expense
- ---------------------------------

Interest expense decreased due to reduced debt levels.

Liquidity and Capital Resources
- ------------------------------

The Company generated $60 million of cash flow from operating activities in the first nine months of 2001, compared to $62 million for the same period last year. Significant uses of cash in 2001 include the construction of expanded manufacturing, warehouse and office facilities in Minneapolis, Minnesota and Sioux Falls, South Dakota, the acquisition of ASM, and reduction of debt.

The Company had unused lines of credit available at September 28, 2001 totaling $74 million. The available credit facilities and internally generated funds provide the Company with the financial flexibility to meet liquidity needs.

Outlook
- -------

The Company remains concerned about the weak North American economy and an economic slowdown in Europe. While internal sales growth will be challenged by difficult economic conditions, management believes the Company is positioned to perform at high levels of profitability in both good and difficult times.

SAFE HARBOR CAUTIONARY STATEMENT
- -------------------------------

The information in this 10-Q 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 2000.

PART II

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

11 Computation of Net Earnings per Common Share

(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: November 8, 2001	By: /s/David A. Roberts
	David A. Roberts President & Chief Executive Officer
Date: November 8, 2001	By: /s/James A. Graner
	James A. Graner Vice President & Controller ("duly authorized officer")

EXHIBIT 11

GRACO INC. AND SUBSIDIARIES
COMPUTATION OF NET EARNINGS PER COMMON SHARE

(Unaudited)

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep. 28, 2001	Sep. 29, 2000	Sep. 28, 2001	Sep. 29, 2000
	(in thousands except per share amounts)			
Net earnings applicable to common shareholders for basic and diluted earnings per share	$16,760	$18,073	$48,128	$51,379
Weighted average shares outstanding for basic earnings per share	31,108	30,318	30,841	30,426
Dilutive effect of stock options computed using the treasury stock method and the average market price	574	509	578	491
Weighted average shares outstanding for diluted earnings per share	31,682	30,827	31,419	30,917
Basic earnings per share	$ 0.54	$ 0.60	$ 1.56	$ 1.69
Diluted earnings per share	$ 0.53	$ 0.59	$ 1.53	$ 1.66