

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 June 30, 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)

4050 Olson Memorial Highway
Golden Valley, Minnesota

55422

(Address of principal executive offices)

(Zip Code)

(612) 623-6000

(Registrant's telephone number, including area code)

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

Yes X No

20,212,321 common shares were outstanding as of July 31, 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		Twenty-six Weeks Ended	
	June 30, 2000	June 25, 1999	June 30, 2000	June 25, 1999
	(In thousands except per share amounts)			
Net Sales	\$130,168	\$114,703	\$250,395	\$217,944
Cost of products sold	64,066	55,084	122,164	105,468
Gross Profit	66,102	59,619	128,231	112,476
Product development	4,896	4,771	9,920	9,525
Selling, marketing and distribution	22,360	18,935	46,174	38,240
General and administrative	8,810	9,606	17,454	19,130
Operating Profit	30,036	26,307	54,683	45,581
Interest expense	1,302	1,858	2,537	3,811
Other (income) expense, net	803	(2,712)	1,240	(2,392)
Earnings Before Income Taxes	27,931	27,161	50,906	44,162
Income taxes	9,600	9,200	17,600	15,000
Net Earnings	\$ 18,331	\$ 17,961	\$ 33,306	\$ 29,162
Basic Net Earnings Per Common Share	\$.91	\$.89	\$ 1.64	\$ 1.45
Diluted Net Earnings Per Common Share	\$.89	\$.86	\$ 1.61	\$ 1.41

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands)

(Unaudited)

	June 30, 2000	Dec. 31, 1999
	-----	-----
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 4,367	\$ 6,588
Accounts receivable, less allowances of \$4,500 and \$4,400	85,450	79,696
Inventories	36,712	37,702
Deferred income taxes	12,264	12,357
Other current assets	1,814	1,646
	-----	-----
Total current assets	140,607	137,989
Property, Plant and Equipment:		
Cost	187,548	182,156
Accumulated depreciation	(102,496)	(95,663)
	-----	-----
	85,052	86,493
Other Assets	10,442	11,551
	-----	-----
	\$236,101	\$236,033
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Notes payable to banks	\$ 12,965	\$ 14,640
Current portion of long-term debt	810	1,215
Trade accounts payable	11,252	13,500
Salaries, wages & commissions	11,164	12,832
Accrued insurance liabilities	11,419	10,332
Income taxes payable	2,577	2,323
Other current liabilities	22,731	23,421
	-----	-----
Total current liabilities	72,918	78,263
Long-term Debt, less current portion	58,474	65,695
Retirement Benefits and Deferred Compensation	26,838	29,135
Shareholders' Equity:		
Common stock	20,210	20,416
Additional paid-in capital	37,350	31,755
Retained earnings	19,505	9,279
Other, net	806	1,490
	-----	-----
Total shareholders' equity	77,871	62,940
	-----	-----
	\$236,101	\$236,033
	=====	=====

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Twenty-six Weeks	
	June 30, 2000	June 25, 1999
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:	(In thousands)	
Net Earnings	\$ 33,306	\$29,162
Adjustments to reconcile net earnings to		
Net cash provided by operating activities:		
Depreciation and amortization	7,996	7,615
Deferred income taxes	(23)	123
(Gain) loss on sale of fixed assets	116	(3,209)
Change in:		
Accounts receivable	(7,014)	(2)
Inventories	697	4,041
Trade accounts payable	(2,197)	(997)
Salaries, wages and commissions	(1,538)	(1,940)
Retirement benefits and deferred		
Compensation	(2,035)	(546)
Other accrued liabilities	674	(2,288)
Other	(667)	139
	-----	-----
	29,315	32,098
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property, plant and equipment additions	(5,932)	(3,844)
Proceeds from sale of property, plant		
and equipment	78	9,473
Acquisition of business	-	(18,389)
	-----	-----
	(5,854)	(12,760)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings on notes payable and lines of		
credit	99,026	58,688
Payments on notes payable and lines of credit	(100,496)	(67,382)
Borrowings on long-term debt	34,090	25,082
Payments on long-term debt	(41,715)	(34,988)
Common stock issued	6,949	3,933
Retirement of common stock	(18,966)	-
Cash dividends paid	(5,703)	(4,445)
	-----	-----
	(26,815)	(19,112)
	-----	-----
Effect of exchange rate changes on cash	1,133	1,794
	-----	-----
Net increase (decrease) in cash and cash	(2,221)	2,020
equivalents		
Cash and cash equivalents:		
Beginning of year	6,588	3,555
	-----	-----
End of Period	\$ 4,367	\$ 5,575
	=====	=====

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 June 30, 2000, and the related statements of earnings for the thirteen and twenty-six weeks ended June 30, 2000 and June 25, 1999, and cash flows for the twenty-six weeks ended June 30, 2000 and June 25, 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 June 30, 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):

	June 30, 2000	Dec. 31, 1999
	-----	-----
Finished products and components	\$30,267	\$25,748
Products and components in various stages of completion	21,037	23,560
Raw materials and purchased components	19,475	21,961
	-----	-----
	70,779	71,269
Reduction to LIFO cost	(34,067)	(33,567)
	-----	-----
	\$36,712	\$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 twenty-six weeks ended June 30, 2000 and June 25, 1999 were as follows (in thousands):

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	June 30, 2000	June 25, 1999	June 30, 2000	June 25, 1999
Net Sales				
Industrial/Automotive	\$ 54,692	\$ 53,948	\$110,681	\$104,695
Contractor	64,767	49,719	118,354	91,414
Lubrication	10,709	11,036	21,360	21,835
	-----	-----	-----	-----
Total	\$130,168	\$114,703	\$250,395	\$217,944
	=====	=====	=====	=====
Operating Profit				
Industrial/Automotive	\$ 13,760	\$ 12,942	\$ 26,267	\$ 22,687
Contractor	14,966	13,144	25,452	22,044
Lubrication	2,409	2,676	4,725	4,964
Unallocated Corporate expenses	(1,099)	(2,455)	(1,761)	(4,114)
	-----	-----	-----	-----
Consolidated Operating Profit	\$ 30,036	\$ 26,307	\$ 54,683	\$ 45,581
	=====	=====	=====	=====

4. There have been no changes to the components of comprehensive income from those noted on the 1999 Form 10K.
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

- - - - -

Net earnings of \$18.3 million (\$.89 per diluted share) for the quarter ended June 30, 2000 increased 2 percent from second quarter 1999 earnings of \$18.0 million (\$.86 per diluted share). Earnings in the second quarter 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. Year to date net earnings increased to \$33.3 million, a 14 percent increase over the same period last year. Strong sales continued to drive improvements in quarterly and year to date net earnings.

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

	Three Months (13 weeks) Ended		Six Months (26 weeks) Ended	
	June 30, 2000	June 25, 1999	June 30, 2000	June 25, 1999
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	49.2	48.0	48.8	48.4
Product development	3.7	4.2	4.0	4.4
Selling, marketing and distribution	17.2	16.5	18.4	17.5
General and administrative	6.8	8.4	7.0	8.8
Operating Profit	23.1	22.9	21.8	20.9
Interest expense	1.0	1.6	1.0	1.7
Other (income) expense, net	0.6	(2.4)	0.5	(1.1)
Earnings Before Income Taxes	21.5	23.7	20.3	20.3
Income taxes	7.4	8.0	7.0	6.9
Net Earnings	14.1%	15.7%	13.3%	13.4%
	=====	=====	=====	=====

Net Sales

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Net sales of \$130.2 million in the second quarter were up 13 percent from the second quarter of 1999. Year to date sales of \$250.4 million increased 15 percent over the prior year. Contractor Equipment segment sales accounted for most of the sales improvement, increasing 30 percent over second quarter last year and 29 percent year to date due to new product releases and an additional sales channel in North America. Graco 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 increased 1 percent from second quarter 1999 and increased 6 percent over 1999 year to date. Lubrication Equipment segment sales decreased 3 percent for the quarter and 2 percent year to date.

Geographically, sales in the Americas increased 19 percent in both the quarter and six month periods due to strong Contractor sales. Sales of \$20.9 million for the quarter in Europe were flat compared to last year but would have increased 12 percent if translated at consistent exchange rates. Compared to prior year to date, European sales increased 5 percent; 17 percent translated at consistent exchange rates. Asia Pacific quarterly sales of \$12.5 million were also flat compared to last year and would have decreased 5 percent if translated at consistent exchange rates. For the six month period, Asia Pacific sales increased by 4 percent, but decreased 1 percent when translated at consistent exchange rates.

Gross Profit

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Gross profit as a percentage of quarterly net sales dropped to 50.8 percent from 52.0 percent. For the six month period, gross profit percentage decreased to 51.2 percent from 51.6 percent. The decrease was due to product mix and the negative impact of changes in exchange rates. The decrease was partially offset by the effects of improved manufacturing efficiencies resulting from higher production and sales levels.

Operating Expenses

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Operating expenses of \$36.1 million for the quarter and \$73.5 million for the six month period increased 8 percent and 10 percent respectively from the same periods of 1999. Selling, marketing and distribution expenses were up 18 percent quarterly, 21 percent year to date, and included increased spending related to the introduction of new products in the home center channel in the first half of 2000. General and administrative expenses were down 8 percent for the quarter and 9 percent for the six month period primarily due to reduced information system spending. Product development spending increased 3 percent to \$4.9 million for the quarter and 4 percent to \$9.9 million year to date.

Other Income (Expense)

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Other expense for the second quarter was \$0.8 million compared to \$2.7 million of income in the same period of 1999. Other income in the second quarter of 1999 included \$3.2 million of gains on sales of real estate.

Liquidity and Capital Resources

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The Company generated \$29 million of cash flow from operating activities in the first six months of 2000, and generated \$32 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 \$9 million on short and long term borrowings.

The Company's Board of Directors has approved a proposal to expand manufacturing facilities in Minneapolis. Also, the Company's corporate headquarters building in Golden Valley, Minnesota is for sale, as headquarters personnel are being moved into other Company owned office space in Minneapolis and Rogers, Minnesota.

The Company had unused lines of credit available at June 30, 2000 totaling \$82 million. The available credit facilities and internally generated funds provide the Company with the financial flexibility to meet liquidity needs.

Outlook

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

SAFE HARBOR CAUTIONARY STATEMENT

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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
Financial Data Schedule (EDGAR filing only)	Exhibit 27

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

SIGNATURES

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

GRACO INC.

Date: August 3, 2000

By: /s/George Aristides

George Aristides
Chief Executive Officer

Date: August 3, 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		Twenty-six Weeks Ended	
	June 30, 2000	June 25, 1999	June 30, 2000	June 25, 1999
(in thousands except per share amounts)				
Net earnings applicable to common shareholders for basic and diluted earnings per share	\$18,331	\$17,961	\$33,306	\$29,162
Weighted average shares outstanding for basic earnings per share	20,246	20,139	20,320	20,122
Dilutive effect of stock options computed using the treasury stock method and the average market price	324	708	321	605
Weighted average shares outstanding for diluted earnings per share	20,570	20,847	20,641	20,727
Basic earnings per share	\$ 0.91	\$ 0.89	\$ 1.64	\$ 1.45
Diluted earnings per share	\$ 0.89	\$ 0.86	\$ 1.61	\$ 1.41

This schedule contains summary financial information extracted from Graco Inc. and subsidiaries consolidated balance sheets for the quarterly period ending June 30, 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

APR-01-2000

JUN-30-2000

1

4,367

0

89,950

4,500

36,712

140,606

187,548

102,496

236,101

72,918

59,284

0

0

20,210

57,661

236,101

130,168

130,168

64,066

64,066

38,171

10

1,302

27,931

9,600

18,331

0

0

0

18,331

0.91

0.89