

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 26, 1997

Commission File Number: 1-9249

GRACO INC.

(Exact name of Registrant as specified in its charter)

Minnesota

(State of incorporation)

41-0285640

(I.R.S. Employer Identification Number)

4050 Olson Memorial Highway
Golden Valley, Minnesota

(Address of principal executive offices)

55422

(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
----- -----

16,979,650 common shares were outstanding as of October 23, 1997.

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GRACO INC. AND SUBSIDIARIES

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PART I

GRACO INC. AND SUBSIDIARIES

Item I. CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	Sept. 26, 1997	Sept. 27, 1996	Sept. 26, 1997	Sept. 27, 1996
	(In thousands except per share amounts)			
Net sales	\$ 101,920	\$ 97,680	\$ 305,740	\$ 284,932
Cost of products sold	50,558	47,704	156,446	140,697
Gross profit	51,362	49,976	149,294	144,235
Product development	4,167	4,714	13,820	13,566
Selling	21,051	21,624	66,448	62,714
General and administrative	8,425	8,316	25,264	29,996
Operating profit	17,719	15,322	43,762	37,959
Interest expense	216	155	663	732
Other expense, net	124	310	371	(447)
Earnings before income taxes	17,379	14,857	42,728	37,674
Income taxes	4,500	4,700	13,250	11,900
Net earnings	\$ 12,879	\$ 10,157	\$ 29,478	\$ 25,774
Net earnings per common and common equivalent share	\$.74	\$.58	\$ 1.69	\$ 1.47
Cash dividend declared per common share	\$.14	\$.12	\$.42	\$.36

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In thousands)

	September 26, 1997 ----- (Unaudited)	December 27, 1996 -----
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 7,382	\$ 6,535
Accounts receivable, less allowances of \$4,196 and \$4,723	82,566	83,474
Inventories	44,768	41,531
Deferred income taxes	12,459	11,633
Other current assets	1,387	1,321
	-----	-----
Total current assets	148,562	144,494
Property, plant and equipment:		
Cost	194,343	183,085
Less Accumulated Depreciation	(94,310)	(88,913)
	-----	-----
	100,033	94,172
Other assets	9,066	9,148
	-----	-----
	\$ 257,661	\$ 247,814
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Notes payable to banks	\$ 2,444	\$ 3,813
Current portion of long-term debt	1,620	1,845
Trade accounts payable	14,191	13,854
Salaries, wages and commissions	13,639	14,808
Accrued insurance liabilities	12,157	10,925
Income taxes payable	7,453	4,647
Other current liabilities	20,810	30,718
	-----	-----
Total current liabilities	72,314	80,610
Long-term debt, less current portion	7,145	8,075
Retirement benefits and deferred compensation	33,795	33,079
Shareholders' equity:		
Common stock	17,020	17,047
Additional paid-in capital	19,399	22,254
Retained earnings	106,471	85,232
Other, net	1,517	1,517
	-----	-----
Total shareholders' equity	144,407	126,050
	-----	-----
	\$ 257,661	\$ 247,814
	=====	=====

See notes to consolidated financial statements

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

Thirty-Nine Weeks

Sept. 26, 1997 Sept. 27, 1996

(In thousands)

CASH FLOWS FROM OPERATING ACTIVITIES:

Net Earnings	\$ 29,478	\$ 25,774
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	10,507	9,633
Deferred income taxes	(2,137)	2,318
Change in:		
Accounts receivable	(2,665)	(3,182)
Inventories	(4,972)	(7,147)
Trade accounts payable	655	(380)
Retirement benefits and deferred compensation	1,036	564
Other accrued liabilities	(5,743)	6,813
Other	(240)	350
	-----	-----
	25,919	34,743
	-----	-----

CASH FLOWS FROM INVESTING ACTIVITIES:

Property, plant and equipment additions	(16,793)	(18,681)
Proceeds from sale of property, plant, and equipment	1,642	62
	-----	-----
	(15,151)	(18,619)
	-----	-----

CASH FLOWS FROM FINANCING ACTIVITIES:

Borrowing on notes payable and lines of credit	40,289	13,932
Payments on notes payable and lines of credit	(41,470)	(13,957)
Borrowing on long-term debt	--	198
Payments on long-term debt	(922)	(1,347)
Common stock issued	2,926	2,352
Retirement of common and preferred stock	(6,971)	(6,819)
Cash dividends paid	(7,219)	(6,293)
	-----	-----
	(13,367)	(11,934)
	-----	-----

Effect of exchange rate changes on cash	3,446	1,568
	-----	-----

Net increase in cash and cash equivalents	847	5,758
---	-----	-------

Cash and cash equivalents:

Beginning of year	6,535	1,643
	-----	-----
End of period	\$ 7,382	\$ 7,401
	=====	=====

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 26, 1997 and the related statements of earnings for the thirteen and thirty-nine weeks ended September 26, 1997 and September 27, 1996 and cash flows for the thirty-nine weeks ended September 26, 1997, and September 27, 1996, have been prepared by the Company without being audited.

In the opinion of management, these consolidated statements reflect all adjustments necessary (consisting of only normal recurring adjustments) to present fairly the financial position of Graco Inc. and Subsidiaries as of September 26, 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):

	Sept. 26, 1997	Dec. 27, 1996
	-----	-----
Finished products and components	\$43,148	\$38,707
Products and components in various stages of completion	26,943	24,691
Raw materials	12,387	15,192
	-----	-----
	82,478	78,590
Reduction to LIFO cost	(37,710)	(37,059)
	-----	-----
	\$44,768	\$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.
4. In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures about Segments of an Enterprise and Related Information", which will be effective for the Company beginning with the 1998 fiscal year. SFAS No. 131 redefines how operating segments are determined and requires disclosure of certain financial and description information about a company's operating segments. The Company has not yet determined the nature of its segments, nor has it determined how adoption of SFAS No. 131 will impact its future disclosures.

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

Results of Operations

Net earnings of \$12.9 million for the quarter ended September 26, 1997 increased 27 percent over the third quarter of 1996 earnings of \$10.2 million. For the nine months ended September 26, 1997, net earnings of \$29.5 million were 14 percent over 1996 earnings of \$25.8 million. The quarterly earnings improvement results primarily from a 4 percent increase in sales, coupled with a 3 percent decline in operating expenses. A lower effective tax rate and income of approximately \$450,000, net of tax, related to the settlement of a lawsuit, also contributed to the net earnings improvement. Partially offsetting the improvements were a lower gross profit margin on product sales and losses resulting from unfavorable exchange rate changes.

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

	Third Quarter (13 weeks) Ended		Nine Months (39 weeks) Ended	
	September 26, 1997	September 27, 1996	September 26, 1997	September 27, 1996
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of Products Sold	49.6	48.8	51.2	49.4
Product Development	4.1	4.8	4.5	4.8
Selling	20.7	22.1	21.7	22.0
General and Administrative	8.2	8.6	8.3	10.5
Operating Profit	17.4	15.7	14.3	13.3
Interest Expense2	.2	.2	.3
Other Income(Expense), Net	(.1)	(.3)	(.1)	.2
Earnings Before Income Taxes	17.1	15.2	14.0	13.2
Income Taxes	4.5	4.8	4.4	4.2
Net Earnings	12.6%	10.4%	9.6%	9.0%

Net Sales

Net sales during the third quarter of \$101.9 million were 4 percent higher than 1996's third quarter. Year-to-date sales of \$305.7 million were 7 percent higher than the first nine months of 1996. Improved sales levels were achieved despite a negative currency impact, which reduced sales by 4 percent for the quarter and 3 percent for the nine month period.

Industrial/Automotive Equipment sales worldwide fell 5 percent to \$53.5 million from last year's third quarter, 4 percent due to exchange and most of the remainder due to a decline in automotive systems demand in Europe. Sales for the nine month period ended September 26, 1997 in Industrial/Automotive of \$160.9 million were 3 percent higher than 1996. Third quarter Contractor Equipment sales of \$37.2 million were 22 percent higher than last year due primarily to new products and price repositioning. Year-to-date Contractor Equipment sales were up 15 percent to \$110.7 million. Lubrication Equipment quarterly sales increased 3 percent to \$11.2 million. Sales of \$34.1 million for the first nine months in Lubrication were up 6 percent over the same period last year reflecting a healthy North American economy and an increased key distributor base.

Sales in the Americas (North, South and Central) increased 12 percent to \$69.3 million for the quarter primarily due to strong sales performance in Contractor Equipment, partially offset by a decline in North American automotive systems sales. Year-to-date sales in the Americas of \$207.8 million were up 11 percent compared to the same period last year. Quarterly sales in Europe of \$18.5 million were 15 percent lower than last year. Much of the decline (9 percent) can be attributed to changes in exchange rates. The remainder is due primarily to a shift in timing of automotive systems sales between quarters. Year-to-date automotive system sales remain ahead of last year. Sales in Europe for the nine months ended September 26, 1997 of \$57.3 million improved 5 percent from the same period last year (a 13 percent volume increase, and an 8 percent decline due to exchange rates). Asia Pacific sales of \$14.1 million were 2 percent higher than last year's third quarter (a 7 percent volume increase, and a 5 percent decline due to exchange rates). Sales in Asia Pacific for nine months of \$40.7 million were 4 percent lower than last year (a 3 percent volume increase, and a 7 percent decline due to exchange rates).

Gross Profit

Gross profit as a percentage of quarterly and year-to-date net sales has risen to 50.4 and 48.8 percent respectively from the second quarter of 1997. These rates, however, are .8 and 1.8 percentage points lower than the 1996 third quarter and year-to-date rates, respectively. The decreases for the quarter and nine months were primarily the result of a shift in the product mix within Contractor Equipment 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, relative to costs, are denominated in currencies other than the U.S. dollar.

Operating Expenses

Operating expenses for the quarter ended September 26, 1997 of \$33.6 million decreased 3 percent from the same quarter of 1996. Operating expenses of \$105.5 million for the first nine months were 1 percent below the 1996 level. Quarterly product development expense decreased 12 percent from 1996 and selling expense decreased 3 percent. The decline in both product development and selling can be attributed to lower employee benefit costs. General and administrative costs remained relatively flat in comparison to the third quarter of 1996.

Other Income (Expense)

Other expense was \$.1 million in the third quarter, compared to expense of \$.3 million for the same period last year. The third quarter of 1997 includes proceeds from the settlement of a lawsuit. This income was partially offset by losses due to exchange rate fluctuations. Other expense for the nine months ended September 26, 1997 was \$.4 million, compared to income of \$.4 million in the same period of 1996.

Income Taxes

The quarterly and year-to-date effective income tax rates decreased to 25.9 percent and 31.0 percent, respectively compared to 31.6 percent for both periods last year. The lower rates in 1997 were principally due to previously unrecognized foreign tax benefits.

Liquidity and Capital Resources

The Company generated \$25.9 million of cash flow from operating activities in the first nine months of 1997 compared to \$34.7 million for the same period last year. Significant uses of operating cash flow in 1997 resulted from an increase in accounts receivable balances attributable to higher sales levels and from a 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 was also used to fund an increase in inventory levels which was driven by higher engineered systems activity in the foreign operations. Available cash, borrowing on lines of credit of \$40.3 million, and proceeds from issuances of common stock were used to fund short-term operating needs, finance capital expenditures of \$16.8 million, repurchase \$7.0 million in common stock and pay dividends of \$7.2 million. The Company had unused lines of credit available at September 26, 1997 totaling \$68.7 million. The available credit facilities and internally-generated funds provide the Company with the financial flexibility to meet liquidity needs.

Outlook

The Company is optimistic about performance for the remainder of the year. With the exception of North American Automotive, the Company is experiencing strong demand for its products. Sales backlog has grown by \$11 million since the beginning of the year to \$30 million. Also, despite continuing unfavorable exchange rate changes, the Company's profitability has improved.

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

Stock Option Agreement. Form of agreement used
for award of nonstatutory stock options to
nonemployee director, dated September 5, 1997 Exhibit 10.1

Trust agreement dated September 30, 1997, between
the Company and Norwest Bank, Minnesota N.A. Exhibit 10.2

Statement on Computation
of Per Share Earnings Exhibit 11

Financial Data Schedule (EDGAR filing only) 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: 11/6/97

By:/s/George Aristides
George Aristides
Chief Executive Officer

Date: 11/6/97

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

GRACO INC.
NONEMPLOYEE DIRECTOR
NONSTATUTORY STOCK OPTION AGREEMENT
(NSO)

THIS AGREEMENT, made this 5th day of September, 1997 by and between Graco Inc., a Minnesota corporation (the "Company") and _____ (the "Nonemployee Director").

WITNESSETH THAT:

WHEREAS, the Company pursuant to its Nonemployee Director Stock Option Plan wishes to grant this stock option to Nonemployee Director.

NOW THEREFORE, in consideration of the premises and of the mutual covenants herein contained, the parties hereto hereby agree as follows:

1. Grant of Option

The Company hereby grants to Nonemployee Director, the right and option (the "Option") to purchase all or any part of an aggregate of ____ common shares, par value \$1.00 per share, at the price of \$____ per share on the terms and conditions set forth herein. This is a nonstatutory stock Option which does not qualify for special tax treatment under Sections 421 or 422 of the Internal Revenue Code.

2. Duration and Exercisability

a. This Option may not be exercised by Employee until the expiration of one (1) year from the date of grant, and this Option shall in all events terminate ten (10) years after the date of Grant. During the first year from the date of grant of this Option, no portion of this Option may be exercised. Thereafter this Option shall become exercisable in four cumulative installments of 25% as follows:

Date	Total Portion of Option Which is Exercisable
One Year after Date of Grant	25%
Two Years after Date of Grant	50%
Three Years after Date of Grant	75%
Four Years after Date of Grant	100%

In the event that Nonemployee Director does not purchase in any one year the full number of shares of common stock of the Company to which he/she is entitled under this Option, he/she may, subject to the terms and conditions of Section 3 hereof, purchase such shares of common stock in any subsequent year during the term of this Option.

b. During the lifetime of the Nonemployee Director, the Option shall be exercisable only by him/her and shall not be assignable or transferable by him/her otherwise than by will or the laws of descent and distribution.

3. Effect of Termination of Membership on the Board

a. In the event a Nonemployee Director ceases being a director of the Company for any reason other than the reasons identified in section 3b below, the Nonemployee Director shall have the right to exercise the Option as follows, subject to the condition that no Option shall be exercisable after the expiration of the term of the Option:

(1) If the Nonemployee Director was a member of the Board of Directors of the Company for five (5) or more years, the option becomes immediately exercisable upon the date the Nonemployee Director ceases being a director. The Nonemployee Director may exercise the Option for a period of thirty six (36) months from the date the Nonemployee Director ceased being a director, provided that if the Nonemployee Director dies before the thirty-six (36) month period has expired, the Option may be exercised by the Nonemployee Director's legal representative or any person who acquires the right to exercise an Option by reason of the Nonemployee Director's death for a period of twelve (12) months from the date of the Nonemployee Director's death.

(2) If the Nonemployee Director was a member of the Board of Directors of the Company for less than five (5) years, the Nonemployee Director may exercise the Option, to the extent the Option was exercisable at the date the Nonemployee Director ceases being a member of the Board, for a period of thirty (30) days following the date the Nonemployee Director ceased being a director, provided that, if the Nonemployee Director dies before the thirty (30) day period has expired, the Option may be exercised by the Nonemployee Director's legal representative, or any person who acquires the right to exercise an Option by reason of the Nonemployee Director's death, for a period of twelve (12) months from the date of the Nonemployee Director's death.

(3) If the Nonemployee Director dies while a member of the Board of Directors of the Company, the Option, to the extent exercisable by the Nonemployee Director at the date of death, may be exercised by the Nonemployee Director's legal representative, or any person who acquires the right to exercise an Option by reason of the Nonemployee Director's death, for a period of twelve (12) months from the date of the Nonemployee Director's death.

(4) In the event the Option is exercised by the executors, administrators, legatees, or distributees of the estate of a deceased optionee, the Company shall be under no obligation to issue stock thereunder unless and until the Company is satisfied that the person or persons exercising the Option are the duly appointed legal representatives of the deceased optionee's estate or the proper legatees or distributees thereof.

b. If a Nonemployee Director ceases being a director of the Company due to an act of (a) fraud or intentional misrepresentation or (b) embezzlement, misappropriation or conversion of assets or opportunities of the Company or any Affiliate of the Company or (c) any other gross or willful misconduct, as determined by the Board, in its sole and conclusive discretion, the Option granted to such Nonemployee Director shall immediately be forfeited as of the date of the misconduct.

4. Manner of Exercise

a. The Option can be exercised only by Nonemployee Director or other proper party within the Option period by delivering written notice to the Company at its principal office in Minneapolis, Minnesota, stating the number of shares as to which the Option is being exercised and, except as provided in sections 4b(2) and 4b(3) below, accompanied by payment in full of one hundred percent (100%) of the Option price.

b. The Nonemployee Director may, at his/her election, pay the Option price as follows:

(1) by cash or by certified check,

(2) by delivery of shares of common stock to the Company, which shall have been owned for at least six (6) months and have a fair market value per share on the date of surrender equal to the exercise price, or

(3) by delivery to Company of a properly executed exercise notice together with irrevocable instructions to a broker to promptly deliver to the Company from sale or loan proceeds the amount required to pay the exercise price.

For purposes of subsection 4b(2) hereunder, the fair market value per share is the last sale price reported on the composite tape by the New York Stock Exchange on the business day immediately preceding the date as of which fair market value is being determined or, if there were no sales of shares of the Company's common stock reported on the composite tape on such day, on the most recently preceding day on which there were sales, or if the shares of the Company's stock are not listed or admitted to trading on the New York Stock Exchange on the day as of which the determination is made, the amount determined by the Board or its delegate to be the fair market value of a share on such day.

c. Such Option price shall be subject to adjustment as provided in Section 6 hereof.

5. Change of Control

a. Notwithstanding Section 2(a) hereof, all outstanding Options not yet exercisable shall become immediately and fully exercisable on the day following a "Change of Control" and shall remain fully exercisable until either exercised or expiring by their terms. A "Change of Control" means:

(1) acquisition by any individual, entity, or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act of 1934), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the 1934 Act) which results in the beneficial ownership by such Person of 25% or more of either

(a) the then outstanding shares of common stock of the Company (the "Outstanding Company Common Stock") or

(b) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

(i) an acquisition directly from the Company,

(ii) an acquisition by the Company,

(iii) an acquisition by an employee benefit plan (or related trust) sponsored or maintained by the

Company or any corporation controlled by the Company,

- (iv) an acquisition by any Person who is deemed to have beneficial ownership of the Company common stock or other Company voting securities owned by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 9, a Trust Person shall not be deemed --- to have beneficial ownership of the Company common stock or other Company voting securities owned by The Graco Foundation or any employee benefit plan of the Company, including, without limitations, the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,
- (v) an acquisition by the Nonemployee Director or any group that includes the Nonemployee Director, or
- (vi) an acquisition by any corporation pursuant to a transaction that complies with clauses (a), (b), and (c) of subsection (4) below; and

provided, further, that if any Person's beneficial ownership of the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (i) or (ii) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (i) or (ii) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

- (2) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or
- (3) The commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; or
- (4) The approval by the shareholders of the Company of a reorganization, merger, consolidation, or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by stockholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation) excluding, however, such a Business combination pursuant to which
 - (a) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,

(b) no Person [excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination] beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination, and

(c) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

(5) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

b. A Change of Control shall not be deemed to have occurred with respect to a Nonemployee Director if:

(1) the acquisition of the 25% or greater interest referred to in subsection a(1) of this Section 5 is by a group, acting in concert, that includes the Nonemployee Director or

(2) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding company voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subsections (4) or (5) of this section by a group, acting in concert, that includes that Nonemployee Director.

6. Adjustments and Changes in the Stock

a. If Nonemployee Director exercises all or any portion of the Option subsequent to any change in the common stock of the Company by reason of any stock dividend, stock split, spin-off, split-up, merger, consolidation, recapitalization, reclassification, combination or exchange of shares, or any other similar corporate event, the aggregate number of shares available under the Plan, and the number and the price of shares of common stock subject to outstanding Options shall be appropriately adjusted automatically.

b. No right to purchase fractional shares shall result from any adjustment in the Option pursuant to subsection 6a of this Agreement. In case of any such adjustment, the shares subject to the Option shall be rounded down to the nearest whole share.

c. Notice of any adjustment shall be given by the Company to Nonemployee Director for the Option which shall have been so adjusted and such adjustment (whether or not such notice is given) shall be effective and binding for all purposes of the Plan.

7. Miscellaneous

a. This Option is issued pursuant to the Company's Nonemployee Director Stock Option Plan and is subject to its terms. A copy of the Plan has been given to the Nonemployee Director. The terms of the Plan are also available for inspection during business hours at the principal offices of the Company.

b. This Agreement shall not confer on Nonemployee Director or other person any claim or right to be granted an Option under the Plan, except as expressly provided in the Plan. Neither the Plan nor any action taken hereunder shall be construed as giving Nonemployee Director any right to be retained in the service of the Company.

c. Neither Nonemployee Director, the Nonemployee Director's legal representative, nor any person who acquires the right to exercise this Option by reason of the Nonemployee Director's death shall be or have any of the rights or privileges of, a shareholder of the Company in respect of any shares of common stock receivable upon the exercise of this Option, in whole or in part, unless and until certificates for such shares shall have been issued upon exercise of this Option.

d. The Company shall at all times during the term of the Option reserve and keep available such number of shares as will be sufficient to satisfy the requirements of this Agreement.

e. This Agreement will be governed by and constructed exclusively in accordance with the laws of the State of Minnesota.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed on the day and year first above written.

By

Its

Nonemployee Director

TRUST AGREEMENT
GRACO INC. NONEMPLOYEE DIRECTOR
DEFERRED STOCK ACCOUNT

THIS TRUST AGREEMENT, Made and entered into as of September 30, 1997, by and between GRACO INC., a Minnesota corporation (hereinafter sometimes referred to as "Graco"), and NORWEST BANK MINNESOTA, N.A., a national banking association, as trustee (said trustee and its successor or successors in trust from time to time being hereinafter collectively referred to as "Trustee"):

WHEREAS, Graco has established a nonemployee director stock plan for the benefit of its outside directors by the adoption of a document known as the "GRACO INC. NONEMPLOYEE DIRECTOR STOCK PLAN" (the "Plan"); and

WHEREAS, Graco may from time to time hereafter amend, renew and extend such Plan; and

WHEREAS, Graco has determined that it will establish a trust fund which, subject to the claims of creditors of Graco, shall be held to pay such portion of the benefits under the Plan which Graco does not directly pay; and

WHEREAS, the creation of such a trust fund requires that Graco select a Trustee and enter into a Trust Agreement; and

WHEREAS, this is the Trust Agreement so contemplated; and

WHEREAS, the Trustee has agreed to serve as Trustee according to the terms of this Trust Agreement and the officers of Graco are authorized to execute this Trust Agreement on behalf of Graco;

NOW, THEREFORE, in consideration of the premises, the parties hereto do hereby agree as follows:

SECTION 1

INTRODUCTION

1.1. Definitions. When used herein with initial capital letters, the following words have the following meanings:

1.1.1. Administrator - the Secretary of Graco appointed by the Plan to administer this Trust.

1.1.2. Beneficiary - a person designated by a Participant (or automatically by operation of the Plan) to receive any benefit remaining at the death of a Participant under the terms of the Plan.

1.1.3. Change in Control

1.1.3.1 A Change of Control means any one of the following events:

1.1.3.1(a) acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act), (a "Person"), of beneficial ownership (within the meaning of Rule 13d-3 under the Exchange Act) which results in the beneficial ownership by such Person of 25% or more of either

1.1.3.1(a)(1) the then outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or

1.1.3.1(a)(2) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities");

provided, however, that the following acquisitions will not result in a Change of Control:

- (i) an acquisition directly from the Company,
- (ii) an acquisition by the Company,
- (iii) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company,
- (iv) an acquisition by any Person who is deemed to have beneficial ownership of the Common Stock or other voting securities of the Company owned by the Trust Under the Will of Clarissa L. Gray ("Trust Person"), provided that such acquisition does not result in the beneficial ownership by such Person of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities, and provided further that for purposes of this Section 1.1.3, a Trust Person shall not be deemed to have beneficial ownership of the Common Stock or other voting securities of the Company owned by The Graco Foundation or any employee benefit plan of the Company, including the Graco Employee Retirement Plan and the Graco Employee Stock Ownership Plan,
- (v) an acquisition by the Participating Director or any group that includes the Participating Director, or
- (vi) an acquisition by any corporation pursuant to a transaction that complies with clauses (1), (2) and (3) of subsection 1.1.3.1(d) below; and

provided, further, that if any Person's beneficial ownership of

the Outstanding Company Common Stock or Outstanding Company Voting Securities is 25% or more as a result of a transaction described in clause (i) or (ii) above, and such Person subsequently acquires beneficial ownership of additional Outstanding Company Common Stock or Outstanding Company Voting Securities as a result of a transaction other than that described in clause (i) or (ii) above, such subsequent acquisition will be treated as an acquisition that causes such Person to own 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities and be deemed a Change of Control; and provided further, that in the event any acquisition or other transaction occurs which results in the beneficial ownership of 32% or more of either the Outstanding Company Common Stock or the Outstanding Company Voting Securities by any Trust Person, the Incumbent Board, as defined below, may by majority vote increase the threshold beneficial ownership percentage to a percentage above 32% for any Trust Person; or

1.1.3.1(b) individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of said Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board will be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial membership on the Board occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board, or

1.1.3.1(c) the commencement or announcement of an intention to make a tender offer or exchange offer, the consummation of which would result in the beneficial ownership by a Person of 25% or more of the Outstanding Company Common Stock or Outstanding Company Voting Securities; or

1.1.3.1(d) the approval by the shareholders of the Company of a reorganization, merger, consolidation or statutory exchange of Outstanding Company Common Stock or Outstanding Company Voting Securities or sale or other disposition of all or substantially all of the assets of the Company ("Business Combination") or, if consummation of such Business Combination is subject, at the time of such approval by shareholders, to the consent of any government or governmental agency, the obtaining of such consent (either explicitly or implicitly by consummation); excluding, however, such a Business Combination pursuant to which

1.1.3.1(d)(1) all or substantially all of the individuals and entities who were the beneficial owners of the Outstanding Company Common Stock or Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 80% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation that as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock or Outstanding Company Voting Securities,

1.1.3.1(d)(2) no Person (excluding any employee benefit plan, or related trust, of the Company or such corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 25% or more of the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation, except to the extent that such ownership existed prior to the Business Combination, and

1.1.3.1(d)(3) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

1.1.3.1(e) approval by the shareholders of the Company of a complete liquidation or dissolution of the Company.

1.1.3.2 A Change of Control shall not be deemed to have occurred with respect to a Participating Director if:

1.1.3.2(a) the acquisition of the 25% or greater interest referred to in subparagraph 1.1.3.1(a) of this Section 1.1.3 is by a group, acting in concert, that includes the Participating Director or

1.1.3.2(b) if at least 25% of the then outstanding common stock or combined voting power of the then outstanding company

voting securities (or voting equity interests) of the surviving corporation or of any corporation (or other entity) acquiring all or substantially all of the assets of the Company shall be beneficially owned, directly or indirectly, immediately after a reorganization, merger, consolidation, statutory share exchange, disposition of assets, liquidation or dissolution referred to in subparagraph 1.1.3.1(d) or 1.1.3.1(e) of this Section by a group, acting in concert, that includes that Participating Director.

1.1.4. Common Stock - common shares of Graco, par value \$1.00.

1.1.5. Company - GRACO INC., a Minnesota corporation, and any successor thereof that adopts the Plan.

1.1.6. Fund - the assets held under this Trust Agreement by the Trustee from time to time, including all contributions of the Company and the investments and reinvestments, earnings and profits thereon.

1.1.7. Insolvent, Insolvency - the condition which exists when Company is: (i) generally unable to pay its debts when they are due, or (ii) subject to a pending proceeding as a debtor under the United States Bankruptcy Code.

1.1.8. Participant - a nonemployee director of the Company who has become and remains a participant in the Plan in accordance with the provisions of the Plan.

1.1.9. Plan - the unfunded, nonqualified "GRACO INC. NONEMPLOYEE DIRECTOR STOCK PLAN" of the Company which has been established for the benefit of the nonemployee directors of the Company eligible to participate therein.

1.1.10. Trust Agreement - this written document entitled "TRUST AGREEMENT, GRACO NONEMPLOYEE DIRECTOR DEFERRED STOCK ACCOUNT" entered into by and between Company and the Trustee effective as of September 30, 1997, as the same may be amended from time to time thereafter.

1.1.11. Trustee - the Trustee originally named hereunder and its successor in Trust.

1.2. Rules of Interpretation. Whenever appropriate, words used herein in the singular may be read in the plural, or words used herein in the plural may be read in the singular; the masculine may include the feminine; and the words "hereof", "herein" or "hereunder" or other similar compounds of the word "here" shall mean and refer to this entire Trust Agreement and not to any particular paragraph or section of this Trust Agreement unless the context clearly indicates to the contrary. The titles given to the various sections of this Trust Agreement are inserted for convenience of reference only and are not part of this Trust Agreement, and they shall not be considered in determining the purpose, meaning or intent of any provision hereof. Any reference in this Trust Agreement to a statute or regulation shall be considered also to mean and refer to any subsequent amendment or replacement of that statute or regulation. This instrument has been executed and delivered in the State of Minnesota and has been drawn in conformity to the laws of that State and shall be construed and enforced in accordance with the laws of the State of Minnesota.

SECTION 2

ESTABLISHMENT OF TRUST

2.1. Establishment of Trust. Company hereby deposits with Trustee in Trust One Hundred Dollars and no/100 (\$100.00), which shall become the principal of the Trust to be held, administered and disposed of by Trustee as provided in this Trust Agreement. The Company shall make additional deposits of cash or other property from time to time as it may determine in its sole and absolute discretion. Neither Trustee nor any Participant or Beneficiary shall have any right to compel any additional deposits.

2.2. Fund Established. A Fund is hereby established by Company. The Fund shall be held by Trustee in Trust and dealt with in accordance with the provisions of this Trust Agreement. This Trust Agreement is intended to create a trust which is a grantor trust within the meaning of section 671 of the Internal Revenue Code, as amended, and shall be construed accordingly. The principal of the Trust, and any earnings thereon shall be held separate and apart from other funds of the Company and shall be used exclusively for the uses and purposes of Plan Participants and general creditors as herein set forth. Plan Participants and their Beneficiaries shall have no preferred claim on, or any beneficial ownership interest in, any assets of the Trust. Any rights created under the Plan and this Trust Agreement shall be mere unsecured contractual rights of Plan Participants and their Beneficiaries against Company. Any assets held by the Trust will be subject to the claims of Company's general creditors under federal and state law in the event of Insolvency.

2.3. Revocable Trust. The Trust hereby established is revocable by Company; it shall become irrevocable upon a Change in Control, as defined herein.

SECTION 3

PAYMENTS TO PLAN PARTICIPANTS AND THEIR BENEFICIARIES

3.1. Company shall deliver to Trustee from time to time one or more schedules (the "Payment Schedule") that indicate the amounts payable in respect of each Participant (and his or her Beneficiaries), that provides a formula or other instructions acceptable to Trustee for determining the amounts so payable, the form in which such amount is to be paid (as provided for or available under the Plan), and the time of commencement for payment of such amounts. Except as otherwise provided herein, Trustee shall make payments to the Participants or

their Beneficiaries in accordance with the Payment Schedule. Company may direct Trustee, with Trustee's consent, to withhold, report and remit any federal, state and local taxes that may be required to be withheld with respect to the payments of benefits pursuant to the terms of the Plan and Trustee shall pay the amounts withheld to the appropriate taxing authorities. In the event Company does not direct the Trustee or Trustee does not consent to withhold, report and remit all federal, state and local taxes, the Company will perform such activities itself.

3.2. The entitlement of a Participant or Beneficiary to benefits under the Plan shall be determined by Company or such party as it shall designate under the Plan, and any claim for such benefits shall be considered and reviewed under the procedures set forth in the Plan.

3.3. Company may make payment of benefits directly to Participants or their Beneficiaries as they become due under the terms of the Plan. Company shall notify Trustee of its decision to make payment of benefits within a reasonable time prior to the time amounts are payable to Participants or their Beneficiaries. In addition, if the principal of the Trust, and any earnings thereon, are not sufficient to make payments of benefits in accordance with the terms of the Plan, Company shall make the balance of each such payment as it falls due. Trustee shall notify Company where principal and earnings are not sufficient.

SECTION 4

PAYMENTS TO COMPANY

Except as provided in Section 3 hereof, after the Trust has become irrevocable, Company shall have no right or power to direct Trustee to return to Company or to divert to others any of the Trust assets before all payments of benefits have been made to Plan Participants and their Beneficiaries pursuant to the terms of the Plan. Prior to the date the Trust becomes irrevocable, the Company may request the Trustee to return assets to the Company which are determined by the Company to be in excess of amounts reasonably believed necessary to satisfy the claims of all Participants and Beneficiaries under the terms of the Plan.

SECTION 5

TRUSTEE RESPONSIBILITY REGARDING PAYMENTS TO TRUST BENEFICIARY WHEN COMPANY IS INSOLVENT

5.1. Cease Payments. Trustee shall cease payment of benefits to Participants and Beneficiaries if the Company is insolvent.

5.2. Claims of Creditors. At all times during the continuance of this Trust, the principal and income of the Trust shall be subject to claims of general creditors of Company under federal and state law as set forth below.

5.2.1. The Administrator and the Chief Executive Officer of the Company shall have the duty to inform Trustee in writing of Company's Insolvency. If a person claiming to be a creditor of Company alleges in writing to Trustee that Company has become Insolvent, Trustee shall determine whether Company is Insolvent and, pending such determination, Trustee shall discontinue payment of benefits to Participants or Beneficiaries.

5.2.2. Unless Trustee has actual knowledge of Company's Insolvency, or has received notice from Company or a person claiming to be a creditor alleging that Company is Insolvent, Trustee shall have no duty to inquire whether Company is Insolvent. Trustee may in all events rely on such evidence concerning Company's solvency as may be furnished to Trustee and that provides Trustee with a reasonable basis for making a determination concerning Company's solvency.

5.2.3. If at any time Trustee has determined that Company is Insolvent, Trustee shall discontinue payments to Participants and Beneficiaries and shall hold the assets of the Trust for the benefit of Company's general creditors. Nothing in this Trust Agreement shall in any way diminish any rights of Participants and Beneficiaries to pursue their rights as general creditors of Company with respect to benefits due under the Plan or otherwise.

5.2.4. Trustee shall resume the payment of benefits to Participants and Beneficiaries in accordance with Section 3 of this Agreement only after Trustee has determined that Company is not Insolvent (or is no longer Insolvent).

5.3. Resumption of Payments. Provided that there are sufficient assets, if Trustee discontinues the payment of benefits from the Trust pursuant to Section 5 hereof and subsequently resumes such payments, the first payment following such discontinuance shall include the aggregate amount of all payments due to Participants and Beneficiaries under the terms of the Plan for the period of such discontinuance, less the aggregate amount of payment, if any, made to Participants and Beneficiaries by Company pursuant to the Plan during any such period of discontinuance.

SECTION 6

INVESTMENT AUTHORITY

Trustee shall invest any funds transferred to it by Company in such manner as may be directed by Company. In the event Company fails to give such instructions to Trustee, Trustee shall then have full authority to invest any funds transferred to it by Company as Trustee sees fit, consistent with the terms and conditions of this Trust Agreement and the Plan. Notwithstanding anything to the contrary, if so directed by the Company, the Trustee shall

invest all or any portion of the Fund in securities (including stock or rights to acquire stock) or obligations issued by Company. All voting rights associated with assets of the Trust consisting of Common Stock of the Company shall be exercisable by the Participants or Beneficiaries in proportion to the number of shares of Common Stock of the Company held in the deferred stock account established under the Plan for each such Participant or Beneficiary as of the applicable record date as determined by the Administrator and pursuant to such rules as may be established by the Administrator and the Trustee. All other rights associated with assets of the Trust, including voting rights with respect to any equity securities held by the Trust (but not including Common Stock of the Company), shall be exercised by Trustee or the person designated by Trustee, and shall in no event be exercisable by or rest with Participants.

Company shall have the right at any time, and from time to time in its sole discretion, to substitute assets of equal fair market value for any asset held by the Trust. This right is exercisable by Company in a nonfiduciary capacity without the approval or consent of any person in a fiduciary capacity.

SECTION 7

DISPOSITION OF INCOME

During the term of this Trust, all income received by the Trust, net of expenses and taxes, if any, shall be accumulated and reinvested in accordance with the terms hereof. All cash dividends, if any, paid with respect to the Common Stock of the Company shall be reinvested in Common Stock of the Company.

SECTION 8

ACCOUNTING BY TRUSTEE

Trustee shall keep accurate and detailed records of all investments, receipts, disbursements, and all other transactions required to be made, including such specific records as shall be agreed upon in writing between Company and Trustee. Within sixty (60) days following the close of each calendar year, or such other date or dates specified by the Company and within sixty (60) days after the removal or resignation of Trustee, Trustee shall deliver to Company a written account of its administration of the Trust during such year or during the period from the close of the last preceding year to the date of such removal or resignation, setting forth all investments, receipts, disbursements and other transactions effected by it, including a description of all securities and investments purchased and sold with the cost of net proceeds of such purchases or sales (accrued interest paid or receivable being shown separately), and showing all cash, securities and other property held in the Trust at the end of such year or as of the date of such removal or resignation, as the case may be. It is recognized that in the operation and administration of the Trust certain mathematical or accounting errors may be made or mistakes may arise by reason of errors in information supplied to Trustee. Trustee shall have the power to cause such equitable adjustments to be made to correct such errors as Trustee in its discretion considers appropriate. Such adjustments shall be final and binding on all persons.

SECTION 9

RESPONSIBILITY OF TRUSTEE

9.1. General Duty of Care. Trustee shall act with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, provided, however, that Trustee shall incur no liability to any person for any action taken pursuant to a direction, request or approval given by Company which is contemplated by, and in conformity, the terms of the Plan or this Trust and is given in writing by Company. In the event of a dispute between Company and any person, Trustee may apply to a court of competent jurisdiction to resolve the dispute.

9.2. No Duty to Determine Taxability. Trustee has no responsibility to advise Company as to the taxability or deductibility of contributions to or distributions from the Trust, or gains or losses thereon, whether with regard to any federal, state, local or other taxes, and Company acknowledges that it has not and will not rely on Trustee for such purposes. Trustee does not warrant and shall not be liable for any tax consequences associated with the Trust or the Plan.

9.3. Indemnification of Trustee. Company will indemnify Trustee and hold it harmless from and against all claims, liabilities, legal fees and expenses that may be asserted against it, otherwise than on account of the Trustee's own negligence or willful misconduct (as found by a final judgment of a court of competent jurisdiction) by reason of the Trustee's taking or refraining from taking any action in accordance with the Trust agreement, whether or not Trustee is a party to a legal proceeding or otherwise.

9.4. Trustee May Rely on Company Information. Trustee shall be entitled to rely on any information furnished to it by the Company or any other party from whom the Trustee reasonably believes it is authorized to provide any information to the Trust. Trustee shall have no duty to determine or inquire whether any contributions to this Trust are in compliance with the Plan, or to compute any amount to be paid to Trustee; nor shall Trustee be responsible for the collection or adequacy of any contributions to the Trust or for the adequacy of the Trust to meet and discharge liabilities to Participants and their Beneficiaries under the Plan or to other creditors of the Company.

9.5. Litigation Expenses. If Trustee undertakes or defends any litigation arising in connection with this Trust, Company agrees to indemnify Trustee against Trustee's costs, expenses and liabilities (including, without limitation, attorneys' fees and expenses) relating thereto and to be primarily liable for such payments. If Company does not pay such costs, expenses and

liabilities in a reasonably timely manner, Trustee may obtain payment from the Trust.

9.6. Use of Counsel. Trustee may consult with legal counsel (who may also be counsel for Company generally) with respect to any of its duties or obligations hereunder.

9.7. Use of Agents. Trustee may hire such attorneys, agents and advisors as are reasonably necessary to interpret the provisions of the Trust and this agreement and to resolve any disputes that may arise on these issues. Trustee may recover the reasonable costs of hiring such attorneys, agents and advisors from the Company or, in the absence of such payment, from the Trust. Trustee shall not be liable to anyone for any action it may take in good faith in reliance upon the advice of such attorneys, agents and advisors.

9.8. General Grant of Authority. Trustee shall have, without exclusion, all powers conferred on trustees by applicable law, unless expressly provided otherwise herein.

9.9. No Business Obligation. Notwithstanding any powers granted to Trustee pursuant to this Trust Agreement or to applicable law, Trustee shall not have any power that could give this Trust the objective or carrying on a business and dividing the gains therefrom, within the meaning of Section 301.7701-2 of the

Procedure and Administrative Regulations promulgated pursuant to the Internal Revenue Code of 1986, as amended.

SECTION 10

COMPENSATION AND EXPENSES OF TRUSTEE

Company shall pay all administrative and Trustee's fees and expenses. If not so paid, the fees and expenses shall be paid from the Trust.

SECTION 11

RESIGNATION AND REMOVAL OF TRUSTEE

11.1. Resignation. Trustee may resign at any time by written notice to Company, which shall be effective thirty (30) days after receipt of such notice unless Company and Trustee agree otherwise.

11.2. Removal. Trustee may be removed by Company on thirty (30) days notice or upon shorter notice accepted by Trustee.

11.3. Change in Control. Upon a Change in Control, as defined herein, Trustee may not be removed by Company for ninety (90) days. If for any reason Trustee resigns or is removed within ninety (90) days of a Change in Control, Trustee shall select a successor Trustee in accordance with the provisions of Section 12.2 hereof prior to the effective date of Trustee's resignation or removal.

11.4. Transfer of Assets. Upon resignation or removal of Trustee and appointment of a successor Trustee, all assets shall subsequently be transferred to the successor Trustee. The transfer shall be completed within thirty (30) days after receipt of notice of resignation, removal or transfer, unless Company extends the time limit.

11.5. Court Appointment. If Trustee resigns or is removed, a successor shall be appointed, in accordance with the terms hereof. If no such appointment has been made, Trustee may apply to a court of competent jurisdiction for appointment of a successor or for instructions. All expenses of Trustee in connection with the proceeding shall be allowed as administrative expenses of the Trust.

SECTION 12

APPOINTMENT OF SUCCESSOR

12.1. New Trustee. If Trustee resigns or is removed in accordance with Section 11.1 or 11.2 hereof, the Administrator may appoint any third party, such as a bank trust department or other party that may be granted corporate trustee powers under Minnesota law, as a successor to replace Trustee upon resignation or removal. The appointment shall be effective when accepted in writing by the new Trustee, who shall have all of the rights and powers of the former Trustee, including ownership rights in the Trust assets. The former Trustee shall execute any instrument necessary or reasonably requested by Company or the successor Trustee to evidence the transfer.

12.2. Change in Control. Upon a Change in Control, if Trustee resigns or is removed and selects a successor Trustee pursuant to Section 11.3, Trustee may appoint any third party such as a bank trust department or other party that may be granted corporate trustee powers under Minnesota law. The appointment of a successor Trustee shall be effective when accepted in writing by the new Trustee. The new Trustee shall have all the rights and powers of the former Trustee, including ownership rights in the Trust assets. The former Trustee shall execute any instrument necessary or reasonably requested by Company or the successor Trustee to evidence the transfer.

SECTION 13

AMENDMENT OR TERMINATION

13.1. This Trust Agreement may be amended by a written instrument executed by Trustee and Company. Notwithstanding the foregoing, no such amendment shall conflict with the terms of the Plan or shall make the Trust revocable after it has become irrevocable in accordance with Section 2.3

13.2. The Trust shall not terminate until the date on which Plan Participants and their Beneficiaries are no longer entitled to benefits pursuant to the terms of the Plan unless sooner revoked in accordance with Section 2.3. Upon termination of the Trust any assets remaining in the Trust shall be returned to the Company.

13.3. Upon written approval of Participants or Beneficiaries entitled to payment of benefits pursuant to the terms of the Plan, Company may terminate this Trust prior to the time all benefit payments under the Plan have been made. All assets in the Trust at termination shall be returned to the Company.

SECTION 14

MISCELLANEOUS

14.1. Separability. Any provision of this Trust Agreement prohibited by law shall be ineffective to the extent of any such prohibition, without invalidating the remaining provisions hereof.

14.2. Spendthrift Provision. Benefits payable to Participants and Beneficiaries under this Trust Agreement may not be anticipated, assigned (either at law or in equity), alienated, pledged, encumbered or subjected to attachment, garnishment, levy, execution or other legal or equitable process.

SECTION 15

EFFECTIVE DATE

The effective date of this Trust Agreement shall be September 30, 1997.

IN WITNESS WHEREOF, each of the parties hereto has caused this Trust Agreement to be executed as of the day and year first above written.

GRACO INC.

By:/s/Mark W. Sheahan

Its: Treasurer

And:/s/Robert M. Mattison

Its: Vice President, General Counsel
and Secretary

NORWEST BANK MINNESOTA, N.A.
as TRUSTEE

By:/s/George S. Scalia

Its: Vice President

And:/s/Donna K. Dickinson

Its: Vice President

EXHIBIT 11

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

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	Sept. 26, 1997	Sept 27, 1996	Sept 26, 1997	Sept. 27, 1996
	(In thousands except per share amounts)			
Net earnings applicable to common stock:				
Net earnings	\$12,879	\$10,157	\$29,478	\$25,774
	=====	=====	=====	=====
Average number of common and common equivalent shares outstanding:				
Average number of common shares outstanding	17,050	17,181	17,096	17,282
Dilutive effect of stock options computed on the treasury stock method	405	229	386	236
	-----	-----	-----	-----
	17,455	17,410	17,482	17,518
	=====	=====	=====	=====
Net earnings per common and common equivalent share	\$.74	\$.58	\$ 1.69	\$ 1.47
	=====	=====	=====	=====

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 September 26, 1997 and is qualified in its entirety by reference to such financial statements.

0000042888
 GRACO INC.
 1,000
 U.S. DOLLARS

	3-MOS	
	DEC-26-1997	
	JUN-28-1997	
	SEP-27-1997	
	1	7,382
		0
		82,566
		4,196
		44,768
	148,562	194,343
		94,310
		257,661
	72,314	8,765
	0	0
		17,020
		127,387
257,661		305,740
	305,740	156,446
		156,446
		106,566
		101
		663
		42,728
		13,250
29,478		0
		0
		0
		29,478
		1.69
		1.69