

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 29, 2000

Commission File Number: 001-9249

GRACO INC.

(Exact name of Registrant as specified in its charter)

Minnesota

41-0285640

(State of incorporation)

(I.R.S. Employer Identification Number)

88 - 11th Avenue N.E.
Minneapolis, Minnesota

55413

(Address of principal executive offices)

(Zip Code)

(612) 623-6000

(Registrant's telephone number, including area code)

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

Yes X No

20,215,088 common shares were outstanding as of October 27, 2000.

GRACO INC. AND SUBSIDIARIES

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PART I

GRACO INC. AND SUBSIDIARIES
 Item I. CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 29, 2000	Sep 24, 1999	Sep 29, 2000	Sep 24, 1999
	(In thousands except per share amounts)			
Net Sales	\$120,800	\$110,076	\$371,195	\$328,020
Cost of products sold	57,851	52,566	180,015	158,034
Gross Profit	62,949	57,510	191,180	169,986
Product development	5,324	4,845	15,244	14,370
Selling, marketing and distribution	20,569	19,049	66,743	57,289
General and administrative	8,531	9,599	25,985	28,729
Operating Profit	28,525	24,017	83,208	69,598
Interest expense	985	1,661	3,522	5,472
Other (income) expense, net	267	(187)	1,507	(2,579)
Earnings Before Income Taxes	27,273	22,543	78,179	66,705
Income taxes	9,200	7,500	26,800	22,500
Net Earnings	\$ 18,073	\$ 15,043	\$ 51,379	\$ 44,205
Basic Net Earnings Per Common Share	\$.89	\$.74	\$ 2.53	\$ 2.19
Diluted Net Earnings Per Common Share	\$.88	\$.72	\$ 2.49	\$ 2.12

See notes to consolidated financial statements.

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

(Unaudited)

	Sep 29, 2000	Dec 31, 1999
	-----	-----
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 2,163	\$ 6,588
Accounts receivable, less allowances of \$4,600 and \$4,400	82,909	79,696
Inventories	33,838	37,702
Deferred income taxes	11,705	12,357
Other current assets	1,540	1,646
	-----	-----
Total current assets	132,155	137,989
Property, Plant and Equipment:		
Cost	190,770	182,156
Accumulated depreciation	(105,823)	(95,663)
	-----	-----
	84,947	86,493
Other Assets	11,051	11,551
	-----	-----
	\$228,153	\$236,033
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Notes payable to banks	\$ 12,034	\$ 14,640
Current portion of long-term debt	810	1,215
Trade accounts payable	12,447	13,500
Salaries, wages and commissions	13,381	12,832
Accrued insurance liabilities	11,501	10,332
Income taxes payable	7,541	2,323
Other current liabilities	22,183	23,421
	-----	-----
Total current liabilities	79,897	78,263
Long-term Debt, Less Current Portion	29,519	65,695
Retirement Benefits and Deferred Compensation	26,672	29,135
Shareholders' Equity:		
Common stock	20,212	20,416
Additional paid-in capital	37,427	31,755
Retained earnings	34,746	9,279
Other, net	(320)	1,490
	-----	-----
Total shareholders' equity	92,065	62,940
	-----	-----
	\$228,153	\$236,033
	=====	=====

See notes to consolidated financial statements.

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

	Thirty-nine Weeks Ended	
	Sep 29, 2000	Sep 24, 1999
	-----	-----
Cash Flows From Operating Activities:		
Net Earnings	(In thousands) \$51,379	\$44,205
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	11,927	11,451
Deferred income taxes	200	(88)
(Gain) loss on sale of property, plant and equipment	131	(3,147)
Change in:		
Accounts receivable	(5,903)	2,534
Inventories	3,220	4,910
Trade accounts payable	(957)	(1,554)
Salaries, wages and commissions	862	(656)
Retirement benefits and deferred compensation	(3,240)	(715)
Other accrued liabilities	5,446	689
Other	(1,047)	300
	----- 62,018	----- 57,929
	-----	-----
Cash Flows From Investing Activities:		
Property, plant and equipment additions	(9,391)	(5,947)
Proceeds from sale of property, plant and equipment	162	9,523
Acquisition of business	-	(18,389)
	----- (9,229)	----- (14,813)
	-----	-----
Cash Flows From Financing Activities:		
Borrowings on notes payable and lines of credit	149,264	90,243
Payments on notes payable and lines of credit	(151,644)	(100,585)
Borrowings on long-term debt	36,135	25,001
Payments on long-term debt	(72,715)	(56,821)
Common stock issued	7,028	6,125
Retirement of common stock	(18,966)	(3,468)
Cash dividends paid	(8,532)	(6,682)
	----- (59,430)	----- (46,187)
	-----	-----
Effect of exchange rate changes on cash	2,216	1,598
	-----	-----
Net increase (decrease) in cash and cash equivalents	(4,425)	(1,473)
Cash and cash equivalents:		
Beginning of year	6,588	3,555
	-----	-----
End of period	\$ 2,163	\$ 2,082
	=====	=====

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The consolidated balance sheet of Graco Inc. and Subsidiaries (the Company) as of September 29, 2000, and the related statements of earnings for the thirteen and thirty-nine weeks ended September 29, 2000 and September 24, 1999, and cash flows for the thirty-nine weeks ended September 29, 2000 and September 24, 1999 have been prepared by the Company without being audited.

In the opinion of management, these consolidated statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of Graco Inc. and Subsidiaries as of September 29, 2000, and the results of operations and cash flows for all periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. Therefore, these statements should be read in conjunction with the financial statements and notes thereto included in the Company's 1999 Form 10-K.

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

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

	Sep 29, 2000	Dec 31, 1999
	-----	-----
Finished products and components	\$28,714	\$25,748
Products and components in various stages of completion	19,677	23,560
Raw materials and purchased components	19,719	21,961
	-----	-----
	68,110	71,269
Reduction to LIFO cost	(34,272)	(33,567)
	-----	-----
	\$33,838	\$37,702
	=====	=====

GRACO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. The Company has three reportable segments; Industrial/Automotive, Contractor and Lubrication. Assets of the Company are not tracked along reportable segment lines. Sales and operating profit by segment for the thirteen and thirty-nine weeks ended September 29, 2000 and September 24, 1999 were as follows (in thousands):

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 29, 2000	Sep 24, 1999	Sep 29, 2000	Sep 24, 1999
Net Sales				
Industrial/Automotive	\$ 56,059	\$ 56,982	\$166,740	\$161,677
Contractor	54,346	42,988	172,700	134,402
Lubrication	10,395	10,106	31,755	31,941
	-----	-----	-----	-----
Total	\$120,800	\$110,076	\$371,195	\$328,020
	=====	=====	=====	=====
Operating Profit				
Industrial/Automotive	\$ 14,484	\$ 11,846	\$ 40,751	\$ 34,533
Contractor	12,857	11,038	38,309	33,081
Lubrication	2,437	2,326	7,162	7,291
Unallocated corporate expenses	(1,253)	(1,193)	(3,014)	(5,307)
	-----	-----	-----	-----
Consolidated Operating Profit	\$ 28,525	\$ 24,017	\$ 83,208	\$ 69,598
	=====	=====	=====	=====

4. There have been no changes to the components of comprehensive income from those noted on the 1999 Form 10K. Total comprehensive income in 2000 was \$16.9 million in the third quarter and \$49.6 million year-to-date. In 1999, comprehensive income was \$15.2 million for the third quarter and \$44.4 million for the nine-month period.
5. In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities", which will be effective for the Company in fiscal year 2001. The statement, as amended by SFAS No. 138 issued June 2000, requires that all derivatives be recognized in the financial statements as either assets or liabilities measured at fair value, and also specifies new methods of accounting for hedging transactions. The Company has not yet determined the impact of SFAS 133 and 138, if any.

Item 2.

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

Results of Operations

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Strong sales, steady gross profit margin rates and reduced expenses (as percentage of sales) continued to drive improvements in quarterly and year-to-date net earnings. Sales of new products accounted for most of the sales increase. For the quarter, sales increased 10 percent over the prior year while gross profit margin rates remained steady and operating expenses increased 3 percent. Year-to-date, sales were up 13 percent, gross profit margin rate was slightly lower and operating expenses increased 8 percent. Earnings in the year-to-date period of 1999 included non-recurring after-tax gains of \$2.1 million (\$.10 per diluted share) from the sale of the Company's Plymouth, Michigan and Los Angeles facilities.

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

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 29, 2000	Sep 24, 1999	Sep 29, 2000	Sep 24, 1999
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	47.9	47.8	48.5	48.2
Product development	4.4	4.4	4.1	4.4
Selling, marketing and distribution	17.0	17.3	18.0	17.5
General and administrative	7.1	8.7	7.0	8.7
Operating Profit	23.6	21.8	22.4	21.2
Interest expense	0.8	1.5	1.0	1.7
Other (income) expense, net	0.2	(0.2)	0.4	(0.8)
Earnings Before Income Taxes	22.6	20.5	21.0	20.3
Income taxes	7.6	6.8	7.2	6.9
Net Earnings	15.0%	13.7%	13.8%	13.4%

Net Sales

Net sales of \$120.8 million were 10 percent higher than third quarter 1999 sales. Year-to-date sales of \$371.2 million increased 13 percent over the prior year. Most of the increase came from the Contractor Equipment segment, which increased 26 percent over third quarter last year and 28 percent year-to-date due to new product releases and an additional sales channel in North America. The Company introduced its new Magnum sprayers in the first quarter of 2000. These units are being sold primarily in the recently established home center sales channel within the Contractor Equipment segment, but are available to customers in other channels. Industrial/Automotive segment sales decreased 2 percent from third quarter 1999 and increased 3 percent over 1999 year-to-date. Lubrication Equipment segment sales were relatively level between quarters and year-to-date.

Sales in all segments were adversely affected by the strengthening dollar in Europe. Sales of \$20.9 million for the quarter in Europe were down 13 percent compared to last year but would have been level if translated at consistent exchange rates. Compared to prior year-to-date, European sales decreased 1 percent, but would have increased 10 percent if translated at consistent exchange rates. The effects of exchange rates were favorable in Asia Pacific, but not enough to offset the adverse impact in Europe. Asia Pacific quarterly sales of \$12.0 million were 7 percent higher compared to last year and would have increased 3 percent if translated at consistent exchange rates. For the nine-month period, Asia Pacific sales increased by 5 percent but would have been level if translated at consistent exchange rates.

Gross Profit

Gross profit as a percentage of net sales was relatively steady for both the quarter and the nine-month periods. Decreases in gross profit margin rate due to product mix and the negative impact of changes in exchange rates were offset by the effects of manufacturing efficiencies resulting from higher production to meet increased sales demand.

Operating Expenses

Selling, marketing and distribution expenses were up 8 percent in the quarter and 17 percent year-to-date, and include increased spending related to the introduction of new products in the home center channel. General and administrative expenses were down 11 percent for the quarter and 10 percent for the nine-month period primarily due to reduced information system spending. Product development expense increased 10 percent between quarters and 6 percent year-to-date, and remained steady as a percentage of sales. The Company continues to make substantial investments in product development to drive future revenue growth.

Interest Expense and Other Income (Expense)

Interest expense continues to decrease due to reduced debt levels. Other expense for the nine-month period was \$1.5 million compared to \$2.6 million of income in the same period of 1999. Other income in 1999 included \$3.2 million of gains on sales of real estate.

Liquidity and Capital Resources

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The Company generated \$62 million of cash flow from operating activities in the first nine months of 2000, and generated \$58 million for the same period last year. In 2000, the Company utilized cash flow to repurchase common shares for \$19 million and made net payments of \$39 million on short and long-term borrowings.

The Company is constructing expanded manufacturing and office facilities in Minneapolis. Also, the Company's former corporate headquarters building in Golden Valley, Minnesota is for sale, as personnel have moved into other Company-owned office space in Minneapolis and Rogers, Minnesota.

The Company had unused lines of credit available at September 29, 2000 totaling \$82 million. The available credit facilities and internally generated funds provide the Company with financial flexibility to meet liquidity needs.

Outlook

While the Company's business was strong in the first three quarters of 2000, management remains cautious about the direction of global economies, and believes it prudent to plan for a slowing in North America. Notwithstanding this cautious outlook, management is optimistic about completing 2000 with continued improved sales and earnings performance versus last year.

SAFE HARBOR CAUTIONARY STATEMENT

The information in this 10-Q contains "forward-looking statements" about the Company's expectations of the future, which are subject to certain risk factors that could cause actual results to differ materially from those expectations. These factors include economic conditions in the United States and other major world economies, currency exchange fluctuations and additional factors identified in Exhibit 99 to the Company's Report on Form 10-K for fiscal year 1999.

PART II

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Computation of Net Earnings per Common Share	Exhibit 11
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Financial Data Schedule (EDGAR filing only)	Exhibit 27
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(b) No reports on Form 8-K have been filed during the quarter for which this report is filed.

SIGNATURES

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

GRACO INC.

Date: October 30, 2000

By: /s/George Aristides

George Aristides
Chief Executive Officer

Date: October 30, 2000

By: /s/James A. Graner

James A. Graner
Vice President & Controller
("duly authorized officer")

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

(Unaudited)

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sep 29, 2000	Sep 24, 1999	Sep 29, 2000	Sep 24, 1999
	(in thousands except per share amounts)			
Net earnings applicable to common shareholders for basic and diluted earnings per share	\$18,073	\$15,043	\$51,379	\$44,205
Weighted average shares outstanding for basic earnings per share	20,212	20,338	20,284	20,194
Dilutive effect of stock options computed using the treasury stock method and the average market price	339	678	327	629
Weighted average shares outstanding for diluted earnings per share	20,551	21,016	20,611	20,823
Basic earnings per share	\$ 0.89	\$ 0.74	\$ 2.53	\$ 2.19
Diluted earnings per share	\$ 0.88	\$ 0.72	\$ 2.49	\$ 2.12

This schedule contains summary financial information extracted from Graco Inc. and subsidiaries consolidated balance sheets for the quarterly period ending September 29, 2000 and is qualified in its entirety by reference to such statements.

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Graco Inc

1

U.S. DOLLARS

3-MOS

DEC-29-2000

JUL-01-2000

SEP-29-2000

1

2,163

0

87,509

4,600

33,838

132,155

190,770

105,823

228,153

78,897

30,329

0

0

20,212

71,853

228,153

120,800

120,800

57,851

57,851

35,676

126

985

27,273

9,200

18,073

0

0

0

18,073

0.89

0.88