

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

- Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 29, 1995 (Fee Required) or
- Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____.

Commission File No. 1-9249

Graco Inc.

(Exact name of Registrant as specified in its charter)

Minnesota 41-0285640
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

4050 Olson Memorial Highway
Golden Valley, Minnesota 55422-5332
(Address of principal executive offices) (Zip Code)

(612) 623-6000
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:
Common Stock, par value \$1.00 per share
Preferred Share Purchase Rights
Shares registered on the New York Stock Exchange.

Securities registered pursuant to Section 12(g) of the Act:
None

As of March 8, 1996, 17,434,828 shares of Common Stock were outstanding.

Indicate by a 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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No .

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K [X].

The aggregate market value of approximately 11,282,000 shares held by non-affiliates of the registrant was approximately \$221 million on March 8, 1996.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive Proxy Statement for its Annual Meeting of Shareholders to be held on May 7, 1996, are incorporated by reference into Part III, as specifically set forth in said Part III.

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GRACO INC.

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NOTE: Certain exhibits listed in the Index to Exhibits beginning on page 30, and filed with the Securities and Exchange Commission, have been omitted. Copies of such exhibits may be obtained upon written request directed to:

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

PART I

Item 1. Business

General Information. Graco Inc. ("Graco" or "the Company") supplies technology and expertise for the management of fluids in both industrial and commercial settings. Based in Minneapolis, Minnesota, Graco serves customers around the world in the manufacturing, processing, construction and maintenance industries. It designs, manufactures and markets systems and equipment to move, measure, control, dispense and apply fluid materials. The Company helps customers solve difficult manufacturing problems, increase productivity, improve quality, conserve energy, save expensive materials, control environmental emissions and reduce labor costs. Primary uses of the Company's equipment include the application of coatings and finishes to various industrial and commercial products; the mixing, metering, dispensing and application of adhesive, sealant and chemical bonding materials; the application of paint and other materials to architectural structures; the lubrication and maintenance of vehicles and industrial machinery; and the transferring and dispensing of various fluids. Graco is the successor to Gray Company, Inc., which was incorporated in 1926 as a manufacturer of auto lubrication equipment, and became a public company in 1969.

It is Graco's goal to become the highest quality, lowest cost, most responsive supplier in the world for its principal products. In working to achieve these goals to become a world class manufacturer, Graco has been converting its Minneapolis manufacturing operations to focused factories organized around team-directed manufacturing cells, a process expected to be completed in 1997. Substantial investments in new manufacturing technology have reduced cycle time and improved quality.

The Company operates in one industry segment, namely the design, manufacture, marketing, sale and installation of systems and equipment for the management of fluids. Financial information concerning geographic operations and export sales for the last three fiscal years is set forth in Note B of the Notes to Consolidated Financial Statements.

Recent Developments. In December, 1995, George Aristides was named Chief Executive Officer of the Company to succeed David A. Koch, who had held the position since 1962. Mr. Koch will remain as Chairman of the Board. During 1995, the Company continued the restructuring and consolidation of its operations in Europe and Japan. Management of its European operations was centralized at the Company's recently expanded facility in Maasmechelen, Belgium. In 1995, Graco implemented recommendations generated by an intensive evaluation of its marketing and sales groups worldwide. Field sales groups were restructured and investments in globally-focused marketing resources were increased. A Customer Support Team, combining customer service, technical assistance, product service and national account program management, was created in the Lubrication Equipment Division and an in-house telemarketing team was organized in the Contractor Equipment Division. The size of the Russell J. Gray Technical Center was more than doubled in 1995 to house additional testing and product development activities and personnel. During 1995, the Company's increased product development efforts resulted in the introduction of approximately 110 new products. Graco recently announced the construction of a world-class manufacturing facility and global distribution center in Rogers, Minnesota, to provide additional production capacity for projected growth. All distribution operations currently being conducted by the Company at its distribution center in Brooklyn Center, Minnesota will be transferred to the new Rogers facility, together with the engineering and manufacturing groups for the Contractor Equipment Division and final assembly operations for Industrial pumps. Manufacturing capacity met the Company's production requirements during 1995, with excess capacity in the

last half of the year due to efforts to reduce inventories and the slowdown in incoming orders.

Products. Graco Inc. manufactures a wide array of specialized pumps, applicators, regulators, valves, meters, atomizing devices, replacement parts, and accessories, which are used in industrial and commercial applications in the movement, measurement, control, dispensing and application of many fluids and semi-solids, including paints, adhesives, sealants, and lubricants. In addition, it offers an extensive line of portable equipment which is used in construction and maintenance businesses for the application of paint and other materials. Graco fluid systems incorporate sophisticated paint circulating and fluid application technology.

Commercial and industrial equipment offered by Graco includes specialized pumps, air and airless spray units, manual finishing equipment and fluid handling systems. A variety of pumps provide fluid pressures ranging from 20 to more than 6,000 pounds per square inch and flow rates from under 1 gallon to 140 gallons per minute. In 1995, Graco introduced a new generation of pumps, which produce higher pressures, have improved corrosion resistance and are easier to service than existing products.

The Company sells accessories for use with its equipment, including hoses, couplings, regulators, valves, filters, reels, meters, and gauges, as well as a complete line of spray guns, tips and applicators. These accessories increase the flexibility, efficiency

and effectiveness of Graco equipment. Packings, seals, hoses and other parts, which must be replaced periodically in order to maintain efficiency and prevent loss of material, are also sold by the Company.

Sales of replacement parts and accessories have averaged 46.5 percent of the Company's consolidated net sales and approximately 52.3 percent of gross profits during the last three years. The following table summarizes the consolidated net sales and gross profits (net sales less cost of products sold) by the Company's principal product groups for that same period.

Product Group Sales and Gross Profit

(In thousands)	1995		1994		1993	
	\$	%	\$	%	\$	%
NET SALES						
Commercial and industrial equipment	\$206,558	53.5%	\$204,584	56.8%	\$179,619	55.7%
Accessories and replacement parts	179,756	46.5	155,429	43.2	142,983	44.3
	<u>\$386,314</u>	<u>100.0%</u>	<u>\$360,013</u>	<u>100.0%</u>	<u>\$322,602</u>	<u>100.0%</u>
GROSS PROFIT						
Commercial and industrial equipment	\$ 90,526	47.7%	\$ 89,262	51.3%	\$ 76,325	49.8%
Accessories and replacement parts	99,101	52.3	84,749	48.7	76,802	50.2
	<u>\$189,627</u>	<u>100.0%</u>	<u>\$174,011</u>	<u>100.0%</u>	<u>\$153,127</u>	<u>100.0%</u>

Marketing and Distribution. Graco's operations are organized to allow its full line of products and systems to be offered in each major geographic market: the Americas, Europe and Asia Pacific. The Industrial Equipment Division, the Automotive Equipment Division, the Contractor Equipment Division, and the Lubrication Equipment Division provide worldwide marketing direction and product design and application assistance to each of these geographic markets.

Graco's equipment is sold worldwide principally through the Company's international sales subsidiaries, direct sales personnel and distributors. Manufacturers' representatives are used with some product lines. In the Americas and Europe, the Company maintains a specialized direct sales force, which handles sales of large systems and sales to certain corporate accounts.

In 1995, Graco's net sales in the Americas were \$238,874,000 or approximately 62 percent of the Company's consolidated net sales; in Europe (including the Middle East and Africa) net sales were \$82,552,000 or approximately 21 percent; and in the Asia Pacific region, net sales were \$64,888,000 or approximately 17 percent.

Research, Product Development and Technical Services. Graco's research, development and engineering activities focus on new product design, product improvements, applied engineering and strategic technologies. A dedicated support group of application engineers and technicians also provides specialized technical assistance to customers in the design and evaluation of fluid transfer and application systems. It is one of Graco's financial goals to generate 30 percent of each year's sales from products introduced in the prior three years. To achieve this goal, Graco substantially increased its new product design and application engineering staff, and more than doubled the size of the Russell J. Gray Technical Center to provide space for engineering, testing and laboratory activities. Occupancy of the new wing of the Technical Center was completed in May 1995. Total research and development expenditures were \$15,715,000, \$14,591,000 and \$12,382,000 for the 1995, 1994 and 1993 fiscal years, respectively.

Intellectual Property. Graco owns a number of patents and has patent applications pending both in the United States and in foreign countries, licenses its patents to others, and is licensed under patents owned by others. In the opinion of the

Company, its business is not materially dependent upon any one or more of these patents or licenses. The Company also owns a number of trademarks in the United States and foreign countries, including the registered trademarks for "GRACO," several forms of a capital "G" and various product trademarks which are material to the business of the Company inasmuch as they identify Graco and its products to its customers.

Competition. Graco faces substantial competition in all of its markets. The nature and extent of this competition varies in different markets due to the diversity of the Company's products. Product quality, reliability, design, customer support and service, specialized engineering and pricing are the major competitive factors. Although no competitor duplicates all of

Graco's products, some competitors are larger than the Company, both in terms of sales of directly competing products and in terms of total sales and financial resources. Graco believes it is one of the world's leading producers of high-quality specialized fluid management equipment and systems. It is impossible, because of the absence of reliable industry-wide figures, to determine its exact relative market position.

Environmental Protection. During the fiscal year ending December 29, 1995, the amounts incurred to comply with federal, state and local legislation pertaining to environmental standards did not have a material effect upon the capital expenditures or earnings of the Company.

Employees. As of December 29, 1995, the Company employed approximately 1,945 persons on a full-time basis. Of this total, approximately 351 were employees based outside the United States, and 763 were hourly factory workers in the United States. Although Graco's U.S. employees are not covered by collective bargaining agreements, various national industry-wide labor agreements apply to certain employees in Europe. The Company believes it has a good relationship with its employees.

Item 2. Properties

The Company's principal operations that occupy more than 10,000 square feet are conducted in the following facilities:

Type of Facility -----	Location -----	Square Footage -----
Owned -----		
Manufacturing/Office	Minneapolis, Minnesota	237,600
Manufacturing/Office	Minneapolis, Minnesota	207,000
Engineering/Research & Development	Minneapolis, Minnesota	138,200
Engineering/Manufacturing/Office	Plymouth, Michigan	106,000
Engineering/Manufacturing/Office	Franklin Park, Illinois	82,000
Assembly/European Headquarters/Warehouse	Maasmechelen, Belgium	75,800
Corporate Headquarters	Golden Valley, Minnesota	68,000
Manufacturing/Office	Sioux Falls, South Dakota	55,000
Sales Office/Warehouse	Atlanta, Georgia	21,700
Sales Office/Warehouse	Los Angeles, California	21,000
Office/Warehouse	Mississauga, Ontario, Canada	20,000
Leased -----		
Distribution/Office/Warehouse	Brooklyn Center, Minnesota	123,800
Engineering/Office/Warehouse	Yokohama, Japan	48,724
Sales Office	Rungis, France	46,600
Assembly/Engineering/Office/Warehouse	Neuss, Germany	41,765
Technical Publications	Minneapolis, Minnesota	18,200
Sales Office	West Midlands, United Kingdom	16,320
Research & Development/Office	Arvada, Colorado	11,600

An 80,000 square foot expansion of the Company's Russell J. Gray Technical Center in Minneapolis was completed and occupied during the first quarter of 1995. An expansion of 8,800 square feet to the Maasmechelen facility was completed in 1995 to accommodate the relocation of European headquarters operations from France to Belgium.

The Company's distribution operations, currently located in 123,800 square feet of space in a Minneapolis suburb under a lease which expires at the end of 1996, will be transferred to a manufacturing and global distribution center under construction in Rogers, Minnesota. The Rogers facility will have 324,000 square feet of space, including office, engineering, research and development, manufacturing, and distribution.

A 55,000 square foot building in Farmington Hills, Michigan and a 57,000 square foot building in Wixom, Michigan were sold during the last quarter of 1995.

The Company leases space for subsidiary sales or liaison offices around the world, some of which have demonstration areas and/or warehouse space.

Graco's facilities are in satisfactory condition, suitable for their respective uses and are sufficient and adequate to meet current needs, with the recent and planned expansions.

Item 3. Legal Proceedings

The Company is engaged in routine litigation incident to its business, which management believes will not have a material adverse effect upon its operations or consolidated financial position.

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

No issues were submitted to a vote of security holders during the fourth quarter of 1995.

Executive Officers of the Company

The following are all the executive officers of the Company as of March 8, 1996. There are no family relationships between any of the officers named.

David A. Koch, 65, is Chairman of the Board, a position he has held since 1985. Prior to January 1, 1996, he was also the Chief Executive Officer of the Company, a position he had held since 1962. He joined the Company in 1956 and held various sales and marketing positions with the Company prior to assuming the office of President in 1962. For a five month period from January to June 1993, he also held the office of President. He has served as a director of the Company since 1962.

George Aristides, 60, was elected President and Chief Executive Officer effective January 1, 1996. He became President and Chief Operating Officer in June 1993. From March 1993 to June 1993, he was Executive Vice President, Industrial/Automotive Equipment Division, Manufacturing, Distribution and Eurafrikan Operations. From 1985 until 1993, he was Vice President, Manufacturing Operations and Controller. He joined the Company in 1973 as Corporate Controller and became Vice President and Controller in 1980. He has served as a director of the Company since 1993.

James A. Graner, 51, was elected Vice President and Controller in February 1994. He became Treasurer in May 1993. Prior to becoming Assistant Treasurer in 1988, he held various managerial positions in the treasury, accounting and information systems departments. He joined Graco in 1974.

Clyde W. Hansen, 63, was elected Vice President, Human Resources and Quality Management Systems, in December 1993. He joined the Company in 1984 as Employee Relations Director, a position he held until his election.

John L. Heller, 59, was elected Vice President, Latin America & Developing Markets, effective January 4, 1996. From July 1993 to December 1995, he was Senior Vice President and General Manager - Contractor Equipment Division. He became Vice President, Far East Operations and Latin America, in 1992. Prior to becoming Vice President, Far East Operations in 1984, he held various management and staff positions in sales and human resources. He joined the Company in 1972.

Roger L. King, 50, was named Vice President & General Manager, European Operations, effective January 4, 1996. From July 1993 to December 1995, he was Senior Vice President and General Manager - International Operations. He became Senior Vice President and Chief Financial Officer in March 1993, and Vice President and Treasurer in 1987. Prior to becoming Vice President, Treasurer and Secretary in 1980, he held the position of Treasurer and Secretary and various treasury management positions with Graco. He joined the Company in 1970.

David M. Lowe, 40, was elected to the position of Treasurer in February 1995. Prior to joining the Company, he was employed by Ecolab Inc., where he held various positions in the Treasury Department, including Manager-Corporate Finance; Director, Corporate Finance and most recently Director, Corporate Development.

Robert M. Mattison, 48, was elected Vice President, General Counsel and Secretary, in January 1992. Prior to joining the Company, he held various legal positions with Honeywell Inc., most recently as Associate General Counsel.

Robert A. Wagner, 45, was elected Vice President, Asia Pacific, of Graco Inc. and President, Graco K.K. effective January 1995. He became Vice President and Treasurer, Graco Inc., in February 1994. He joined the Company in December 1991, as Vice President, Corporate Development and Planning. Prior to joining the Company, he was employed by Texas Instruments for nearly five years, where he held various managerial positions, most recently as Vice President and Manager, Corporate Development.

Clayton R. Carter, 57, was appointed to the position of Vice President, Worldwide Lubrication Equipment Division, effective January 1, 1995. He became Director, Vehicle Services Division, in February 1994. He joined the Company in 1962 and has held various sales management positions, most recently in the Contractor Equipment Division.

Thomas J. Fay, 45, was appointed to the position of Vice President, Worldwide Automotive Equipment Division, effective January 4, 1996. During 1995, he was Vice President, European Operations. Prior to becoming General Manager of European Operations in March 1994, he held the position of General Manager, Region III, in Europe. Mr. Fay joined the Company in 1984 and held various sales management positions before moving to Europe in 1990.

Charles L. Rescorla, 44, is Vice President, Manufacturing Operations, a position to which he was appointed on January 1, 1995. Prior to becoming the Director of Manufacturing in March 1994, he was the Director of Engineering, Industrial Division, a position which he assumed in 1988 when he joined the Company.

With the exception of Clayton R. Carter, Thomas J. Fay, and Charles L. Rescorla, the officers identified were elected by the Board of Directors on May 2, 1995, to hold office until the next annual meeting of directors or until their successors are elected and qualify. George Aristides was elected to the office of President and Chief Executive Officer on December 15, 1995, effective January 1, 1996. Additionally, John L. Heller was elected to the office of Vice President, Latin America & Developing Markets, and Roger L. King was elected to the office of Vice President & General Manager, European Operations on December 15, 1995 effective January 4, 1996. Messrs. Carter, Fay, and Rescorla were appointed to their positions by management effective January 1, 1995, January 4, 1996, and January 1, 1995, respectively.

PART II

Item 5. Market for the Company's Common Stock and Related Stockholder Matters

Graco Common Stock. Graco common stock is traded on the New York Stock Exchange under the ticker symbol "GGG." As of March 8, 1996, there were 17,434,828 shares outstanding and 1,800 common shareholders of record, with another estimated 3,000 shareholders whose stock is held by nominees or broker dealers.

Quarterly Financial Information.

(In thousands, except per share amounts)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1995				
Net Sales	\$ 95,527	\$103,402	\$ 94,797	\$ 92,588
Gross Profit	46,527	51,415	46,287	45,398
Net Earnings (Loss)	5,436	8,532	6,569	7,169
Per Common Share:				
Net Earnings (Loss)	0.31	0.49	0.37	0.41
Dividends Declared	0.11	0.11	0.11	0.12
Stock Price (per share)				
High	\$ 16.17	\$ 19.50	\$ 23.17	\$ 25.50
Low	13.17	16.00	17.42	20.00
Volume (# of shares)	457.9	569.4	1020.4	930.0
1994				
Net Sales	\$ 80,930	\$ 94,179	\$ 89,048	\$ 95,856
Gross Profit	38,436	44,227	43,269	48,079
Net Earnings (Loss)	1,836	4,195	4,248	5,047
Per Common Share:				
Net Earnings (Loss)	0.11	0.24	0.25	0.29
Dividends Declared	0.09	0.09	0.09	0.11
Stock Price (per share)				
High	\$ 16.11	\$ 15.33	\$ 12.59	\$ 14.50
Low	13.33	12.50	11.25	12.00
Volume (# of shares)	3,085.5	561.0	904.5	432.0

1 All per share data has been restated for the three-for-two stock splits declared December 15, 1995 and December 17, 1993 and paid February 7, 1996 and February 2, 1994, respectively.

Item 6. Selected Financial Data

Graco Inc. & Subsidiaries

(In thousands, except per share amounts)

	1995	1994	1993	1992	1991
Net Sales	\$386,314	\$360,013	\$322,602	\$320,334	\$311,874
Earnings Before Change in Accounting Principles	27,706	15,326	9,493	11,145	8,946
Net Earnings	27,706	15,326	9,493	5,301	8,946
Per Common Share:					
Earnings Before Change in Accounting Principles	\$ 1.59	\$ 0.88	\$ 0.55	\$ 0.65	\$ 0.53
Net Earnings	1.59	0.88	0.55	0.31	0.53
Total Assets	\$217,833	\$228,385	\$216,365	\$220,418	\$205,929
Long-term Debt (including current portion)	12,009	32,483	19,480	22,762	23,898
Redeemable Preferred Stock	0	1,474	1,485	1,487	1,493

Cash Dividends Declared
per Common Share

\$ 0.44	\$ 0.39	\$ 2.15	\$ 0.33	\$ 0.30
-----	-----	-----	-----	-----

1 All per share data has been restated for the three-for-two stock splits declared December 15, 1995 and December 17, 1993 and paid February 7, 1996 and February 2, 1994, respectively.

2 Includes the special one-time dividend of \$1.80 per post-split share declared December 17, 1993 and paid March 21, 1994.

Above information includes Lockwood Technical, Inc. (LTI) and Graco Robotics Inc. (GRI), former wholly-owned subsidiaries, sold in 1992 and 1991, respectively.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

MANAGEMENT'S REVIEW AND DISCUSSION

The following is Management's Review and Discussion and is not covered by the Independent Auditors' Report. All per share data has been restated for the three-for-two stock splits declared December 15, 1995 and December 17, 1993 and paid February 7, 1996 and February 2, 1994, respectively.

Graco's net earnings of \$27.7 million in 1995 are 81 percent higher than the \$15.3 million earned in 1994 and are significantly higher than the \$9.5 million recorded in 1993. The large increases in 1995 and 1994 primarily reflect higher global sales and enhanced profit margins. Operating costs include increased product development expenditures and restructuring charges.

The following table indicates the percentage relationship between income and expense items, included in the Consolidated Statements of Earnings for the three most recent fiscal years and the percentage changes in those items for such years.

	Revenue & Expense Item As a % of Net Sales			Revenue & Expense Item % Increase (Decrease)	
	1995	1994	1993	1995/94	1994/93
Net Sales	100.0	100.0	100.0	7	12
Cost of Products Sold	50.9	51.7	52.6	6	10
Product Development	4.1	4.0	3.8	8	18
Selling	22.4	25.8	26.6	(7)	8
General & Administrative	10.9	11.2	11.8	4	6
Operating Profit	11.7	7.3	5.2	71	56
Interest Expense	(0.6)	(0.5)	(0.7)	21	(16)
Other Income (Expense), Net	0.2	(0.3)	(0.3)	nmf	nmf
Earnings Before Income Taxes	11.3	6.5	4.2	86	70
Income Taxes	4.1	2.2	1.3	96	88
Net Earnings	7.2	4.3	2.9	81	61

nmf - No Meaningful Figure

NET SALES

In 1995, Graco posted a year of record net sales, with a 7 percent increase over 1994 to \$386 million. The 1995 increase was principally due to higher worldwide sales in all divisions except Contractor Equipment. Geographically, net sales in the Americas of \$239 million in 1995 decreased by 1 percent when compared to 1994. With improving economies and strong currencies during most of the year, European sales increased 25 percent in 1995 to \$82 million (a 15 percent volume increase and a 10 percent gain due to foreign currency exchange rates). Sales in Asia Pacific were up 23 percent in 1995 to \$65 million (a 15 percent volume increase and an 8 percent gain due to foreign currency exchange rates). The impact of foreign currency exchange rate translations

on sales was not significant in 1994 when compared to 1993.

Consolidated backlog at December 29, 1995 was \$20 million compared to \$25 million at the end of 1994 and \$20 million at the end of 1993.

Sales increased 7 percent in 1995 when compared to 1994 and 12 percent in 1994 compared to 1993.

(In thousands)	1995	1994	1993	% Increase 1995/94	(Decrease) 1994/93
Division Sales:					
Industrial Equipment	\$151,016	\$136,995	\$118,155	10	16
Automotive Equipment	75,637	67,457	64,765	12	4
Contractor Equipment	118,818	121,478	110,802	(2)	10
Lubrication Equipment	40,843	34,083	28,880	20	18
Consolidated	\$386,314	\$360,013	\$322,602	7	12
Geographic Sales:					
Americas	\$238,874	\$241,169	\$206,464	(1)	17
Europe	82,552	65,888	60,546	25	9
Asia Pacific	64,888	52,956	55,592	23	(5)
Consolidated	\$386,314	\$360,013	\$322,602	7	12

COST OF PRODUCTS SOLD

The cost of products sold, as a percent of net sales, declined in 1995 to 50.9 percent from 51.7 percent in 1994. This decrease was the result of a combination of factors, including modest price increases. In 1994, cost of products sold, as a percent of net sales, declined from 52.6 percent in 1993, primarily due to manufacturing efficiencies gained from continued investment in state-of-the-art manufacturing technology and increased manufacturing volumes.

Periodic price increases have generally permitted the Company to recover increases in the cost of products sold. The Company's most recent U.S. price increase was effective in January of 1996, and represented an average 4 percent increase from its January 1995 price lists. The January 1995 price change was an average 2 percent increase from April 1994 prices.

OPERATING EXPENSES

Operating expenses in 1995 decreased 2.2 percent from 1994, due primarily to the impact of Graco's worldwide cost restructuring initiatives and reduced restructuring charges in 1995. Operating expenses in 1994 increased 8.4 percent from 1993, due primarily to continuing investment in product development and ongoing restructuring initiatives. In 1994, restructuring and workforce reduction charges accounted for over half of the increase from 1993 operating expenses.

Product development expenses in 1995 increased 7.7 percent over 1994 to \$15.7 million. In 1994, product development costs were 17.8 percent higher than 1993. These increases reflect Graco's commitment to expanding sales through new product introductions.

FOREIGN CURRENCY EFFECTS

The costs of the Company's products are generally denominated in U.S. dollars, with approximately 16 percent sourced in non-U.S. currencies. A greater proportion of sales, approximately 38 percent, is denominated in currencies other than the U.S. dollar. As a result, a weakening of the U.S. dollar increases sales more than costs and expenses, improving the Company's gross margin and operating profits. During both 1995 and 1994, the U.S. dollar was generally weaker against other major currencies.

The gains and losses that resulted from the translation of the financial statements for all non-U.S. subsidiaries and the gains and losses on the forward and option contracts the Company uses to hedge these exposures, are included in Other income (expense).

In total, the effect of the changes in foreign currency exchange rates on operating profits and the gains and losses included in Other income (expense) increased earnings before income taxes by \$3.5 million in 1995 when compared to 1994, and by \$2.3 million

in 1994 when compared to 1993.

OTHER INCOME (EXPENSE)

The Company's interest expense grew in 1995, reflecting an increase in the average levels of debt during the year and slightly higher interest rates. This increase was principally used to support the funding of Graco's working capital requirements and capital expenditures during the first half of the year. Strong cash flows from operations during the second half of the year resulted in long term debt (including the current portion thereof) declining to \$12 million as compared to \$32 million at the end of 1994 and \$19 million at the end of 1993.

Other income of \$0.7 million, and other expense of \$1 million and \$0.8 million for 1995, 1994, and 1993, respectively, include, among other things, the foreign currency exchange gains and losses discussed above and a \$0.9 million gain from the sale of unutilized real estate in 1995.

INCOME TAXES

The Company's net effective tax rate of 36 percent in 1995 is 1 percentage point higher than the 1995 U.S. federal tax rate of 35 percent. The increase from the 35 percent effective tax rate in 1994 was due primarily to the reduced relative effect of U.S. general business tax credits. The effective tax rate of 31 percent in 1993 was less than the 1994 rate of 35 percent, principally as a result of a non-recurring tax benefit. Detailed reconciliations of the U.S. federal tax rate to the effective rates for 1995, 1994, and 1993 are discussed in Note D to the consolidated financial statements.

EARNINGS

In 1995, earnings increased by 81 percent to \$27.7 million, or \$1.59 per share as compared to 1994, when earnings increased by 61 percent to \$15.3 million or \$.88 per share as compared to 1993.

STOCK BASED COMPENSATION

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation," which encourages a fair value based method of accounting for stock based compensation plans and requires adoption of disclosure provisions no later than fiscal years beginning after December 15, 1995. Graco has not yet determined if it will elect to change to the fair value method, nor has it determined the effect the new standard will have on net income and earnings per share should it elect to make such a change. Adoption of this new standard will have no effect on Graco's cash flows.

OUTLOOK

Graco is cautiously optimistic about improved financial performance in 1996 given softness in the North American and German economies. Graco has successfully undertaken significant restructuring efforts in recent years and anticipates implementing additional measures in 1996. These efforts have resulted in improving customer service and profit margins along with providing resources that will be used for investments in product development and capital additions.

Margins are expected to improve slightly in 1996, subject to fluctuations in the U.S. dollar and increased sales volumes. Operating expenses as a percentage of net sales are expected to decline, even though product development expenses will increase as the Company continues to invest in its long-term strategic initiatives in product development.

DIVIDEND ACTIONS

Periodically, the Company initiates measures aimed at enhancing shareholder value, broadening common stock ownership, improving the liquidity of its common shares, and effectively managing its cash balances. A summary of recent actions follows:

- a three-for-two stock split declared in 1995;
- a 13 percent increase in the regular dividend in 1995;
- a 14 percent increase in the regular dividend in 1994;
- a three-for-two stock split declared in 1993;
- a special one-time dividend of \$1.80 per post-split share declared in 1993 (\$31.2 million in total); and
- a 10 percent increase in the regular dividend in 1993.

ASSETS

The following table highlights several key measures of asset performance.

(\$ in thousands)	1995	1994	1993
Cash, Cash Equivalents & Marketable Securities	\$ 1,643	\$ 2,444	\$37,440
Working Capital	\$56,899	\$54,405	\$47,648
Current Ratio	1.8	1.6	1.5
Average Days Receivables Outstanding	73	71	71
Inventory Turnover	4.3	4.3	4.0

Average inventory balances increased during 1995 when compared to 1994; however, year-end inventory decreased 17.5 percent to \$41.7 million. The year-end decline in inventories was primarily due to shipments of several large engineered systems in the last quarter and efforts to bring inventory levels in line with reduced sales volume. Accounts receivable decreased 3.2 percent to \$73.2 million. The decrease was due to a combination of factors, including lower sales during the last quarter of 1995.

LIABILITIES

During 1995, total debt (notes payable plus long-term debt, including the current portion) was reduced by \$27.1 million. At the end of 1995, the Company's long-term debt (including the current portion thereof) was 10 percent of capital (long-term debt plus shareholders' equity) compared to 28 percent in 1994 and 21 percent in 1993. The Company's total debt to total capital (notes payable plus long-term debt plus shareholders' equity) fell to 14 percent at the end of 1995; down from 35 percent in 1994. The Company had \$67.5 million in unused credit lines available at December 29, 1995. While the Company believes that available credit lines plus operating cash flows are adequate to fund its short and long-term initiatives, additional credit lines may be arranged from time to time as deemed necessary.

SHAREHOLDERS' EQUITY

Shareholders' equity totaled \$103.6 million on December 29, 1995, \$21.7 million higher than 1994, and \$28.9 million higher than 1993.

CASH FLOWS FROM OPERATING ACTIVITIES

During 1995, the Company's operating cash flow of \$51.7 million increased significantly over 1994 due to higher net earnings and changes in working capital requirements. Cash flow from operating activities in 1994 was \$8.6 million, \$14.5 million less than the \$23.1 million recorded in 1993.

Cash flows from operating activities have been, and are expected to be, the principal source of funds required for future additions to property, plant and equipment, and working capital, as well as for other corporate purposes.

CASH FLOWS FROM INVESTING ACTIVITIES

Capital expenditures were \$19.8 million in 1995, \$23.1 million in 1994, and \$16.2 million in 1993. These expenditures have enhanced the Company's engineering and manufacturing capabilities, improved product quality, increased capacity, and lowered costs. Substantial expenditures in 1995 included the completion of the Russell J. Gray Technical Center expansion located in Minneapolis, Minnesota and the addition of major manufacturing equipment assets.

The Company expects to spend approximately \$35 million on capital improvements in 1996. This amount includes approximately \$17 million for the construction of the new manufacturing and distribution facility in Rogers, Minnesota. The balance of capital expenditures in 1996 will be primarily for manufacturing

equipment and cellular manufacturing initiatives.

During 1995, the Company realized cash proceeds of \$3.0 million from sales of unutilized real estate. In 1994, the Company sold its marketable securities to fund a special one-time dividend of \$31.2 million paid to shareholders on March 21, 1994.

CASH FLOWS FROM FINANCING ACTIVITIES

The amount of common stock issued represents the funds received for shares sold through the Company's dividend reinvestment plan, its Employee Stock Purchase Plan, and the distribution of shares pursuant to its Long Term Stock Incentive Plan, more fully described in Note F to the Consolidated Financial Statements.

Graco offers an Automatic Dividend Reinvestment Plan, which provides shareholders with a simple and convenient way to reinvest quarterly cash dividends in additional shares of Graco common stock. Brokerage and service charges are paid by the Company.

All Graco employees in the U.S. participate in the Graco Employee Stock Ownership Plan. Eligible employees may also purchase Graco common stock through the Company's Employee Stock Purchase Plan.

From time to time, the Company may make open market purchases of its common shares. On February 25, 1994, the Company's Board of Directors authorized management to repurchase up to 600,000 shares for a period not to exceed two years. As of December 29, 1995, under this repurchase program, the Company has repurchased 380,100 shares at an average price per share of \$11.96. No shares were acquired in 1995. On February 23, 1996, the Board of Directors authorized management to repurchase up to 800,000 shares for a period ending on February 28, 1998.

Graco is currently paying 12 cents per share as its regular quarterly dividend. Annual cash dividends paid on the Company's common and preferred stock, including a special one-time dividend of \$31.2 million paid on March 21, 1994, were \$7.5 million in 1995, \$37.7 million in 1994, and \$5.9 million in 1993. The Company expects to continue paying regular quarterly dividends to its common shareholders at amounts which will be adjusted periodically to reflect earnings performance and management expectations.

In 1995, the Company redeemed all of its 5 percent cumulative preferred stock for approximately \$1.5 million.

During 1995, debt was reduced by \$27.1 million, reflecting strong cash flows from operations attributable to higher net income and lower working capital requirements.

Item 8. Financial Statements and Supplementary Data

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Responsibility For Financial Reporting

Management is responsible for the accuracy, consistency, and integrity of the information presented in this annual report on Form 10-K. The consolidated financial statements and financial statement schedules have been prepared in accordance with generally accepted accounting principles and, where necessary, include estimates based upon management's informed judgment.

In meeting this responsibility, management believes that its internal control structure provides reasonable assurance that the Company's assets are safeguarded and transactions are executed and recorded by qualified personnel in accordance with approved procedures. Internal auditors periodically review the internal control structure. Deloitte & Touche LLP, independent certified public accountants, are retained to audit the consolidated financial statements, and express an opinion thereon. Their opinion follows.

The Board of Directors pursues its oversight role through its Audit Committee. The Audit Committee, composed of directors who are not employees, meets twice a year with management, internal auditors, and Deloitte & Touche LLP to review the internal control structure, accounting practices, financial reporting, and the results of auditing activities.

INDEPENDENT AUDITORS' REPORT

Shareholders and Board of Directors
Graco Inc.
Minneapolis, Minnesota

We have audited the accompanying consolidated balance sheets of Graco Inc. and Subsidiaries (the "Company") as of December 29, 1995, December 30, 1994, and December 31, 1993, and the related consolidated statements of earnings and consolidated cash flows for each of the three years in the period ended December 29, 1995. Our audit also included the financial statement schedule listed in the Index at Item 14. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Graco Inc. and Subsidiaries as of December 29, 1995, December 30, 1994, and December 31, 1993, and the results of their operations and their cash flows for each of the three years in the period ended December 29, 1995, in conformity with generally accepted accounting principles. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Deloitte & Touche LLP

Deloitte & Touche LLP
Minneapolis, Minnesota
January 23, 1996

CONSOLIDATED STATEMENTS OF EARNINGS

GRACO INC. & Subsidiaries

Years Ended

(In thousands, except per share amounts)	December 29, 1995	December 30, 1994	December 31, 1993
Net Sales	\$386,314	\$360,013	\$322,602
Cost of products sold	196,687	186,002	169,475
Gross Profit	189,627	174,011	153,127
Product development	15,715	14,591	12,382
Selling	86,634	92,752	85,757
General and administrative	42,044	40,279	38,086
Operating Profit	45,234	26,389	16,902
Interest expense	(2,335)	(1,923)	(2,288)
Other income (expense), net	657	(1,040)	(821)
Earnings before Income Taxes	43,556	23,426	13,793
Income taxes	15,850	8,100	4,300
Net Earnings	\$ 27,706	\$ 15,326	\$ 9,493
Net Earnings Per Common Share	\$ 1.59	\$ 0.88	\$ 0.55

See Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

GRACO INC. & Subsidiaries

(In thousands, except share amounts)	December 29, 1995	December 30, 1994	December 31, 1993
Assets			
Current Assets:			
Cash and cash equivalents	\$ 1,643	\$ 2,444	\$ 11,095
Marketable securities	-	-	26,345
Accounts receivable, less allowances of \$4,800, \$4,700, and \$4,100	73,205	75,589	62,178
Inventories	41,693	50,529	35,719
Deferred income taxes, net	10,608	11,755	8,843
Other current assets	1,333	3,628	3,079
Total current assets	128,482	143,945	147,259
Property, Plant and Equipment, at Cost:			
Land	3,502	3,547	3,125
Buildings and improvements	50,534	46,777	41,526
Manufacturing equipment	71,437	60,014	53,629
Office, warehouse & automotive equipment	28,578	27,337	29,092
Construction in progress	2,117	7,489	2,504
Accumulated depreciation	(79,310)	(75,124)	(72,132)
Other Assets	12,493	14,400	11,362
	\$217,833	\$228,385	\$216,365
Liabilities and Shareholders' Equity			
Current Liabilities:			
Notes payable to banks	\$ 5,051	\$ 11,675	\$ 3,234
Current portion of long-term debt	1,935	5,685	5,543
Trade accounts payable	13,849	19,764	16,737
Salaries, wages and commissions	14,260	13,433	12,115
Dividends payable	2,072	1,857	32,535
Accrued insurance liabilities	10,792	9,918	8,783
Income taxes payable	4,229	5,761	5,658
Other current liabilities	19,395	21,447	15,006
Total current liabilities	71,583	89,540	99,611
Long-term Debt, less current portion	10,074	26,798	13,937
Retirement Benefits & Deferred Compensation	32,605	30,196	28,132
Commitments and Contingencies (Note H)			
Shareholders' Equity			
5% Cumulative Preferred Stock, \$100 par value; 22,549 shares authorized; 0, 14,740, and 14,845 shares outstanding	-	1,474	1,485
Common stock, \$1 par value; 22,500,000 shares authorized; 17,264,509, 11,377,004, and 11,449,623 shares outstanding	17,265	11,377	11,449
Additional paid-in capital	20,397	18,289	19,813
Retained earnings	64,949	50,702	42,430
Other, net	960	9	(492)
Total Shareholders' Equity	103,571	81,851	74,685
	\$217,833	\$228,385	\$216,365

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

GRACO INC. & Subsidiaries

(In thousands)	Years Ended		
	December 29, 1995	December 30, 1994	December 31, 1993
Cash Flows from Operating Activities:			
Net earnings	\$ 27,706	\$ 15,326	\$ 9,493
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	11,082	10,447	9,292
Deferred income taxes	1,938	(4,042)	827
Change in:			
Accounts receivable	4,499	(10,806)	(730)
Inventories	9,693	(13,967)	14,901
Trade accounts payable	(6,193)	2,358	(3,226)
Accrued salaries	999	1,439	(749)
Retirement benefits and deferred compensation	2,448	1,670	2,481
Other accrued liabilities	(3,417)	6,858	(4,782)
Other	2,955	(696)	(4,391)
	51,710	8,587	23,116
Cash Flows from Investing Activities:			
Property, plant and equipment additions	(19,848)	(23,100)	(16,178)
Proceeds from sale of property, plant and equipment	3,036	693	795
Purchases of marketable securities	-	(5,464)	(25,703)
Proceeds from sales of marketable securities	-	31,809	18,675
	(16,812)	3,938	(22,411)
Cash Flows from Financing Activities:			
Borrowing on notes payable and lines of credit	44,248	10,411	15,098
Payments on notes payable and lines of credit	(50,927)	(2,395)	(15,567)
Proceeds from long-term debt	-	16,632	1,297
Payments on long-term debt	(20,333)	(5,380)	(5,739)
Common stock issued	2,485	3,102	3,390
Retirement of common & preferred stock	(1,547)	(4,564)	(1,750)
Cash dividends paid	(7,490)	(37,732)	(5,879)
	(33,564)	(19,926)	(9,150)
Effect of exchange rate changes on cash	(2,135)	(1,250)	671
Net decrease in cash and cash equivalents	(801)	(8,651)	(7,774)
Cash and cash equivalents:			
Beginning of year	2,444	11,095	18,869
End of year	\$ 1,643	\$ 2,444	\$ 11,095

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

GRACO INC. & Subsidiaries

Years Ended December 29, 1995, December 30, 1994, and December 31, 1993

A. Summary of Significant Accounting Policies

FISCAL YEAR. The Company's fiscal year is 52 or 53 weeks, ending on the last Friday in December.

BASIS OF STATEMENT PRESENTATION. The consolidated financial statements include the accounts of the parent company and its subsidiaries after elimination of all significant intercompany balances and transactions. As of December 29, 1995, all subsidiaries are 100 percent owned. Subsidiaries outside North America have been included principally on the basis of fiscal years ended November 30 to effect more timely consolidated financial reporting. The U.S. dollar was the functional currency for all foreign subsidiaries. Prior to 1995, the local currency was the functional currency for Graco K.K. (Japan), and prior to 1994 for Graco N.V. (Belgium).

CASH, CASH EQUIVALENTS, AND MARKETABLE SECURITIES. All highly liquid investments with a maturity of three months or less at the date of purchase are considered to be cash equivalents. Marketable securities include debt securities of various maturities. Realized gains and losses are computed based on the specific identified cost method. At December 31, 1993, the securities were reported at fair value, which approximated cost.

INVENTORY VALUATION. Inventories are stated at the lower of cost or market. The last-in, first-out (LIFO) cost method is used for valuing all U.S. inventories. Inventories of foreign subsidiaries are valued using the first-in, first-out (FIFO) cost method.

CURRENCY HEDGES. The Company periodically evaluates its monetary asset and liability positions denominated in foreign currencies. Subsequently, the Company enters into forward contracts, borrowings in various currencies, or options, in order to hedge its net monetary positions. Consistent with financial reporting requirements, these hedges of net monetary positions are recorded at current market values and the gains and losses are included in Other income (expense). The Company believes it uses strong financial counterparties in these transactions and that the resulting credit risk under these hedging strategies is not significant. The notional amounts (which do not represent credit or market risk) of such contracts were (in U.S. dollars) \$10,226,000, \$9,086,000, and \$15,258,000, at December 29, 1995, December 30, 1994, and December 31, 1993, respectively.

PROPERTY, PLANT AND EQUIPMENT. For financial reporting purposes, plant and equipment are depreciated over their estimated useful lives, primarily by using the straight-line method as follows:

Buildings and improvements	10 to 30 years
Leasehold improvements	3 to 10 years
Manufacturing equipment and tooling	3 to 10 years
Office, warehouse and automotive equipment	4 to 10 years

REVENUE RECOGNITION. Revenue is recognized on large contracted systems using the percentage-of-completion method of accounting. The Company recognizes revenue on other products when title passes, which is usually upon shipment.

INCOME TAXES. The Company provides taxes on unremitted earnings of subsidiaries.

EARNINGS PER COMMON SHARE. The Board of Directors approved three-for-two stock splits on December 15, 1995 and on December 17, 1993 effected in the form of 50 percent stock dividends payable February 7, 1996 and February 2, 1994, respectively, to shareholders of record on January 3, 1996 and January 5, 1994, respectively. All share and per share data has been restated to reflect the splits. Earnings per common share are computed on earnings reduced by dividend requirements on preferred stock and based upon the weighted average number of common shares and common equivalent shares, consisting of the

dilutive effect of stock options outstanding during each year. Earnings per common share, assuming full dilution, are substantially the same.

STOCK BASED COMPENSATION. In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation," which encourages a fair value based method of accounting for stock based compensation plans and requires adoption of disclosure provisions no later than fiscal years

beginning after December 15, 1995. The new standard encourages a fair value method of accounting for stock options and other equity instruments. Under the fair value method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the service period, which is usually the vesting period. The Company has not yet determined if it will elect to change to the fair value method, nor has it determined the effect the new standard will have on net income and earnings per share should it elect to make such a change. Adoption of the new standard would have no effect on the Company's cash flows.

B. INDUSTRY SEGMENT AND FOREIGN OPERATIONS

The Company operates in one industry segment, namely the design, manufacture, marketing, sale and installation of systems, and equipment for the management of fluids.

The Company's operations by geographical area for the last three years are shown below.

(In thousands)	1995	1994	1993

Sales to unaffiliated customers:			
Americas	\$238,874	\$241,169	\$206,464
Europe	82,552	65,888	60,546
Asia Pacific	64,888	52,956	55,592
	-----	-----	-----
	386,314	360,013	322,602
Intercompany sales between geographic areas:			
Americas	56,703	51,939	38,902
Europe	32	14	3,798
Asia Pacific	1,398	450	402
Eliminations	(58,133)	(52,403)	(43,102)
	-----	-----	-----
Total sales	\$386,314	\$360,013	\$322,602
	=====	=====	=====
Operating profit:			
Americas	\$ 70,037	\$ 62,650	\$ 46,260
Europe	1,916	(5,463)	(2,780)
Asia Pacific	4,384	1,639	654
Eliminations	1,139	(2,205)	1,627
	-----	-----	-----
	77,476	56,621	45,761
General corporate expenses	(31,585)	(31,272)	(29,680)
Interest expense	(2,335)	(1,923)	(2,288)
	-----	-----	-----
Earnings before income taxes	\$ 43,556	\$ 23,426	\$ 13,793
	=====	=====	=====
Assets:			
Americas	\$152,831	\$163,201	\$128,713
Europe	46,618	50,503	30,737
Asia Pacific	26,985	26,605	25,680
Corporate	1,643	2,444	37,440
Eliminations	(10,244)	(14,368)	(6,205)
	-----	-----	-----
Total assets	\$217,833	\$228,385	\$216,365
	=====	=====	=====

1 Included are U.S. export sales to unaffiliated customers of \$29,549, \$23,408, and \$25,251 in 1995, 1994, and 1993, respectively.

2 Transfers between entities are made at prices which allow appropriate markups to the manufacturing and selling unit.

Net earnings (loss) for subsidiaries operating outside the U.S. were \$12,506,000, (\$5,624,000), and (\$2,261,000) for 1995, 1994, and 1993, respectively.

Retained earnings for subsidiaries operating outside the U.S. were \$4,373,000, \$8,860,000, and \$9,760,000 for 1995, 1994, and 1993, respectively.

Transaction and translation net gains or losses, included in Other income (expense), net were \$528,000, \$366,000, and

(\$1,294,000) for 1995, 1994, and 1993, respectively.

C. INVENTORIES

Major components of inventories for the last three years were as follows:

(In thousands)	1995	1994	1993
Finished products and components	\$ 40,335	\$ 46,694	\$ 42,010
Products and components in various stages of completion	22,597	24,826	21,410
Raw materials	13,152	13,918	8,642
	-----	-----	-----
Reduction to LIFO cost	76,084 (34,391)	85,438 (34,909)	72,062 (36,343)
	-----	-----	-----
	\$ 41,693	\$ 50,529	\$ 35,719
	=====	=====	=====

Inventories valued under the LIFO method were \$23,783,000, \$32,743,000, and \$19,700,000 for 1995, 1994, and 1993, respectively. The balance of the inventory was valued on the FIFO method.

In 1995 and 1993, certain inventory quantities were reduced, resulting in liquidation of LIFO inventory quantities carried at different costs from prior years. The effect was to decrease net earnings in 1995 by approximately \$100,000 and increase net earnings in 1993 by approximately \$900,000.

D. INCOME TAXES

Earnings before income tax expense consists of:

(In thousands)	1995	1994	1993
Domestic	\$27,247	\$28,168	\$13,796
Foreign	16,309	(4,742)	(3)
	-----	-----	-----
Total	\$43,556	\$23,426	\$13,793
	=====	=====	=====

Income tax expense consists of:

(In thousands)	1995	1994	1993
Current:			
Domestic:			
Federal	\$ 9,629	\$ 9,383	\$ 1,598
State and local	1,591	1,030	385
Foreign	3,479	2,596	1,551
	-----	-----	-----
	14,699	13,009	3,534
	-----	-----	-----
Deferred:			
Domestic	227	(3,617)	(134)
Foreign	924	(1,292)	900
	-----	-----	-----
	1,151	(4,909)	766
	-----	-----	-----
Total	\$15,850	\$ 8,100	\$ 4,300
	=====	=====	=====

Income taxes paid were \$16,019,000, \$12,136,000, and \$4,620,000 in 1995, 1994, and 1993, respectively.

A reconciliation between the U.S. federal statutory tax rate and the effective tax rate is as follows:

	1995	1994	1993
	----	----	----
Statutory tax rate	35%	35%	35%
Foreign earnings with (lower) higher tax rates	(1)	2	1
State taxes, net of federal effect	2	3	2
Increase in deferred tax assets from statutory tax rate increase	-	-	(3)
U.S. general business tax credits	(1)	(3)	(1)
Other	1	(2)	(3)
	----	----	----
Effective tax rate	36%	35%	31%
	====	====	====

Deferred income taxes are provided for all temporary differences between the financial reporting and the tax basis of assets and liabilities. The deferred tax assets (liabilities) resulting from these differences are as follows:

(In thousands)	1995	1994	1993
Inventory valuations	\$ 3,726	\$ 4,616	\$ 3,004
Cost reductions and severance accruals	1,115	1,377	742
Insurance accruals	3,505	3,232	2,876
Vacation accruals	1,378	1,428	1,398
Bad debt reserves	961	893	894
Other	(77)	422	(71)
Valuation allowance	-	(213)	-
Current	\$10,608	\$11,755	\$ 8,843
Unremitted earnings of consolidated foreign subsidiaries	(3,529)	(2,938)	(4,141)
Excess of tax over book depreciation	(3,896)	(3,104)	(2,845)
Postretirement benefits	4,653	4,447	4,194
Pension and deferred compensation	5,666	5,103	4,856
Net operating loss carry forward	4,404	6,715	2,066
Other	1,207	407	895
Valuation allowance	(5,015)	(6,680)	(2,740)
Non-current	3,490	3,950	2,285
Net deferred tax assets	\$14,098	\$15,705	\$11,128

1 Payable at the time these earnings are distributed to the parent.

Net non-current deferred tax assets above are included in other assets. Total deferred tax assets were \$23,040,000, \$22,506,000, and \$18,637,000, and total deferred tax liabilities were \$8,942,000, \$6,801,000, and \$7,509,000 on December 29, 1995, December 30, 1994, and December 31, 1993, respectively. A valuation allowance of \$5,015,000, \$6,893,000, and \$2,740,000 has been recorded as of December 29, 1995, December 30, 1994, and December 31, 1993, respectively, primarily related to the uncertainty of obtaining tax benefits for subsidiary operating losses, which expire beginning in 1998 in Japan and in later years for other subsidiaries. The effect of these allowances has been considered in "Foreign earnings with (lower) higher tax rates" in the Company's tax rate reconciliation.

E. DEBT

Long-term debt consists of the following:

(In thousands)	1995	1994	1993
Term debt, 6.53%, payable in equal annual installments through 1995	\$ -	\$ 4,000	\$ 8,000
Term debt, 5.36% at December 29, 1995, payable in equal annual installments through 1997	600	900	1,200
Industrial development refunding revenue bonds, 4.65% at December 29, 1995, payable through 2002 (property carried at \$3,265 pledged as collateral)	4,500	5,000	5,500
Revolving credit agreement, 7% at December 30, 1994, payable September 30, 1996	-	14,850	-
Obligations related to low income housing investments	4,063	4,534	2,867
Other	2,846	3,199	1,913
Total long-term debt	12,009	32,483	19,480
Less current portion	1,935	5,685	5,543
Long-term portion	\$10,074	\$26,798	\$13,937

Aggregate annual scheduled maturities of long-term debt for the next five years are as follows: 1996, \$1,935,000; 1997, \$1,781,000; 1998, \$1,798,000; 1999, \$3,433,000; 2000, \$1,202,000. Interest paid on debt during 1995, 1994, and 1993

amounted to \$2,179,000, \$1,923,000, and \$3,230,000, respectively. The fair value of the Company's long-term debt at December 29, 1995, December 30, 1994, and December 31, 1993, is not materially different than its recorded value.

The Company has an interest rate swap agreement in place whereby it fixed the interest rate of the remaining principal amounts of the Company's previously variable interest rate revenue bond debt at 4.65 percent through 1997, at which time the debt will revert back to a variable interest rate. The cash flows related to the swap agreement are recorded as income when received and expense when paid. Market and credit risk are not significant.

On December 29, 1995, the Company had lines of credit with U.S. and foreign banks of \$71,697,000, including a \$25,000,000 revolving credit agreement. The unused portion of these credit lines was \$67,521,000 at December 29, 1995. Borrowing rates under these facilities vary with the prime rate, rates on domestic certificates of deposit, and the London interbank market. The weighted short-term borrowing rates were 2.2 percent, 5.6 percent, and 4.4 percent at December 29, 1995, December 30, 1994, and December 31, 1993, respectively. The Company pays commitment fees of up to 3/16 percent per annum on the daily average unused amounts on certain of these lines. No compensating balances are required.

The Company is in compliance with the financial covenants of its debt agreements. Under the most restrictive terms of the agreements, approximately \$18,669,000 of retained earnings were available for payment of cash dividends at December 29, 1995.

F. SHAREHOLDERS' EQUITY

During 1995, the Company redeemed all 14,740 outstanding shares of cumulative preferred stock at the call price of \$105 per share, plus accrued and unpaid dividends. Prior to the redemption, the holders of the cumulative preferred stock were entitled to fixed cumulative dividends of 5 percent per annum on the par value before cash dividends were paid or declared on common stock. At December 29, 1995, the Company has 22,549 authorized, but not issued, cumulative preferred shares.

The Company has authorized, but not issued, a separate class of 3,000,000 shares of preferred stock, \$1 par value.

The Company has a leveraged Employee Stock Ownership Plan (ESOP) under which outstanding debt was \$600,000, \$900,000, and \$1,200,000 at December 29, 1995, December 30, 1994, and December 31, 1993, respectively. This is also the remaining balance of a concurrent loan to the ESOP Trust from the Company on the same terms. The Company's loan is included in long-term debt with the receivable from the ESOP in a like amount recorded as a reduction of shareholders' equity reflected in the Other, net category. The Company is obligated to make annual contributions to the ESOP Trust through 1997 sufficient to repay the loan and interest thereon.

The Board of Directors approved three-for-two stock splits on December 15, 1995, and on December 17, 1993, effected in the form of 50 percent stock dividends payable February 7, 1996 and February 2, 1994, respectively, to shareholders of record on January 3, 1996 and January 5, 1994, respectively. Accordingly, December 29, 1995, and December 31, 1993 balances reflect the splits with an increase in common stock and reduction in retained earnings of \$5,754,000 and \$3,817,000, respectively. All stock option, share, and per share data has been restated to reflect the splits.

On December 17, 1993, the Board of Directors approved a special one-time dividend of \$1.80 per common share to be paid March 21, 1994, on post-split shares to shareholders of record on March 7, 1994. Dividends payable at December 31, 1993, reflect the special one-time dividend.

On May 3, 1994, the shareholders approved a Nonemployee Director Stock Plan which enables individual nonemployee directors of the Company to elect to receive all or part of a director's annual

retainer in the form of shares of the Company's common stock instead of cash. For the year ended December 29, 1995, the Company has issued 485 shares under this plan. No shares were issued during 1994.

Under the Company's Employee Stock Purchase Plan, 3,150,000 common shares have been authorized for sale to employees, 478,219 of which remained unissued at the end of 1995. The purchase price of the shares under the plan is the lesser of 85 percent of the fair market value on the first day or the last day of the plan year.

The Company maintains a plan in which one preferred share purchase right (Right) exists for each common share of the Company. Each Right will entitle its holder to purchase one one-hundredth of a share of a new series of junior participating preferred stock at an exercise price of \$80, subject to adjustment. The Rights are exercisable only if a person or group

acquires beneficial ownership of 20 percent or more of the Company's outstanding common stock. The Rights expire in March 2000 and may be redeemed earlier by the Board of Directors for \$.01 per Right.

The Company has a Long Term Stock Incentive Plan, under which a total of 2,475,000 common shares have been reserved for issuance, with 1,158,167 shares remaining reserved at December 29, 1995. Grants under this plan are in the form of restrictive share awards and stock options. Restrictive share awards of 597,609 common shares have been made to certain key employees under the plan, with 48,551 shares still restricted for disposition, such restrictions lapse in 1996 and 1997. Unearned compensation expense relating to the remaining restricted shares is \$256,000 at December 29, 1995, and is included as a reduction of shareholders' equity in the Other, net category.

Stock options for 1,349,577 common shares have also been granted under the plan. The option price is the market price at the date of grant. Options become exercisable at such time and in such installments as set by the Company, and expire in five to ten years from the date of grant.

In 1993, the Company granted Stock Appreciation Rights (SARs) to certain key employees, utilizing a portion of the above options. Upon exercise of the SARs, the employee will surrender the unexercised related option and will receive a cash payment equal to the excess of the fair market value at the time of exercise over the price of the related option. Compensation expense related to the SARs is not significant.

Shares and options on common shares granted and exercisable, as well as the exercise price, are shown for the last three years in the table below:

	Number Of Shares			Option Price Per Share
	Reserved	Granted	Exercisable	
Balance at December 25, 1992	1,413,417	476,132	261,931	\$ 7.73 - 10.73
Granted	-	124,200	38,813	10.33 - 13.28
Exercised	(195,948)	(195,948)	(195,948)	7.73 - 12.61
Canceled	34,983	(5,175)	7,425	8.44 - 11.83
Balance at December 31, 1993	1,252,452	399,209	112,221	7.73 - 13.28
Granted	-	387,555	80,753	7.72 - 15.09
Exercised	(78,315)	(78,315)	(78,315)	7.72 - 12.61
Canceled	12,081	(23,906)	(3,885)	7.72 - 12.61
Balance at December 30, 1994	1,186,218	684,543	110,774	7.72 - 15.09
Granted	-	147,144	78,266	10.33 - 22.00
Exercised	(38,985)	(38,985)	(38,985)	7.72 - 10.72
Canceled	10,934	(88,839)	(10,813)	11.58 - 20.63
Balance at December 29, 1995	1,158,167	703,863	139,242	\$ 7.72 - 22.00

The changes in shareholders' equity accounts are as follows:

(In thousands)	1995	1994	1993
Preferred stock			
Balance, beginning of year	\$ 1,474	\$ 1,485	\$ 1,487
Shares repurchased	(1,474)	(11)	(2)
Balance, end of year	-	1,474	1,485
Common stock			
Balance, beginning of year	11,377	11,449	7,547
Stock split	5,754	-	3,817
Shares issued	143	188	157
Shares repurchased	(9)	(260)	(72)
Balance, end of year	17,265	11,377	11,449
Additional paid-in capital			
Balance, beginning of year	18,289	19,813	18,569
Shares issued	2,342	2,914	3,198
Shares repurchased	(234)	(4,438)	(1,954)
Balance, end of year	20,397	18,289	19,813
Retained earnings			
Balance, beginning of year	50,702	42,430	73,697
Net Income	27,706	15,326	9,493
Cash Dividends	(7,705)	(7,054)	(36,943)
Stock split	(5,754)	-	(3,817)
Balance, end of year	64,949	50,702	42,430
Cumulative translation adjustment			
Balance, end of year	1,816	1,654	1,958
Other, net			
Balance, end of year	(856)	(1,645)	(2,450)
Total Shareholders' Equity	\$103,571	\$ 81,851	\$ 74,685

G. RETIREMENT BENEFITS

The Company has a defined contribution plan, under Section 401(k) of the Internal Revenue Code, which provides additional retirement benefits to all U.S. employees who elect to participate. Currently, the Company matches employee contributions at a 50 percent rate, up to 3 percent of the employee's compensation. Employer contributions were \$852,000 in 1995, \$850,000 in 1994, and \$819,000 in 1993.

The Company has non-contributory defined benefit pension plans covering substantially all U.S. employees and directors and most of the employees of the Company's non-U.S. subsidiaries. For the U.S. plans, the benefits are based on years of service and the highest five consecutive years' earnings in the ten years preceding retirement. The Company funds these plans annually in amounts consistent with minimum funding requirements and maximum tax deduction limits and invests primarily in common stocks and bonds, including the Company's common stock. The market value of the plan's investment in the common stock of the Company was \$9,188,000, \$6,550,000, and \$7,305,000 at December 29, 1995, December 30, 1994, and December 31, 1993, respectively. The expenses for these plans consist of the following components:

(In thousands)	1995	1994	1993
Service cost - benefits earned during the period	\$ 2,385	\$ 2,499	\$ 2,244
Interest cost on projected benefit obligation	4,561	4,301	4,115
Actual return on assets	(12,774)	579	(11,736)

Net amortization and deferral	7,879	(5,583)	7,354
Cost of pension plans which are not significant and have not adopted SFAS No. 87	65	312	190
	-----	-----	-----
Net periodic pension cost	\$ 2,116	\$ 2,108	\$ 2,167
	=====	=====	=====

The status of the Company's plans and the amounts recognized in the financial statements are:

(In thousands)	1995	1994	1993
Actuarial present value:			
Vested benefit obligation	\$56,710	\$49,429	\$43,492
Accumulated benefit obligation	\$62,408	\$54,884	\$48,644
Projected benefit obligation	\$71,677	\$66,093	\$60,144
Plan assets at fair value	66,182	55,057	57,151
Funded status	(5,495)	(11,036)	(2,993)
Unrecognized net gain	(10,607)	(3,787)	(10,910)
Unrecognized net liability being amortized	113	204	249
Adjustment required to recognize minimum liability	(473)	(1,192)	(467)
Accrued pension cost	(\$16,462)	(\$15,811)	(\$14,121)

Major assumptions at year-end:

	1995	1994	1993
Discount rate	4 - 7%	4 - 7 1/2%	4 - 7 1/2%
Rate of increase in future compensation levels	2 1/2 - 7%	3 - 7%	3 - 7%
Expected long-term rate of return on plan assets	9%	9%	9%

In addition to providing pension benefits, the Company pays part of the health insurance costs for its retired U.S. employees and their dependents.

The cost of retiree health benefit expense for 1995, 1994 and 1993 was as follows:

(In thousands)	1995	1994	1993
Service cost	\$ 496	\$ 503	\$ 454
Interest cost	890	947	976
Net benefit expense	\$1,386	\$1,450	\$1,430

The Company's policy is to fund these benefits on a pay-as-you-go basis. The actuarial present value of these health benefit obligations and the amounts recognized in the consolidated balance sheets were as follows:

(In thousands)	1995	1994	1993
Accumulated postretirement benefit obligation:			
Retirees and beneficiaries	(\$ 4,684)	(\$ 5,502)	(\$ 5,387)
Fully eligible active plan participants	(2,657)	(2,168)	(2,010)
Other active plan participants	(6,067)	(6,104)	(6,090)
Accumulated benefit obligations	(13,408)	(13,774)	(13,487)
Unrecognized net loss	114	1,069	1,504
Accrued postretirement benefit cost	(\$ 13,294)	(\$ 12,705)	(\$ 11,983)

The Company's retirement medical benefit plan limits the annual cost increase that will be paid by the Company. In measuring the

Accumulated postretirement benefit obligation (APBO), a 6 percent maximum annual trend rate for healthcare costs was assumed for the year ended December 29, 1995. This rate is assumed to remain constant through the year 2001, decline by 1/2 percent for each of the following three years to 4.5 percent and remain at that level thereafter. The discount rate assumption at year-end for 1995, 1994, and 1993 was 7.0 percent, 7.5 percent, and 7.5 percent, respectively. If the assumed healthcare cost trend rate changed by 1 percent, the APBO as of December 29, 1995 would change by 8.6 percent. The effect of a 1 percent change in the cost trend rate on the service and interest cost components of the net periodic postretirement benefits expense would be a change of 10.3 percent.

H. COMMITMENTS AND CONTINGENCIES

LEASE COMMITMENTS:

Aggregate annual rental commitments at December 29, 1995, under operating leases with noncancelable terms of more than one year, were \$10,051,000, payable as follows:

(In thousands)	Buildings	Vehicles & Equipment	Total
-----	-----	-----	-----
1996	\$ 3,121	\$ 738	\$ 3,859
1997	2,130	428	2,558
1998	1,606	150	1,756
1999	833	13	846
2000	461	3	464
Thereafter	568	-	568
	-----	-----	-----
	\$ 8,719	\$ 1,332	\$10,051
	=====	=====	=====

Total rental expense was \$4,722,000 for 1995, \$4,103,000 for 1994, and \$4,276,000 for 1993.

CONTINGENCIES:

In 1993, the U.S. District Court for the Southern District of Texas awarded the Company \$2,750,000 in a patent infringement judgment. A subsequent ruling has disallowed treble damages and attorneys' fees, significantly reducing the potential recovery. The Company no longer considers this event material.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

PART III

Part III, Items 10, 11, 12 and 13, except for certain information relating to Executive Officers included in Part I, is omitted as the Company intends to file with the Securities and Exchange Commission within 120 days of the close of the fiscal year ended December 29, 1995, a definitive proxy statement containing such information pursuant to Regulation 14A of the Securities Exchange Act of 1934 and such information shall be deemed to be incorporated herein by reference from the date of filing such document.

The Company knows of no contractual arrangements which may, at a subsequent date, result in a change in control of the Company.

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) The following documents are filed as part of this report:

(1) Financial Statements
See Part II

(2) Financial Statement Schedule Page
- Schedule II - Valuation and Qualifying Accounts 28

All other schedules are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements or Notes thereto.

(3) Management Contract, Compensatory Plan or Arrangement. 30
(See Exhibit Index) Those entries marked by an asterisk are Management Contracts, Compensatory Plans or Arrangements.

(b) Reports on Form 8-K
There were no reports on Form 8-K for the thirteen weeks ended December 29, 1995.

(c) Exhibit Index. 30

Schedule II - Valuation and Qualifying Accounts

GRACO INC. & Subsidiaries

(In thousands)

Description	Balance at beginning of year	Additions charged to costs and expenses	Deductions from reserves	Balance at end of year
Year ended December 29, 1995:				
Allowance for doubtful accounts	\$ 2,700	\$ 700	\$ 600	\$ 2,800
Allowance for obsolete and overstock inventory	6,400	1,400	1,900	5,900
Allowance for returns and credits	2,000	3,400	3,400	2,000
Valuation allowance for tax benefits	6,900	-	1,880	5,020
	<u>\$18,000</u>	<u>\$ 5,500</u>	<u>\$ 7,780</u>	<u>\$15,720</u>
Year ended December 30, 1994:				
Allowance for doubtful accounts	\$ 2,200	\$ 1,200	\$ 700	\$ 2,700
Allowance for obsolete and overstock inventory	5,500	3,100	2,200	6,400
Allowance for returns and credits	1,900	2,000	1,900	2,000
Valuation allowance for tax benefits	2,740	4,160	-	6,900
	<u>\$12,340</u>	<u>\$10,460</u>	<u>\$ 4,800</u>	<u>\$18,000</u>
Year ended December 31, 1993:				
Allowance for doubtful accounts	\$ 2,700	\$ 500	\$ 1,000	\$ 2,200
Allowance for obsolete and overstock inventory	6,100	1,300	1,900	5,500
Allowance for returns and credits	1,800	1,900	1,800	1,900
Valuation allowance for tax benefits	-	2,740	-	2,740
	<u>\$10,600</u>	<u>\$ 6,440</u>	<u>\$ 4,700</u>	<u>\$12,340</u>

1 Accounts determined to be uncollectible and charged against reserve, net of collections on accounts previously charged against reserves.

2 Items scrapped or otherwise disposed of during the year.

3 Credits issued and returns processed, related to prior years.

Exhibit Index

Exhibit Number	Description
3.1	Restated Articles of Incorporation. See also Exhibit 4.3.
3.2	Restated Bylaws. (Incorporated by reference to Exhibit 2 to the Company's Report on Form 8-K dated January 12, 1988.)
3.3	Bylaws Amendment. (Incorporated by reference to Exhibit 1 to the Company's Report on Form 8-K dated March 1, 1990.)
4.1	Credit Agreement dated October 1, 1990, between the Company and First Bank National Association. (Incorporated by reference to Exhibit 5 to the Company's Report on Form 10-Q for the thirty-nine weeks ended September 28, 1990.)
4.2	Amendment 1 dated June 12, 1992, to Credit Agreement dated October 1, 1990, between the Company and First Bank National Association; and Amendment 2 dated December 31, 1992, to the same Agreement. (Incorporated by reference to Exhibit 1 to the Company's Report on Form 8-K dated March 11, 1993.) Amendment 3 dated November 8, 1993, and Amendment 4, dated February 8, 1994. (Incorporated by reference to Exhibit 4.2 to the Company's 1993 Annual Report on Form 10-K.) Amendment 5, dated April 10, 1995. Pursuant to Item 601(b)(4)(iii) of Regulation S-K, copies of certain instruments defining the rights of holders of certain long-term debt of the Company and its subsidiaries are not filed as exhibits because the amount of debt authorized under any such instrument does not exceed 10 percent of the total assets of the Company and its subsidiaries. The Company agrees to furnish copies thereof to the Securities and Exchange Commission upon request.
4.3	Rights Agreement dated as of March 9, 1990, between the Company and Norwest Bank Minnesota, National Association, as Rights Agent, including as Exhibit A the form of the Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Shares. (Incorporated by reference to Exhibit 1 to the Company's Report on Form 8-K dated March 19, 1990.)
*10.1	1995 Corporate and Business Unit Annual Bonus Plan. (Incorporated by reference to Exhibit 10 to the Company's Report on Form 10-Q for the twenty-six weeks ended June 30, 1995.)
*10.2	Deferred Compensation Plan Restated, effective December 1, 1992. (Incorporated by reference to Exhibit 2 to the Company's Report on Form 8-K dated March 11, 1993.)
*10.3	Executive Deferred Compensation Agreement. Form of supplementary agreement entered into by the Company which provides a retirement benefit to executive officers, as amended by Amendment 1, effective September 1, 1990. (Incorporated by reference to Exhibit 3 to the Company's Report on Form 8-K dated March 11, 1993.)
*10.4	Chairman's Award Plan. (Incorporated by reference to Exhibit 3 to the Company's Report on Form 8-K dated March 7, 1988.)

*10.5 Executive Long Term Incentive
Agreements. Form of restricted stock award
agreement used for awards to executive officers.
(Incorporated by reference to Attachment B to Item
5 to the Company's Report on Form 10-Q for the
thirteen weeks ended March 29, 1991.) Form of
restricted stock award agreement used for awards
to Chairman. (Incorporated by reference to
Attachment A to Item 5 to the Company's Report on
Form 10-Q for the twenty-six weeks ended June 28,
1991.)

- *10.6 Executive Long Term Incentive Agreement. Form of agreement used for restricted stock awards to two new officers. (Incorporated by reference to Attachment B to Company's Report on Form 10-Q for the thirteen weeks ended March 27, 1992.)
- *10.7 Executive Long Term Incentive Agreement. Form of agreement used for one year restricted stock award to one officer. (Incorporated by reference to Exhibit 2 to Company's Report on Form 10-Q for the twenty-six weeks ended June 25, 1993.)
- *10.8 Long Term Stock Incentive Plan (Incorporated by reference to Attachment C to the Company's Report on Form 10-Q for the thirteen weeks ended March 27, 1992.)
- *10.9 Retirement Plan for Non-Employee Directors. (Incorporated by reference to Attachment C to Item 5 to the Company's Report on Form 10-Q for the thirteen weeks ended March 29, 1991.)
- *10.10 Deferred Compensation Plan for Non-Employee Directors. (Incorporated by reference to Exhibit 2 to the Company's Report on Form 8-K dated March 7, 1988.)
- *10.11 Restoration Plan, restating Excess Benefit Plan, effective as of July 1, 1988. (Incorporated by reference to Exhibit 1 to the Company's Report on Form 10-Q for the thirteen weeks ended March 26, 1993.)
- *10.12 Stock Option Agreement. Form of agreement used for incentive stock option/alternative stock appreciation right award to selected officers, dated February 25, 1993. (Incorporated by reference to Exhibit 10.14 to the Company's 1993 Annual Report on Form 10-K.)
- *10.13 Stock Option Agreement. Form of agreement used for non-incentive stock option/alternative stock appreciation right award to selected officers, dated May 4, 1993. (Incorporated by reference to Exhibit 10.15 to the Company's 1993 Annual Report on Form 10-K.)
- *10.14 Nonemployee Director Stock Plan (Incorporated by reference to Exhibit 10.1 to the Company's Report on Form 10-Q for the twenty-six weeks ended July 1, 1994.)
- *10.15 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to executive officers, dated May 2, 1994. (Incorporated by reference to Exhibit 10.3 to the Company's Report on Form 10-Q for the twenty-six weeks ended July 1, 1994.)
- *10.16 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to selected officers, dated December 15, 1994, December 27, 1994 and February 23, 1995. (Incorporated by reference to Exhibit 10.16 to the Company's 1994 Annual Report on Form 10-K.)
- *10.17 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to executive officers, dated March 1, 1995. (Incorporated by reference to Exhibit 10 to the Company's Report on Form 10-Q for the thirteen weeks ended March 31, 1995.)
- *10.18 Stock Option Agreement. Form of agreement used for award of non-incentive stock option to one executive officer, dated December

15, 1995.

- *10.19 Stock Option Agreement. Form of agreement used for award of non-incentive stock options to executive officers, dated March 1, 1996.
- *10.20 Salary protection arrangement with one executive officer.
- *10.21 Form of salary protection arrangement between the Company and executive officers.
- 11 Statement of Computation of Earnings per share included herein on page 33.

21 Subsidiaries of the Registrant included herein on page 34.

23 Independent Auditor's Consent included herein on page 34.

24 Power of Attorney included herein on page 35.

27 Financial Data Schedule (EDGAR filing only).

*Management Contracts, Compensatory Plans or Arrangements.

Graco Inc. & Subsidiaries

Computation of Per Share Earnings

(In thousands, except per share amounts)	Years Ended		
	December 29, 1995	December 30, 1994	December 31, 1993
PRIMARY			
Net earnings applicable to common stock:			
Net earnings	\$27,706	\$15,326	\$ 9,493
Less dividends on preferred stock	61	74	74
	-----	-----	-----
	\$27,645	\$15,252	\$ 9,419
	=====	=====	=====
Average number of common shares and common equivalent shares outstanding:			
Average number of common shares outstanding	17,214	17,309	17,079
Dilutive effect of stock options computed based on the treasury stock method using average market price	206	63	119
	-----	-----	-----
	17,420	17,372	17,198
Net earnings per common share and common equivalent share	\$ 1.59	\$.88	\$.55
	=====	=====	=====
FULLY DILUTED			
Net earnings applicable to common stock:			
Net earnings	\$27,706	\$15,326	\$ 9,493
Less dividends on preferred stock	61	74	74
	-----	-----	-----
	\$27,645	\$15,252	\$ 9,419
	=====	=====	=====
Average number of common shares and common equivalent shares outstanding:			
Average number of common shares outstanding	17,214	17,309	17,079
Dilutive effect of stock options computed based on the treasury stock method using the year end market price, if higher than average market price	227	73	137
	-----	-----	-----
	17,441	17,382	17,216
Net earnings per common share and common equivalent share	\$ 1.59	\$.88	\$.55
	=====	=====	=====

1 All share and per share data has been restated for the three-for-two stock splits declared December 15, 1995, and December 17, 1993 and paid February 7, 1996 and February 2, 1994, respectively.

Exhibit 21

Subsidiaries of Graco Inc.

The following are subsidiaries of the Company:

Subsidiary	Jurisdiction of Organization	Percentage of Voting Securities Owned by the Company
Graco N.V.	Belgium	100%*
Graco Canada Incorporated	Canada	100%
Graco Chile Limitada	Chile	100%*
Graco Europe N.V.	Belgium	100%*
Graco GmbH	Germany	100%
Graco Hong Kong Limited	Hong Kong	100%*
Graco K.K.	Japan	100%
Graco Korea Inc.	Korea	100%
Graco A.S.	Norway	100%
Graco S.A.	France	100%*
Graco S.r.l.	Italy	100%*
Graco Limited	England	100%*
Graco Barbados FSC Limited	Barbados	100%

* Includes shares held by selected directors and/or executive officers of the Company or the relevant subsidiary to satisfy the requirements of local law.

The Registrant has additional subsidiaries, which considered in the aggregate as a single subsidiary, do not constitute a significant subsidiary.

Exhibit 23

Independent Auditors' Consent

We consent to the incorporation by reference in Registration Statement No. 33-47829 on Form S-8 (the Company's Long Term Stock Incentive Plan), in Registration Statement No. 33-44821 on Form S-8 (the Company's Employee Stock Purchase Plan) and in Registration Statement No. 33-54205 on Form S-8 (the Company's Nonemployee Director Stock Plan) of our report dated January 23, 1996, on the audit of the consolidated financial statements and financial statement schedule of Graco Inc. and Subsidiaries for each of the three years in the period ended December 29, 1995, included in the Annual Report on Form 10-K for the year ended December 29, 1995.

/s/ Deloitte & Touche LLP

Deloitte & Touche LLP
Minneapolis, Minnesota
March 15, 1996

Power of Attorney

Know all by these presents, that each person whose signature appears below hereby constitutes and appoints George Aristides or David M. Lowe, that person's true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution for that person and in that person's name, place and stead, in any and all capacities, to sign the Report on Form 10-K for the year ended December 29, 1995, of Graco Inc. (and any and all amendments thereto) and to file the same with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent, full power and authority to do and perform each and every act and thing requisite or necessary to be done in and about the premises, as fully to all intents and purposes as that person might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, or his substitutes, may lawfully do or cause to be done by virtue hereof.

In witness whereof, this Power of Attorney has been signed by the following persons on the date indicated.

	Date
\G.Aristides ----- G.Aristides	February 23, 1996 -----
\R. O. Baukol ----- R. O. Baukol	February 23, 1996 -----
\D. A. Koch ----- D. A. Koch	February 23, 1996 -----
\J. R. Lee ----- J. R. Lee	February 23, 1996 -----
\R. D. McFarland ----- R. D. McFarland	February 23, 1996 -----
\L. R. Mitau ----- L. R. Mitau	February 23, 1996 -----
\M. A.M. Morfitt ----- M. A.M. Morfitt	February 23, 1996 -----
\D. R. Olseth ----- D. R. Olseth	February 23, 1996 -----
\C. M. Osborne ----- C. M. Osborne	February 23, 1996 -----
\G. C. Planchon ----- G. C. Planchon	February 23, 1996 -----
\W. G. Van Dyke ----- W. G. Van Dyke	February 23, 1996 -----

ARTICLES OF AMENDMENT
RESTATING
ARTICLES OF INCORPORATION OF
GRACO INC.

1. The name of the corporation is Graco Inc., a Minnesota corporation.
2. On December 15, 1995, the Board of Directors of Graco Inc. amended Article 5.1(a) of its Articles of Incorporation, pursuant to the Minnesota Business Corporation Act, Minnesota Statutes, Section 302A.402, subd. 3, to read as follows:

5.1 (a) The total number of shares which this corporation shall be authorized to issue is Twenty-five Million Five Hundred Twenty-two Thousand Five Hundred Forty-nine (25,522,549), of which Twenty-two Million Five Hundred Thousand (22,500,000) shares of the par value of \$1.00 per share shall be Common Shares, Three Million (3,000,000) shares of the par value of \$1.00 per share shall be Preferred Shares and Twenty-two Thousand Five Hundred Forty-nine (22,549) shares of the par value of \$100.00 per share shall be Cumulative Preferred Shares.
3. The document entitled "Restated Articles of Incorporation of Graco Inc." marked as Exhibit A and attached hereto, contains the full text of the Articles of Incorporation of Graco Inc., incorporating in its entirety the amendment to Article 5.1(a) adopted by the Board of Directors on December 15, 1995.
4. The document entitled "'Restated Articles of Incorporation of Graco Inc." attached hereto as Exhibit A correctly sets forth, without change, the corresponding provisions of the existing articles as previously amended and merely restates the existing Articles, including the amendment to Article 5.1(a), in their entirety.
5. The "Restated Articles of Incorporation of Graco Inc.," attached hereto as Exhibit A, supersede the prior restated Articles and all amendments thereto.

IN WITNESS WHEREOF, the undersigned, the Secretary of Graco Inc., being duly authorized on behalf of Graco Inc., has executed this document this fifteenth day of December, 1995.

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

STATE OF MINNESOTA

SS

COUNTY OF HENNEPIN

The foregoing instrument was acknowledged before me on December 15, 1995, by Robert M. Mattison, as Secretary of Graco Inc., on behalf of such corporation.

/s/ Susan M. Paurus
Susan M. Paurus

Exhibit A

RESTATED ARTICLES OF INCORPORATION
OF
GRACO INC.

ARTICLE I

1. The name of this corporation shall be Graco Inc.

ARTICLE 2

2. CT Corporation System Inc., is this corporation's registered agent in the State of Minnesota, and 405 Second Avenue South, Minneapolis, Minnesota 55401, the business office address of CT Corporation System Inc., is the registered office of this corporation.

ARTICLE 3

3. Except as provided in Article 6, (i) the holders of a majority of the Common Shares outstanding shall have power to authorize the sale, lease, exchange, or other disposal of all, or substantially all, of the property and assets of the corporation, including its goodwill, to adopt or reject a plan of merger or exchange and (ii) the holders of a majority of the Common Shares present and entitled to vote at a meeting shall have the power to amend the Articles of Incorporation.

ARTICLE 4

4. Any action required or permitted to be taken at a meeting of the Board of Directors of this corporation not needing approval by the shareholders under Minnesota Statutes, Chapter 302A, may be taken by written action signed by the number of directors that would be required to take such action at a meeting of the Board of Directors at which all directors are present.

ARTICLE 5

5.1 (a) The total number of shares which this corporation shall be authorized to issue is Twenty-five Million Five Hundred Twenty-two Thousand Five Hundred Forty-nine (25,522,549), of which Twenty-two Million Five Hundred Thousand (22,500,000) shares of the par value of \$1.00 per share shall be Common Shares, Three Million (3,000,000) shares of the par value of \$1.00 per share shall be Preferred Shares and Twenty-two Thousand Five Hundred Forty-nine (22,549) shares of the par value of \$100.00 per share shall be Cumulative Preferred Shares.

(b) Preferred Shares may be issued from time to time in one or more series as the Board of Directors may determine, as hereinafter provided. The Board of Directors is hereby authorized by resolution or resolutions, to provide from time to time for series of Preferred Shares out of the unissued Preferred Shares not then allocated to any series of Preferred Shares. Before any shares of any such series are issued, the Board of Directors shall fix and determine, and is hereby expressly empowered to fix and determine, by resolution or resolutions, the designations and the relative rights and preferences thereof, of the shares of such series. Preferred Shares will be senior to the Cumulative Preferred Shares in terms of dividend and liquidation rights unless the Board of Directors specifically provides otherwise in the resolution or resolutions establishing a series of Preferred Shares.

The Board of Directors is expressly authorized to vary the provisions relating to the foregoing matters among the various series of Preferred Shares.

Preferred Shares of any series that shall be issued and thereafter acquired by the corporation through purchase, redemption (whether through the operation of a sinking fund or otherwise), conversion, exchange or otherwise, shall, upon appropriate filing and recording to the extent required by law, have the status of authorized and unissued Preferred Shares and may be reissued as part of such series or as part of any other series of Preferred Shares. Unless otherwise provided in the resolution or resolutions of the Board of Directors providing for the issue thereof, the number of authorized shares of any series of Preferred Shares may be increased or decreased (but not below the number of shares thereof then outstanding) by resolution or

resolutions of the Board of Directors and appropriate filing and recording to the extent required by law. In case the number of shares of any such series of Preferred Shares shall be decreased, the shares representing such decrease shall, unless otherwise provided in the resolution or resolutions of the Board of Directors providing for the issuance thereof, resume the status of authorized but unissued Preferred Shares, undesignated as to series.

5.2 The designations, relative rights, voting powers, preferences and restrictions granted to or imposed upon the Common Shares and Cumulative Preferred Shares, which shall be subject to the rights granted to any series of Preferred Shares in the resolutions authorizing the series, are as follows:

(a) Voting. Except as expressly set forth in subdivision (f) below and except as otherwise provided in the resolutions authorizing any series of Preferred Shares or by law, the holders of Common Shares shall have the sole voting rights of shareholders of the corporation and shall be entitled to one vote for each share held. The shareholders of the corporation shall have no right to cumulate votes for the election of directors.

(b) No Pre-emptive Rights. Except as provided in the resolutions authorizing any series of Preferred Shares, no holders of any share of stock of any class of this corporation shall have any pre-emptive right to subscribe to any issue of shares of any class of this corporation now or hereafter authorized or any security hereafter issued by this corporation convertible into shares of this corporation.

(c) Dividends. The holders of Cumulative Preferred Shares shall be entitled to receive out of any assets legally available therefor, when and as declared by the Board of Directors, fixed cumulative dividends at the rate of five percent (5%) per annum upon the par value thereof, and no more, payable semiannually on January 1 and July 1 of each year. Such dividends shall be cumulative from January 1, 1969.

In no event shall any dividend be paid or declared (other than dividends payable in Common Shares of any class), nor shall any distribution be made on the Common Shares of any class of the corporation, nor shall any Common Shares of any class be purchased, redeemed or otherwise acquired by the corporation for value unless all dividends on the Cumulative Preferred Shares for all past semiannual dividend periods and for the then current semiannual dividend period shall have been paid, or declared and a sum sufficient for the payment thereof set apart for payment.

Subject to the provisions of this Article 5 and not otherwise, dividends may be declared by the Board of Directors and paid from time to time, out of any funds legally available therefor, upon the Common Shares, and the holders of Cumulative Preferred Shares shall not be entitled to participate in any such dividends.

(d) Redemption. The Cumulative Preferred Shares of the corporation may be redeemed as a whole at any time or in part from time to time at the option of the corporation by resolution of the Board of Directors at the redemption price of \$105 per share together with an amount equal to all accrued and unpaid cumulative dividends thereon from the date on which dividends thereon became cumulative to the redemption date. If less than all of the outstanding Cumulative Preferred Shares are to be redeemed, the shares to be redeemed shall be selected by the Board of Directors or by a person appointed for such purpose by the Board of Directors.

Notice of every redemption of Cumulative Preferred Shares shall be mailed addressed to the holders of record of the shares to be redeemed at their respective addresses as they appear on the stock books of the corporation not less than thirty (30) and not more than sixty (60) days prior to the date fixed for redemption.

If notice of redemption shall have been duly given as

aforesaid and if on or before the redemption date specified in the notice, all funds necessary for the redemption shall have been deposited in trust with a bank or trust company in good standing and doing business at any place within the United States, and designated in the notice of redemption, for the pro rata benefit of the shares so called for redemption, so as to be and continue to be available therefor, then, from and after the date of such deposit, notwithstanding that any certificate for Cumulative Preferred Shares so called for redemption shall not have been surrendered for cancellation, the shares represented thereby shall no longer be deemed outstanding, and the dividends thereon shall cease to accumulate from and after the date fixed for redemption, and all rights with respect to the Cumulative Preferred Shares so called for redemption shall forthwith, on the date of such deposit, cease and terminate except only the right of the holders thereof to receive the redemption price of the shares so redeemed, including accrued cumulative dividends to the redemption date, but without interest. Any funds deposited by the corporation pursuant to this paragraph and unclaimed at the end of six (6) years after the date fixed for redemption shall be repaid to the corporation upon its request expressed in a resolution of its Board of Directors, after which repayment the holders of the shares so called for redemption shall look only to the corporation for the payment thereof.

(e) Dissolution, Liquidation, etc. In the event of any dissolution, liquidation or winding up of the affairs of the corporation, before any distribution or payment shall be made to the holders of Common Shares, the holders of the Cumulative Preferred Shares shall be entitled to be paid in full the par value thereof if such liquidation, dissolution or winding up shall be involuntary, and the sum of \$105 per share if such liquidation, dissolution or winding up shall be voluntary, together, in either event, with a sum, in the case of each share, equal to the cumulative accrued and unpaid dividends thereon to the date fixed for such distribution or payment. If such distribution or payment shall have been made to the holders of the Cumulative Preferred Shares or moneys made available for such payment in full, the remaining assets and funds of the corporation shall be distributed ratably to the holders of the Common Shares. If there shall be insufficient assets to make full payment to the holders of Cumulative Preferred Shares as above provided, the assets of the corporation shall be distributed among the holders of Cumulative Preferred Shares ratably. Except as herein otherwise expressly provided, the Cumulative Preferred Shares shall not be entitled to participate in any of the profits, surplus or assets of the corporation. The consolidation or merger of the corporation into or with any other corporation or corporations pursuant to the statutes of the State of Minnesota shall not be deemed a liquidation, dissolution or winding up of the affairs of the corporation within the meaning of any of the provisions of this paragraph.

(f) Special Voting Rights. The holders of Cumulative Preferred Shares shall not be entitled as such to vote at any meeting of the shareholders of the corporation except as required by law or as hereinafter otherwise provided.

(i) If an amendment to the Articles of Incorporation of the corporation would adversely affect the rights of the holders of Cumulative Preferred Shares, then in addition to the vote thereon by the holders of the Common Shares, the holders of Cumulative Preferred Shares shall be entitled to vote separately as a class thereon, and such amendment shall be adopted only if it receives the affirmative vote of the holders of a majority of the Cumulative Preferred Shares.

(ii) After an amount equivalent to three (3) full semi-annual dividend installments of the Cumulative Preferred Shares shall be in default, the holders of Cumulative Preferred Shares at the time outstanding, voting separately as a class shall, at any annual meeting of the shareholders or any special meeting of the shareholders called

as herein provided occurring during such period, elect two (2) members of the Board of Directors, and the holders of the Common Shares, voting separately as a class, shall elect the remaining directors of the corporation.

(iii) After an amount equivalent to six (6) full semi-annual dividend installments of the Cumulative Preferred Shares shall be in default, the holders of Cumulative Preferred Shares, voting separately as a class, shall, at any annual meeting of the shareholders or any special meeting of the shareholders called as herein provided occurring during such period, elect the smallest number of directors necessary to constitute a majority of the full Board of Directors, and the holders of the Common Shares, voting separately as a class, shall elect the remaining directors of the corporation.

At any annual meeting or special meeting of shareholders for the election of directors occurring after all cumulative dividends then in default on the Cumulative Preferred Shares then outstanding, including the dividend for the then current semi-annual period, shall have been paid, or declared and set apart for payment, the Cumulative Preferred Shares shall thereupon be divested of any rights with respect to the election of directors as above provided, but always subject to the same provisions for the reversion of such voting power in the Cumulative Preferred Shares in the case of a future like default or defaults in dividends on Preferred Shares.

Voting power for the election of directors vested in the holders of the Cumulative Preferred Shares as above provided may be exercised at any annual meeting of shareholders or at a special meeting of shareholders held for such purpose, which special meeting of shareholders shall be called by the proper officers of the corporation at any time when such voting power shall be vested within twenty (20) days after written request therefor signed by the holder or holders of not less than ten percent (10%) of the Cumulative Preferred Shares then outstanding, the date of such special meeting to be not more than twenty (20) days from the date of giving notice thereof, and such notice shall be given to all holders of Cumulative Preferred Shares and Common Shares not less than ten (10) days prior to said meeting. In each such case such notice shall direct attention to the voting rights of the holders of Cumulative Preferred Shares. At any such meeting the presence in person or by proxy of the holders of a majority of the Cumulative Preferred Shares outstanding shall be required to constitute a quorum for the election of directors whom the holders of Cumulative Preferred Shares are entitled to elect and, likewise, the presence in person or by proxy of the holders of a majority of the Common Shares outstanding shall be required to constitute a quorum for the election of directors whom the holder of Common Shares are entitled to elect; provided that either the Cumulative Preferred shareholders or the Common shareholders who are present in person or by proxy at such a meeting shall have power to adjourn such meeting for the election of directors to be elected by them from time to time, without notice other than announcement at the meeting and, provided further, that the adjournment of the meeting for lack of a quorum of the Common shareholders shall not prevent the election at that meeting of the directors whom the Cumulative Preferred shareholders are entitled to elect if there is a quorum of the Cumulative preferred shareholders.

If at any time the holders of Cumulative Preferred Shares shall become entitled to elect two (2) directors or a majority of the Board of Directors as aforesaid, the terms of all incumbent directors shall expire whenever such two (2) directors or such majority have been duly elected and qualified.

Whenever the Cumulative Preferred Shares shall be divested of voting power with respect to the election of directors the terms of all then incumbent directors shall expire upon the election of a new board by the holders of

Common Shares at the next annual or special meeting for the election of directors.

If a vacancy or vacancies in the Board of Directors shall exist with respect to a director or directors elected by the Cumulative Preferred shareholders, the remaining director or directors elected by the Cumulative Preferred shareholders may, by the vote of such remaining director if there be but one, or by the vote of a majority of such remaining directors if there be more than one, elect a successor or successors to hold office for the unexpired term. Likewise, a vacancy or vacancies existing with respect to directors elected by the Common shareholders may be filled by the remaining director or directors elected by the Common shareholders.

ARTICLE 6

6.1 Whether or not a vote of shareholders is otherwise required, the affirmative vote of the holders of not less than two-thirds of the outstanding shares of "Voting Stock" (as hereafter defined) of the corporation shall be required for the approval or authorization of any "Business Combination" (as hereafter defined) with any Related Person (as hereafter defined) involving the corporation or the approval or authorization by the corporation in its capacity as a shareholder of any Business Combination involving a "Subsidiary" (as hereafter defined) which requires the approval or authorization of the shareholders of the Subsidiary; provided, however, that the two-thirds voting requirement shall not be applicable if:

(a) The "Continuing Directors" (as hereafter defined) by a majority vote have expressly approved the Business Combination; or

(b) The Business Combination is a merger, consolidation, exchange of shares or sale of all or substantially all of the assets of the corporation and the cash or fair market value (determined as of the effective date of such Business Combination or, in the case of a sale of assets as of the date of the distribution of the proceeds of the sale to the shareholders of the corporation) of the property, securities or other consideration to be received per share by holders of common stock of the corporation other than the Related Person is not less than the highest per share price (with appropriate adjustments for recapitalizations, stock splits, stock dividends and like distributions), paid by the Related Person in acquiring any of its holdings of the corporation's common stock during the two-year period prior to the effective date of the Business Combination or the distribution of the proceeds of a sale of assets.

6.2 For the purposes of this Article 6:

(a) The term "Business Combination" shall mean

(i) any merger or consolidation of the corporation or a Subsidiary with or into a Related Person,

(ii) any exchange of shares of the corporation or a Subsidiary for shares of a Related Person which, in the absence of this Article, would have required the affirmative vote of at least a majority of the voting power of the outstanding shares of the corporation entitled to vote or the affirmative vote of the corporation, in its capacity as a shareholder of the Subsidiary,

(iii) any sale, lease, exchange, transfer or other disposition (in one transaction or a series of transactions), including, without limitation, a mortgage or any other security device, of all or any "Substantial Part" (as hereinafter defined) of the assets either of the corporation (including, without limitation, any voting securities of a Subsidiary) or of a Subsidiary, to or with a Related Person,

(iv) any sale, lease, exchange, transfer or other

disposition (in one transaction or a series of transactions) of all or any Substantial Part of the assets of a Related Person to or with the corporation or a Subsidiary,

(v) the issuance of any securities to a Related Person (except pursuant to stock dividends, stock splits or similar transactions which would not have the effect of increasing the proportionate voting power of a Related Person) of the corporation, or of a Subsidiary (except pursuant to a pro rata distribution to all holders of common stock of the corporation),

(vi) any recapitalization or reclassification that would have the effect of increasing the voting power of a Related Person, and

(vii) any agreement, contract or other arrangement providing for any of the transactions described in this definition of Business Combination.

(b) The term "Related Person" shall mean and include any individual, corporation, partnership or other person or entity which, together with its "Affiliates" and "Associates" (as defined on February 24, 1984 by Rule 12b-2 under the Securities Exchange Act of 1934), "Beneficially Owns" (as defined on February 24, 1984 by Rule 13d-3 under the Securities Exchange Act of 1934) in the aggregate 15 percent or more of the outstanding Voting Stock of the corporation, and any Affiliate or Associate (other than the corporation or a wholly-owned subsidiary of the corporation) of any such individual, corporation, partnership or other person or entity.

(c) The term "Substantial Part" shall mean more than 30 percent of the fair market value of the total assets of the corporation in question, as of the end of its most recent fiscal year ending prior to the time the determination is being made.

(d) Without limitation, any shares of common stock of the corporation that any Related Person has the right to acquire pursuant to any agreement, or upon exercise of conversion rights, warrants or options, or otherwise, shall be deemed beneficially owned by the Related Person.

(e) The term "Subsidiary" shall mean any corporation, a majority of the equity securities of any class of which are owned by the corporation, by another Subsidiary, or in the aggregate by the corporation and one or more of its Subsidiaries.

(f) The term "Voting Stock" shall mean all outstanding shares of capital stock of the corporation entitled to vote generally in the election of directors and each reference to a proportion of shares of Voting Stock shall refer to such proportion of the votes entitled to be cast by such shares.

(g) The term "Continuing Director" shall mean (i) a director who was a member of the Board of Directors of the corporation either on February 24, 1984 or immediately prior to the time that any Related Person involved in the Business Combination in question became a Related Person and (ii) any person becoming a director whose election, or nomination for election by the corporation's shareholders, was approved by a vote of a majority of the Continuing Directors; provided, however, that in no event shall a Related Person involved in the Business Combination in question be deemed to be a Continuing Director.

6.3 For the purposes of this Article 6 the Continuing Directors by a majority vote shall have the power to make a good faith determination, on the basis of information known to them, of: (i) the number of shares of Voting Stock of the corporation that any person or entity Beneficially Owns, (ii) whether a person or entity is an Affiliate or Associate of another, (iii) whether the assets subject to any Business Combination constitute a Substantial Part, (iv) whether any business transaction is one in which a Related Person has an interest, (v) whether the cash

or fair market value of the property, securities or other consideration to be received per share by holders of capital stock of the corporation other than the Related Person in a Business Combination is an amount at least equal to the highest per share price paid by the Related Person and (vi) such other matters with respect to which a determination is required under this Article 6.

6.4 The provisions set forth in this Article 6 may not be repealed or amended in any respect, unless such action is approved by the affirmative vote of the holders of not less than two-thirds of the outstanding shares of Voting Stock of the corporation.

ARTICLE 7

7.1 The number of directors shall initially be ten and, thereafter, shall be fixed from time to time by the Board of Directors or by the affirmative vote of the holders of two-thirds of the voting power of the outstanding capital stock of the corporation, voting together as a single class. The directors shall be divided into three classes, as nearly equal in number as reasonably possible, with the term of office of the first class to expire at the 1988 annual meeting of shareholders, the term of office of the second class to expire at the 1989 annual meeting of shareholders and the term of office of the third class to expire at the 1990 annual meeting of shareholders. At each annual meeting of shareholders following such initial classification and election, directors elected to succeed those directors whose terms expire shall be elected for a term of office to expire at the third succeeding annual meeting of shareholders after their election.

7.2 Subject to the rights of the holders of any series of Preferred Stock then outstanding, newly created directorships resulting from any increase in the authorized number of directors or any vacancies in the Board of Directors resulting from death, resignation, retirement, disqualification, removal from office or other cause may be filled by a majority vote of the directors then in office though less than a quorum, and directors so chosen shall hold office for a term expiring at the next annual meeting of shareholders. No decrease in the number of directors constituting the Board of Directors shall shorten the term of any incumbent director.

7.3 Any directors, or the entire Board of Directors, may be removed from office at any time, but only for cause and only by the affirmative vote of the holders of the proportion or number of the voting power of the shares of the classes or series the director represents sufficient to elect them.

7.4 The provisions of this Article 7 may not be repealed or amended in any respect, unless such action is approved by the affirmative vote of the holders of not less than two-thirds of the outstanding shares of the capital stock of the corporation entitled to vote generally in the election of directors, voting together as a single class.

ARTICLE 8

8. No director of the corporation shall be personally liable to the corporation or its shareholders for monetary damages for breach of fiduciary duty by such director as a director; provided, however, that this Article 8 shall not eliminate or limit the liability of a director (i) for any breach of the director's duty of loyalty to the corporation or its shareholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 302A.559 of the Minnesota Business Corporation Act or Section 80A.23 of the Minnesota Securities Law, or (iv) for any transaction from which the director derived an improper personal benefit. No amendment to or repeal of this Article 8 shall apply to or have any effect on the liability or alleged liability of any director of the corporation for or with respect to any acts or omissions of such director occurring prior to such amendment or repeal.

ARTICLE 9

9. The Board of Directors of the corporation (the "Board"), when evaluating any offer of another party, (a) to make

a tender or exchange offer for any Voting Stock (as defined in Article 6) of the corporation or (b) to effect a Business Combination (as defined in Article 6), shall, in connection with the exercise of its judgment in determining what is in the best interests of the corporation as a whole, be authorized to give due consideration to such factors as the Board determines to be relevant, including, without limitation:

(i) the interests of the corporation's shareholders;

(ii) the social, legal and economic effects upon employees, suppliers, customers and others having similar relationships with the corporation, and the communities in which the corporation conducts its business;

(iii) whether the proposed transaction might violate federal or state laws; and

(iv) not only the consideration being offered in the proposed transaction, in relation to the then current market price for the outstanding capital stock of the corporation, but also the market price for the capital stock of the corporation over a period of years, the estimated price that might be achieved in a negotiated sale of the corporation as a whole or in part of through orderly liquidation, the premiums over market price for the securities of other corporations in similar transactions, current political, economic or other factors bearing on securities prices and the corporation's financial condition and future prospects.

In connection with any such evaluation, the Board is authorized to conduct such investigations and to engage in such legal proceedings as the Board may determine.

FIFTH AMENDMENT TO CREDIT AGREEMENT

THIS FIFTH AMENDMENT (this "Amendment") dated as of April 10, 1995, amends and modifies that certain Credit Agreement, dated as of October 1, 1990, as amended pursuant to Amendments dated as of June 12, 1992, December 31, 1992, November 8, 1993 and February 8, 1994 (as so amended, the "Credit Agreement"), between GRACO INC., a Minnesota corporation (the "Company") and FIRST NATIONAL ASSOCIATION (the "Bank"). Terms not otherwise expressly defined herein shall have the meanings set forth in the Credit Agreement.

FOR VALUE RECEIVED, the Company and the Bank agree that the Credit Agreement is amended as follows.

ARTICLE I - AMENDMENTS TO THE CREDIT AGREEMENT

1.1 Defined Terms. Section 1.01 is amended as follows:

(a) The definition of "Applicable Margin" is amended by deleting column (d) from the chart in such Section (which had provided an Applicable Margin for Federal Funds Rate Loans).

(b) The definitions of "Federal Funds Rate", and "Federal Funds Rate Loan" are deleted. Any further reference to Federal Funds Rate and Federal Funds Rate Loans not otherwise expressly amended herein shall be deemed to refer to the Daily Rate and Daily Rate Loans.

(c) Definitions of "Daily Rate" and "Daily Rate Loans" are added and shall read as follows:

"Daily Rate": For any day upon which a Daily Rate Loan is outstanding, a rate per annum (rounded upward, if necessary, to the nearest 1/16 of 1%) determined pursuant to the following formula, which rate shall continue in effect until the next succeeding Business Day:

$$\text{Daily Rate} = \frac{\text{(LIBO Rate)}}{\text{(-----)}} \text{ plus } 0.20\% \\ \text{(1.00-Eurocurrency Reserve)} \\ \text{Percentage}$$

In such formula, (i) "Eurocurrency Reserve Percentage" means the percentage (expressed as a decimal) for such day prescribed by the Board of Governors of the Federal Reserve System (or any successor) for determining reserve requirements applicable to "Eurocurrency liabilities" pursuant to Regulation D or any other applicable regulation of the Board of Governors which prescribes such reserve requirements, and (ii) "LIBO Rate" means the offered rate for deposits in United State Dollars (rounded upwards, if necessary, to the nearest 1/16 of 1%), for delivery of such deposits two eurodollar business days after such day, for an interest period of one month, which appears on the Reuters Screen LIBO Page as of the time selected by the Bank on such day. If at least two rates appear on the Reuters Screen LIBO Page, the rate shall be the arithmetic mean of such rates (rounded as provided above). If fewer than two rates appear, the rate may be determined by the Bank based on other services selected for such purpose by the Bank or based on rates offered to the Bank for United States Dollar deposits in the interbank eurodollar market. "Reuters Screen LIBO Page" means the display designated as page "LIBO" on the Reuter Monitor Money Rates Service (or such other page as may replace the LIBO Page on that service for the purpose of displaying London interbank offered rates of major banks for United States Dollar deposits).

"Daily Rate Loans": Loans bearing interest at the Daily Rate."

(d) The definition of "Interest Payment Date" is amended by amending subparagraph (c) thereof to read as follows:

"and (c) Daily Rate Loans, the next Business Day."

(e) The definition of "Permitted Interest Rate" is amended by amending subparagraph (iv) thereof to read as follows:

"and (iv) Daily Rate "

1.2 Revolving Credit Commitment. Section 2.01(a) is amended by deleting "\$15,000,000" and inserting in place thereof "\$25,000,000".

1.3 Interest. Section 2.03 is amended by amending subsection (d) to read as follows:

"(d) During such period as any such Loan is a Daily Rate Loan, a rate equal to the Daily Rate from time to time in effect."

1.4 Note. A promissory note substantially in the form of Exhibit AA to this Amendment shall be executed and delivered by the Borrower and shall be and constitute the "Graco Revolving Credit Note", and one of the "Revolving Credit Notes" and "Notes" for purposes of all references thereto in the Credit Agreement.

1.5 Construction. All references in the Credit Agreement to "this Agreement", "herein" and similar references shall be deemed to refer to the Credit Agreement as amended by this Amendment.

ARTICLE II - REPRESENTATIONS AND WARRANTIES

To induce the Bank to enter into this Amendment and to make and maintain the Loans under the Credit Agreement as amended hereby, the Company hereby warrants and represents to the Bank that it is duly authorized to execute and deliver this Amendment, and to perform its obligations under the Credit Agreement as amended hereby, and that this Amendment constitutes the legal, valid and binding obligation of the Company, enforceable in accordance with its terms.

ARTICLE III - CONDITIONS PRECEDENT

This Amendment shall become effective on the date first set forth above, provided, however, that the effectiveness of this Amendment is subject to the satisfaction of each of the following conditions precedent:

3.1 Warranties. Before and after giving effect to this Amendment, the representations and warranties in Section 6 of the Credit Agreement shall be true and correct as though made on the date hereof, except for changes that are permitted by the terms of the Credit Agreement. The execution by the Borrower of this Amendment shall be deemed a representation that the Borrower has complied with the foregoing condition.

3.2 Defaults. Before and after giving effect to this Amendment, no Event of Default and no Unmatured Event of Default shall have occurred and be continuing under the Credit Agreement. The execution by the Borrower of this Amendment shall be deemed a representation that the Borrower has complied with the foregoing condition.

3.3 Documents. The following shall have been delivered to the Bank, each duly executed and dated, or certified, as of the date hereof, as the case may be:

(a) Note. The Note in the form of Exhibit AA to this Amendment.

(b) Resolutions. Certified copies of resolutions of the Board of Directors of the Borrower authorizing or ratifying the execution, delivery and performance, respectively, of this Amendment, the Note and other documents provided for in this Amendment, together with an incumbency certificate of officers executing this Amendment and the Note:

ARTICLE IV - GENERAL

4.1 Expenses. The Company agrees to reimburse the Bank upon demand for all reasonable expenses, including reasonable fees of attorneys (who may be employees of the Bank) and legal

expenses incurred by the Bank in the preparation, negotiation and execution of this Amendment and any other document required to be furnished herewith, and in enforcing the obligations of the Company hereunder, and to pay and save the Bank harmless from all liability for, any taxes which may be payable with respect to the execution or delivery of this Amendment or the issuance of the Note hereunder, which obligations of the Company shall survive any termination of the Credit Agreement.

4.2 Counterparts. This amendment may be executed in as many counterparts as may be deemed necessary or convenient, and by the different parties hereto on separate counterparts, each of which, when so executed, shall be deemed an original but all such counterparts shall constitute but one and the same instrument.

4.3 Severability. Any provision of this Amendment which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining portions hereof or affecting the validity or enforceability of such provisions in any other jurisdiction.

4.4 Law. This Amendment shall be a contract made under the laws of the State of Minnesota, which laws shall govern all the rights and duties hereunder.

4.5 Successors; Enforceability. The Amendment shall be binding upon the Borrower and the Bank and their respective successors and assigns, and shall inure to the benefit of the Company and the Bank and the successors and assigns of the Bank. Except as hereby amended, the Credit Agreement shall remain in full force and effect and is hereby ratified and confirmed in all respects.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be executed at Minneapolis, Minnesota by their respective officers thereunto duly authorized as of the date first written above.

GRACO INC.

By: /s/David M. Lowe

Title: Treasurer

FIRST BANK NATIONAL ASSOCIATION

By: Marc Meirovitz

Title: Commercial Banking Officer

EXHIBIT AA
PROMISSORY NOTE
(Revolving Credit Note)

\$25,000,000

April 10, 1995
Minneapolis, Minnesota

FOR VALUE RECEIVED, GRACO INC., a Minnesota corporation, hereby promises to pay to the order of FIRST BANK NATIONAL ASSOCIATION (the "Bank") at its main office at 601 2nd Avenue South, Minneapolis, Minnesota 55402, the lessor of the principal amount of TWENTY FIVE MILLION DOLLARS (\$25,000,000) or the aggregate unpaid principal amount of all Loans made to the undersigned by the Bank under the Revolving Credit Commitment (as such term and each other capitalized term used herein is defined in the Credit Agreement hereinafter referred to), together with interest (computed on the basis of the actual number of days elapsed and a year of 360 days) on any and all unpaid principal amounts from time to time outstanding hereunder in the currency and at the times and interest rates provided for in the Credit Agreement.

The Bank is hereby authorized by the undersigned to endorse on the schedule attached to this note the amount and type of, and the duration of each Interest Period (if applicable) for, each Loan made to the undersigned by the Bank under the Revolving Credit Commitment, the date such Loan is made or continued or converted from a Loan of another type, and the amount of each payment or prepayment of principal of such Loan received by the Bank, provided that any failure by the Bank to make any such endorsement shall not affect the obligations of the undersigned hereunder or under the Credit Agreement in respect of such Loans.

This note is one of the Revolving Credit Notes referred to in, and is entitled to the benefits of, the Credit Agreement dated as of October 1, 1990 between the undersigned and the Bank (as the same has been, and may hereafter be, amended, modified, supplemented or restated from time to time, the "Credit Agreement"). This note is subject to certain permissive and mandatory prepayments and its maturity is subject to acceleration, in each case upon the terms provided in the Credit Agreement. This note continues and evidences principal indebtedness outstanding under that certain Promissory Note (Revolving Credit Note) dated October 1, 1990, by the undersigned to the order of the Bank in the original principal amount of \$15,000,000 ("Existing Note"), provided that any principal of or interest on and other obligations under the Existing Note accrued prior to the date of this note but remaining unpaid on the date of this note shall not be deemed discharged and shall be due and payable in advance with the terms of this note and the Credit Agreement.

This note shall be construed in accordance with the internal law, and law of conflicts, of the State of Minnesota. In the event of default hereunder, the undersigned agrees to pay all costs and expenses of collection, including reasonable attorneys' fees.

GRACO INC.

By: /s/ David M. Lowe

Title: Treasurer

STOCK OPTION AGREEMENT
(NON-ISO)

THIS AGREEMENT, made this day of 199 , by and between Graco Inc., a Minnesota corporation (the "Company") and (the "Employee").

WITNESSETH THAT:

WHEREAS, the Company pursuant to it's Long-Term Incentive Stock Plan wishes to grant this stock option to Employee;

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 Employee, the right and option (hereinafter called 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.

2. Duration and Exercisability

(a) This option may not be exercised by Employee until the expiration of two (2) years from the date of grant, and this option shall in all events terminate ten (10) years after the date of grant. During the first two years 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
----- Two Years after Date of Grant	----- 25%
Three Years after Date of Grant	50%
Four Years after Date of Grant	75%
Five Years after Date of Grant	100%

In the event that Employee 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 Employee, 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 Employment

(a) In the event that Employee shall cease to be employed by the Company or its subsidiaries for any reason other than his/her gross and willful misconduct, death, retirement (as defined in Section 3(d) below), or disability (as defined in Section 3(d) below), Employee shall have the right to exercise the option at any time within one month after such termination of employment to the extent of the full number of shares he/she was entitled to purchase under the option on the date of termination, subject to the condition that no option shall be exercisable after the expiration of the term of the option.

(b) In the event that Employee shall cease to be employed by the Company or its subsidiaries by reason of his/her gross and willful misconduct during the course of his/her employment, including but not limited to wrongful appropriation of Company funds or the commission of a felony, the option shall be terminated as of the date of the misconduct.

(c) If the Employee shall die while in the employ of the Company or a subsidiary or within one month after termination of employment for any reason other than gross and willful misconduct and shall not have fully exercised the option, all remaining shares shall become immediately exercisable and such option may be exercised at any time within twelve months after his/her death by the executors or administrators of the Employee or by any person or persons to whom the option is transferred by will or the applicable laws of descent and distribution, and subject to the condition that no option shall be exercisable after the expiration of the term of the option.

(d) If the Employee's termination of employment is due to retirement (either after attaining age 55 with 10 years of service, or attaining age 65, or due to disability within the meaning of the provisions of the Graco Long-Term Disability Plan), all remaining shares shall become immediately exercisable and the option may be exercised by the Employee at any time within three years of the employee's retirement, or in the event of the death of the Employee within the three-year period after retirement, the option may be exercised at any time within twelve months after his/her death by the executors or administrators of the Employee or by any person or persons to whom the option is transferred by will or the applicable laws of descent and distribution, to the extent of the full number of shares he/she was entitled to purchase under the option on the date of death, and subject to the condition that no option shall be exercisable after the expiration of the term of the option.

4. Manner of Exercise

(a) The option can be exercised only by Employee or other proper party within the option period 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 Section 4(c), accompanied by payment-in-full of the option price for all shares designated in the notice.

(b) The Employee may, at Employee's election, pay the option price either by check (bank check, certified check, or personal check) or by delivering to the Company for cancellation Common Shares of the Company with a fair market value equal to the option price. For these purposes, the fair market value of the Company's Common Shares shall be the closing price of the Common Shares on the date of exercise on the New York Stock Exchange (the "NYSE") or on the principal national securities exchange on which the shares are traded if the shares are not then traded on the NYSE. If there is not a quotation available for such day, then the closing price on the next preceding day for which such a quotation exists shall be determinative of fair market value. If the shares are not then traded on an exchange, the fair market value shall be the average of the closing bid and asked prices of the Common Shares as reported by the National Association of Securities Dealers Automated Quotation System. If the Common Shares are not then traded on NASDAQ or on an exchange, then the fair market value shall be determined in such manner as the Company shall deem reasonable.

(c) The Employee may, with the consent of the Company, pay the option price by arranging for the immediate sale of some or all of the shares issued upon exercise of the option by a securities dealer and the payment to the Company by the securities dealer of the option exercise price.

5. Payment of Withholding Taxes

Upon exercise of any portion of this option, Employee shall pay to the Company an amount sufficient to satisfy any federal, state, or local withholding tax requirements which arise as a result of the exercise of the option or provide the Company with satisfactory indemnification for such payment.

6. Adjustments

If Employee exercises all or any portion of the option subsequent to any change in the number or character of the Common Shares of the Company (through merger, consolidation, reorganization, recapitalization, stock dividend, or otherwise), Employee shall then receive for the aggregate price paid by

him/her on such exercise of the option, the number and type of securities or other consideration which he/she would have received if such option had been exercised prior to the event changing the number or character of outstanding shares.

7. Miscellaneous

(a) This option is issued pursuant to the Company's Long-Term Incentive Stock Plan and is subject to its terms. A copy of the Plan has been given to the Employee. 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 Employee any right with respect to continuance of employment by the Company or any of its subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time. Employee shall have none of the rights of a shareholder with respect to shares subject to this option until such shares shall have been issued to him upon exercise of this option.

(c) 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.

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

GRACO INC.

By _____
Its: Chairman

Employee

STOCK OPTION AGREEMENT
(NON-ISO)

THIS AGREEMENT, made this _____ day of _____, 199_____, by and between Graco Inc., a Minnesota corporation (the "Company") and _____ (the "Employee").

WITNESSETH THAT:

WHEREAS, the Company pursuant to its Long-Term Incentive Stock Plan wishes to grant this stock option to Employee;

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 Employee, the right and option (hereinafter called 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.

2. Duration and Exercisability

(a) This option may not be exercised by Employee until the expiration of two (2) years from the date of grant, and this option shall in all events terminate ten (10) years after the date of grant. During the first two years 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
----- Two Years after Date of Grant	----- 25%
Three Years after Date of Grant	50%
Four Years after Date of Grant	75%
Five Years after Date of Grant	100%

In the event that Employee 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 Employee, 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 Employment

(a) In the event that Employee shall cease to be employed by the Company or its subsidiaries for any reason other than his/her gross and willful misconduct, death, retirement (as defined in Section 3(d) below), or disability (as defined in Section 3(d) below), Employee shall have the right to exercise the option at any time within one month after such termination of employment to the extent of the full number of shares he/she was entitled to purchase under the option on the date of termination, subject to the condition that no option shall be exercisable after the expiration of the term of the option.

(b) In the event that Employee shall cease to be employed by the Company or its subsidiaries by reason of his/her gross and willful misconduct during the course of his/her employment, including but not limited to wrongful appropriation of Company funds or the commission of a felony, the option shall be

terminated as of the date of the misconduct.

(c) If the Employee shall die while in the employ of the Company or a subsidiary or within one month after termination of employment for any reason other than gross and willful misconduct and shall not have fully exercised the option, all remaining shares shall become immediately exercisable and such option may be exercised at any time within twelve months after his/her death by the executors or administrators of the Employee or by any person or persons to whom the option is transferred by will or the applicable laws of descent and distribution, and subject to the condition that no option shall be exercisable after the expiration of the term of the option.

(d) If the Employee's termination of employment is due to retirement (either after attaining age 55 with 10 years of service, or attaining age 65, or due to disability within the meaning of the provisions of the Graco Long-Term Disability Plan), all remaining shares shall become immediately exercisable and the option may be exercised by the Employee at any time within three years of the employee's retirement, or in the event of the death of the Employee within the three-year period after retirement, the option may be exercised at any time within twelve months after his/her death by the executors or administrators of the Employee or by any person or persons to whom the option is transferred by will or the applicable laws of descent and distribution, to the extent of the full number of shares he/she was entitled to purchase under the option on the date of death, and subject to the condition that no option shall be exercisable after the expiration of the term of the option.

4. Manner of Exercise

(a) The option can be exercised only by Employee or other proper party within the option period 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 Section 4(c), accompanied by payment-in-full of the option price for all shares designated in the notice.

(b) The Employee may, at Employee's election, pay the option price either by check (bank check, certified check, or personal check) or by delivering to the Company for cancellation Common Shares of the Company with a fair market value equal to the option price. For these purposes, the fair market value of the Company's Common Shares shall be the closing price of the Common Shares on the date of exercise on the New York Stock Exchange (the "NYSE") or on the principal national securities exchange on which the shares are traded if the shares are not then traded on the NYSE. If there is not a quotation available for such day, then the closing price on the next preceding day for which such a quotation exists shall be determinative of fair market value. If the shares are not then traded on an exchange, the fair market value shall be the average of the closing bid and asked prices of the Common Shares as reported by the National Association of Securities Dealers Automated Quotation System. If the Common Shares are not then traded on NASDAQ or on an exchange, then the fair market value shall be determined in such manner as the Company shall deem reasonable.

(c) The Employee may, with the consent of the Company, pay the option price by arranging for the immediate sale of some or all of the shares issued upon exercise of the option by a securities dealer and the payment to the Company by the securities dealer of the option exercise price.

5. Payment of Withholding Taxes

Upon exercise of any portion of this option, Employee shall pay to the Company an amount sufficient to satisfy any federal, state, or local withholding tax requirements which arise as a result of the exercise of the option or provide the Company with satisfactory indemnification for such payment.

6. Adjustments

If Employee exercises all or any portion of the option subsequent to any change in the number or character of the Common Shares of the Company (through merger, consolidation, reorganization, recapitalization, stock dividend, or otherwise),

Employee shall then receive for the aggregate price paid by him/her on such exercise of the option, the number and type of securities or other consideration which he/she would have received if such option had been exercised prior to the event changing the number or character of outstanding shares.

7. Miscellaneous

(a) This option is issued pursuant to the Company's Long-Term Incentive Stock Plan and is subject to its terms. A copy of the Plan has been given to the Employee. 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 Employee any right with respect to continuance of employment by the Company or any of its subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time. Employee shall have none of the rights of a shareholder with respect to shares subject to this option until such shares shall have been issued to him upon exercise of this option.

(c) 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.

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

GRACO INC.

By _____
Its: Chairman and Chief
Executive Officer

Employee

October 17, 1994

Mr. Robert A. Wagner
2591 Abbey Hills Drive
Minnetonka, MN 55305

Dear Bob:

The purpose of this Letter of Assignment is to document the practice interpretation pertinent to your temporary assignment as President, Graco K.K. (Japan); V.P. Graco Asia Pacific Operations. We would appreciate your thoroughly reviewing and executing this Letter of Assignment and the International Assignment Manuals to ensure accuracy and mutual understanding. The practices contained in the attached International Assignment Manuals issued October 1994 will apply to you, with the following clarification.

Title: President, Graco K.K. (Japan); V.P. Graco Asia Pacific Operations.

Base Salary: U.S. \$13,933 per month. It is understood that allowances and benefits provided in addition to this amount will be subject to reduction, modification, or elimination by the Company.

Annual Bonus Plan: (Corporate Program 100% based on Corporate results.) 30% participation of base on-plan.

Executive Long Term Incentive Plan: Participation will continue.

Mobility Premium: A gross Mobility Premium of \$20,000 will be paid to you immediately prior to your departure for your assignment. You will personally be responsible for U.S. federal, state, and F.I.C.A. taxes on this amount.

Mr. Robert Wagner
Page 2
10/17/94

DETAIL

Duration and Scope of Assignment: As your assignment to Asia is temporary, Graco Inc. may, at any time, reduce or expand your duties or assign you duties different from those for which you have been engaged. Further, pursuant to Graco's international activities, Graco may, at any time, terminate your employment, your assignment, and/or repatriate you to the United States or assign you to serve with any of its affiliated companies in any other country.

At this time, your assignment is scheduled to begin January 1, 1995. You are expected to reside in Yokohama, up to, but not beyond, January 1999.

You will be responsible for managing (Graco K.K., and Asia Pacific

Operations) according to instructions and/or restrictions as Graco Inc. may from time to time issue. You will report to Roger King, Sr. V.P. Int'l Operations at Graco Inc.

Procedure (No.)

Method of Payment (2): You will be paid in accordance with the attached balance sheet. The yen amount will be paid to you by Graco K.K. (Japan). This yen amount will be reviewed in accordance with provisions of the Policy and Procedure Manual.

Benefit Provisions (3): Coverage on U.S. health and welfare, retirement and investment plans will continue.

Goods & Services

Differential (5): You will be paid a goods and services differential. See attached balance sheet for estimated applicable amount. We will calculate and begin paying a differential once you have relocated to Yokohama and are off of expenses.

Mr. Robert Wagner

Page 3

10/17/94

Host Country

Housing (9): Graco will pay for rental housing and utility services in Yokohama subject to a maximum to be established by Human Resources prior to your departure on your house-hunting trip. The actual housing and utility costs to be paid by Graco must be approved by Roger King before any housing commitments are made.

Advance Trip to

Secure Housing

(10): An exception to policy will be made to allow your wife to fly business class on the house-hunting trip only.

Taxation (18):

Please call Lesa Mellis at Ernst & Young in Minneapolis (371-8367) to arrange a meeting so that your U.S. and state hypothetical taxes can be calculated. Your contact at the Ernst & Young office in Tokyo will be named later.

Other:

A car will be provided. In addition a driver will be provided for twelve months.

As the addendum to your employment offer letter states, in the event of your involuntary separation from Graco, you will be paid your base salary for twelve months or until other employment is secured, whichever occurs first.

The amount that you will actually be paid in Yokohama will be finalized closer to your departure and will reflect interim adjustments to differential, foreign exchange, and hypothetical tax rates.

Any specific employment practices not covered in this letter or the International Assignments Manuals will be covered under Graco's established employment practices.

While on foreign assignment, your employment relationship with the Company will be considered to be subject to Minnesota law, and any disputes will be subject to the exclusive jurisdiction of the courts of the State of Minnesota. We understand, however, that certain laws of the place of employment may be of mandatory application. Nonetheless, neither of us intends that you should

	Home Country Currency (U.S. \$)	Host Country Currency (JPY)
COMPENSATION SUMMARY		
1. Base Salary (Monthly)	13,933	
2. Goods and Services Differential (Line 7)	6,241	
3. Housing Deduction	(2,090)	
4. Hypothetical Tax	(3,390)	

5. NET COMPENSATION (1 through 4)	14,694	
	=====	

METHOD OF PAY

(A.) Portion paid in HOST Country

6. Home Country Spendable Income for Goods & Services	4,755	
7. Host Country Diff. for Goods & Services (1.31255%xLine 6)	6,241	

8. Host Country Spendable Income	10,996	1,086,955
	-----	-----
9. HOST COUNTRY TOTAL PAYMENT	10,996	1,086,955
	=====	=====

(B.) Portion paid in U.S.

10. Base Salary	13,933	
11. Home Country Spendable Income for Goods & Services	(4,755)	
12. Housing Deduction	(2,090)	
13. Hypothetical Tax	(3,390)	

14. U.S. Payment (Subtotal, 10 through 13)	3,698	

15. NET COMPENSATION (9 and 14)	14,694	
	=====	

December 30, 1994

Mr. Robert A. Wagner
2591 Abbey Hills Drive
Minnetonka, MN 55305

Dear Bob:

This letter is intended to supplement your Letter of Assignment dated October 17, and provide further details concerning your temporary assignment as Vice President, Asia Pacific Operations, Graco Inc.

As Vice President, Asia Pacific Operations, you are expected to manage the operations of Graco Inc. and direct the sales of Graco Inc. products in the Asia-Pacific region (excluding Japan). You are expected to perform these duties in the Asia-Pacific region and in the United States. You will report to Roger King, Senior Vice President, International Operations, Graco Inc. You are expected to spend approximately twenty-five percent (25%) of your work time on these activities.

In lieu of providing you with a salary for activities performed by you as Vice President, Asia Pacific Operations, Graco Inc. will provide you and your family with a residence in Japan, upon which Graco Inc. will make monthly lease payments pursuant to the terms of a negotiated lease from January 1995 through the termination of your assignment.

The Letter of Assignment of October 17, 1994, as supplemented by this letter of December 30, 1994, remains in full force and effect.

Sincerely,

/s/ Roger L. King 12/39/94

Roger L. King Date
Senior Vice President and
General Manager, International Operations

Page 2
December 30, 1994
Mr. Robert A. Wagner

Concurrence:

/s/ Clyde Hansen 12/30/94

Clyde Hansen Date
Vice President, Human Resources

Agreed:

/s/ Robert A. Wagner 12/30/94

Robert A. Wagner Date
Vice President, Asia Pacific Operations

July 17, 1995

Mr. Robert A. Wagner
Kirin Bayside Court C
119-33, Yamate-cho, Naka-ku
Yokohama, 231 JAPAN

Dear Bob:

This letter is intended to supplement your Letter of Assignment dated October 17, 1994.

As an additional benefit to your current conditions of employment as stated in above-mentioned Letter of Assignment, the Company will provide you and your wife membership in the Yokohama Country and Athletic Club. This membership will be provided for the duration of your assignment there.

The Letter of Assignment dated October 17, 1994, as supplemented by this letter of July 17, 1995, remains in full force and effect.

Sincerely,

/s/ Roger L. King 7/17/95

Roger L. King Date
Senior V.P. and G.M., International Operations

Concurrence:

/s/ Clyde Hensen 7/17/94

Salary Protection Arrangement
Executive Officers

It is the Company's practice to pay to any executive officer whose employment is involuntarily terminated his/her base salary for up to twelve months following termination or until the officer secures other employment.

The Company does not believe that this practice is a contractual commitment to said executive officers nor is it intended to constitute a plan. The Company reserves the right, in its sole discretion, to discontinue this practice at any time.

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM GRACO INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF EARNINGS AND CONSOLIDATED BALANCE SHEETS FOR THE FISCAL YEAR ENDING DECEMBER 29, 1995, AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

0000042888
GRACO INC.
1,000

YEAR		
DEC-29-1995	DEC-29-1995	
		1,643
		0
	78,005	
	4,800	
	41,693	
	128,482	156,168
	79,310	
	217,833	
71,583		12,009
	0	0
		17,265
		86,306
217,833		386,314
	386,314	196,687
		196,687
	146,071	
	1,135	
	2,335	
	43,556	
	15,850	
27,706		0
	0	0
		0
	27,706	
	1.59	
	1.59	