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 27, 1996

Commission File Number: 1-9249

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

17,099,116 common shares were outstanding as of October 25, 1996.

GRACO INC. AND SUBSIDIARIES

INDEX

PART I

GRACO INC. AND SUBSIDIARIES

Item I. CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	Sept. 27, 1996	Sept. 29, 1995	Sept. 27, 1996	Sept. 29, 1995
	(In thousands except per share amounts)			
Net sales	$ 97,680	$ 94,797	$ 284,932	$ 293,726
Cost of products sold	47,704	48,510	140,697	149,497
Gross profit	49,976	46,287	144,235	144,229
Product development	4,714	3,557	13,566	11,419
Selling	21,624	21,982	62,714	65,740
General and administrative	8,316	10,263	29,996	32,345
Operating profit	15,322	10,485	37,959	34,725
Interest expense	155	596	732	2,025
Other expense, net	310	220	(447)	563
Earnings before income taxes	14,857	9,669	37,674	32,137
Income taxes	4,700	3,100	11,900	11,600
Net earnings	$ 10,157	$ 6,569	$ 25,774	$ 20,537
Net earnings per common and common equivalent share	$ .58	$ .37	$ 1.47	$ 1.18
Cash dividend declared per common share	$ .12	$ .11	$ .36	$ .32

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In Thousands)

	September 27, 1996 (Unaudited)	December 29, 1995
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 7,401	$ 1,643
Accounts receivable, less allowances of $5,181 and $4,856	76,744	73,205
Inventories	48,319	41,693
Deferred income taxes	10,609	10,608
Other current assets	1,946	1,333
Total current assets	145,019	128,482
Property, plant and equipment:		
Cost	173,423	156,168
Less Accumulated Depreciation	(87,586)	(79,310)
	85,837	76,858
Other assets	8,883	12,493
	$ 239,739	$ 217,833
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Notes payable to banks	$ 4,712	$ 5,051
Current portion of long-term debt	1,865	1,935
Trade accounts payable	13,164	13,849
Customer advances	4,963	803
Dividends payable	2,053	2,072
Income taxes payable	3,797	4,229
Other current liabilities	48,559	43,644
Total current liabilities	79,113	71,583
Long-term debt, less current portion above	8,911	10,074
Retirement benefits and deferred compensation	32,917	32,605
Shareholders' equity:		
Common stock	17,092	17,265
Additional paid-in capital	16,102	20,397
Retained earnings	84,451	64,949
Other, net	1,153	960
	$ 239,739	$ 217,833

See notes to consolidated financial statements.

GRACO INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Thirty-Nine Weeks	
	Sept. 27, 1996	Sept. 29, 1995
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Earnings	$ 25,774	$ 20,537
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	9,633	9,251
Deferred income taxes	2,318	1,186
Change in:		
Accounts receivable	(3,182)	2,733
Inventories	(7,147)	1,241
Trade accounts payable	(380)	(4,954)
Retirement benefits and deferred compensation	564	2,659
Other accrued liabilities	6,813	(3,191)
Other	350	821
	34,743	30,283
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property, plant and equipment additions	(18,681)	(16,546)
Proceeds from sale of property, plant, and equipment	62	151
	(18,619)	(16,395)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowing on notes payable and lines of credit	13,932	111,279
Payments on notes payable and lines of credit	(13,957)	(120,794)
Borrowing on long-term debt	198	--
Payments on long-term debt	(1,347)	(613)
Common stock issued	2,352	2,234
Retirement of common and preferred stock	(6,819)	--
Cash dividends paid	(6,293)	(5,625)
	(11,934)	(13,519)
Effect of exchange rate changes on cash	1,568	(2,164)
Net increase(decrease)in cash and cash equivalents	5,758	(1,795)
Cash and cash equivalents:		
Beginning of year	1,643	2,444
End of period	$ 7,401	$ 649

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 27, 1996 and the related statements of earnings and cash flows for the thirty-nine weeks ended September 27, 1996, and September 29, 1995, have been prepared by the Company without being audited.

   In the opinion of management, these consolidated statements reflect all adjustments necessary to present fairly the financial position of Graco Inc. and Subsidiaries as of September 27, 1996, 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 1995 Form 10-K.

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

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

	Sept. 27, 1996	Dec. 29, 1995
Finished products and components	$45,497	$40,335
Products and components in various stages of completion	27,248	22,597
Raw materials	12,188	13,152
	84,933	76,084
Reduction to LIFO cost	(36,614)	(34,391)
	$48,319	$41,693

Item 2. GRACO INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

Net earnings of $10.2 million for the quarter ended September 27, 1996 increased $3.6 million, or 55 percent, over the same period last year. Net earnings of $25.8 million for the nine months ended September 27, 1996 increased $5.2 million, or 26 percent, over the first nine months of 1995. The earnings improvement came primarily as a result of improved gross margin, reduced operating expenses, a $1.5 million pretax settlement of a lawsuit involving an escrow deposit dating back to 1986, lower interest expense resulting from lower debt balances, and a lower effective tax rate.

Sales for the quarter of $97.7 million were $2.9 million, or 3 percent higher, than the third quarter of 1995. The increase in quarterly sales occurred primarily in the Americas. Year-to-date sales of $284.9 million were $8.8 million, or 3 percent, lower than 1995. The decline in year-to-date sales can be attributed primarily to economic softness in the international markets and currency fluctuations.

Sales in the Americas of $62.0 million for the quarter were 8 percent higher than 1995. Year-to-date sales of $187.9 million were 1 percent higher. European sales continue to lag behind last year with quarterly and year-to-date sales of $21.7 million and $54.6 million, respectively. Europe's third quarter sales were equal to 1995's level (a 4 percent volume increase, offset by a 4 percent loss due to exchange rates). Year-to-date European sales are 7 percent lower than 1995 (a 6 percent volume decease, and a 1 percent loss due to exchange rates). In Asia Pacific, sales decreased 12 percent from last year's third quarter to $13.9 million (a 2 percent volume decease, and a 10 percent loss due to exchange rates). For the nine month period ended September 27, 1996, Asia Pacific sales of $42.4 million were 12 percent lower than 1995 (a 5 percent volume decrease, and a 7 percent loss due to exchange rates).

While many of the markets the Company serves were slow in the first half of 1996, the Company is encouraged by the somewhat improved levels of business activity during the third quarter. Worldwide, Industrial/Automotive Equipment sales improved 3 percent to $56.2 million from last year's third quarter, Contractor Equipment sales improved 4 percent to $30.6 million, and Lubrication Equipment sales improved 2 percent to $10.9 million. For 1996's first nine months, Industrial/Automotive Equipment sales of $156.1 million were 6 percent lower than the same period last year, Contractor Equipment sales of $96.6 million were at the 1995 level, and Lubrication Equipment sales of $32.2 million were 5 percent higher than 1995.

The gross profit margin percentage for both the quarter and year-to-date increased 2 percentage points over a year ago to 51 percent. The increase can be attributed to improved pricing in the Americas and Europe, manufacturing volume and efficiencies.

Operating expenses of $34.7 million for the quarter and $106.3 million for the first nine months are both 3 percent lower than the same periods last year. While investments in product development and marketing reached record levels, close control of selling and general and administrative costs have kept operating expenses below 1995 levels.

Interest expense of $0.2 million is $0.4 million, or 74 percent, lower than the third quarter of 1995. Year-to-date interest expense of $0.7 million is $1.3 million, or 64 percent lower. The decreases in interest expense result from lower debt balances at September 27, 1996 as compared to September 29, 1995.

The effective tax rate for both the quarter and the nine month period ended September 27, 1996 of 32 percent is 4 percentage points lower than the year-to-date rate for 1995. The decline in the effective tax rate in 1996 results from lower effective tax rates on foreign earnings. The Company expects a higher effective tax rate in 1997.

The Company's backlog of $33.0 million is nearly $10.0 million higher than the level a year ago and the current rate of incoming orders provides the Company with reason to be cautiously optimistic about a solid fourth quarter. The earnings momentum and modestly improved sales activity achieved by the Company across all divisions gives it added confidence that its investments in new products, technology, globalization, and world-class manufacturing are having a significant impact on the Company's long-term ability to grow profitably.

Liquidity and Capital Resources

The Company generated cash from operations of $34.7 million for the first nine months of 1996 as compared to $30.3 million for the same period last year. Significant uses of cash include increases in inventory balances in anticipation of a November factory move to a new facility as discussed below, purchases of property, plant and equipment, payments of cash dividends, and repurchases of common stock. Working capital increased $9.0 million to $65.9 million from $56.9 million at December 29, 1995. The Company plans on spending approximately $17.0 million in 1996 ($8.5 million to date) for the construction of a 325,000 square foot world-class manufacturing facility and global distribution center in Rogers, Minnesota (approximately 20 miles northwest of Minneapolis). This expenditure will be funded primarily with cash generated through operations. The Company has unused lines of credit available at September 27, 1996 totaling $70.1 million.

PART II

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Sixth Amendment dated September 27, 1996 to Credit Agreement between the Company and First Bank National Association	Exhibit 4
Statement on Computation of Per Share Earnings	Exhibit 11
Financial Data Schedule	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: November 4, 1996 By:/S/George Aristides

George Aristides
President and Chief Executive Officer

Date: November 4, 1996 By:/S/David M. Lowe

David M. Lowe
Treasurer
(Principal Financial Officer)

SIXTH AMENDMENT TO CREDIT AGREEMENT

THIS SIXTH AMENDMENT (this "Amendment") dated as of September 27, 1996, 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, February 8, 1994, and April 10, 1995 (as so amended, the "Credit Agreement"), between GRACO INC., a Minnesota corporation (the "Company") and FIRST BANK 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 1 - AMENDMENTS TO THE CREDIT AGREEMENT

1.1 Defined Terms. Section 1.01 is amended as follows:

(a) The definition of "Applicable Margin" is amended to read as follows:

> "'Applicable Margin': For each CD loan shall mean 0.75%, for each Reference Rate Loan shall mean 0% and for each Eurocurrency loan shall mean 0.625%."

(b) The definition of "Maturity Date" is amended to read as follows:

> "'Maturity Date': June 30, 1997."

(c) The following new definition are added:

> "'EBIT': for any period of determination, Consolidated Net Earnings of the Company and its Subsidiaries before provision for income taxes and Interest Expenses, all as determined in accordance with generally accepted accounting principles, excluding therefrom (to the extent included during any period) the net total of the following, to the extent that such net total is less than or equal to $2,000,000: (a) non-operating (including, without limitations, extraordinary or nonrecurring gains, gains from discontinuance of operations and gains arising from the sale of assets other than inventory) during the applicable period; and (b) similar non-operating losses during such period."

> "'EBITDA': for any period of determination, EBIT, plus to the extent deducted in Consolidated Net Earnings, depreciation and amortization."

> "'Interest-bearing Indebtedness': all interest-bearing indebtedness of the Company and its Subsidiaries for borrowed money, determined in accordance generally accepted accounting principles."

> "'Interest Expense'" for any period of determination, all interest accrued on indebtedness of the Company and its Subsidiaries determined in accordance with generally accepted accounting principals, including without limitation implicit interest expense on capitalized leases."

1.2 Deleted Sections. The following Sections are amended to read as follows (and definitions only used in such Sections shall be deemed deleted):

> "7.11 Intentionally omitted."

> "7.12 Intentionally omitted."

> "7.15 Intentionally omitted."

> "7.16 Intentionally omitted."

1.3 Consolidated Tangible Net Worth. Section 7.13 is amended to read as follows:

> "7.13 Consolidated Tangible Net Worth. Not at any time permit Consolidated Tangible Net Worth to be less than $75,000,000 plus 50% of Consolidated Net Earnings after December 31, 1995."

1.4 Leverage Ratio. Section 7.14 is amended to read as follows:

> "7.14 Leverage Ratio. Not permit the ratio of Interest-bearing Indebtedness as of the last day of any fiscal quarter to EBITDA for the period of four consecutive fiscal quarters then ending to be more than 2.5 to 1.00."

1.5 Interest Coverage Ratio. New Section 7.18 is added following Section 7.17 and shall read as follows:

> "7.18 Interest Coverage Ratio. Not permit the ratio of EBIT to Interest Expense, each measured for each period of four consecutive fiscal quarters, to be less than 4.00 to 1.00."

1.6 Exhibit G. Exhibit G to the Credit Agreement is replaced by Exhibit G attached to this Amendment.

1.7 Note. The Loans shall continue to be evidenced by Note dated April 10, 1995 in the principal amount of $25,000,000.

1.8 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 - WAIVER

The Borrower has informed the Bank that with respect to its fiscal year ended December 31, 1995, it may not have complied with certain provisions of ERISA, as required by Section 7.17 of the Credit Agreement. The Borrower has requested that the Bank waive such failure to comply. Effective as provided below, the Bank waives the Borrower's compliance with Section 7.17 of the Credit Agreement as applied to such fiscal year, on the further condition that fines and charges resulting from any such non-compliance shall not exceed $50,000. Except as expressly provided herein, all provisions of the Credit Agreement remain in full force and effect and this waiver shall not apply to any other or subsequent failure to comply with such Section or any other provision of the Credit Agreement.

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 Agreement 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 thought made on the date hereof, except for changes that are permitted by the terms of the Credit Agreement. The execution by the Company of this Agreement shall be deemed a representation that the Company has complied with the foregoing condition.

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

3.3 Documents. The Company shall have delivered this Amendment and certified copies of resolutions of the Board of Directors of the Company authorizing or ratifying the execution, delivery and performance, respectively, of this Amendment, together with an incumbency certificate of officers executing this Amendment.

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 Agreement, which obligations of the Company shall survive any termination of the Credit Agreement.

4.2 Counterparts. This Agreement 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 of unenforceablility 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. This Amendment shall be binding upon the Company 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:/S/Michael S. Harter

Title: Commercial Banking Officer

EXHIBIT G

SUBSIDIARIES OF
GRACO INC.

Subsidiary	Jurisdiction of Incorporation	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%

EXHIBIT 11

GRACO INC. AND SUBSIDIARIES

COMPUTATION OF NET EARNINGS PER COMMON SHARE

(Unaudited)

	Thirteen Weeks Ended		Thirty-NineWeeks Ended	
	Sept. 27, 1996	Sept. 29, 1995	Sept. 27, 1996	Sept. 29, 1995
	(In thousands except per share amounts)			
Net earnings applicable to common stock:				
Net earnings	$10,157	$ 6,569	$25,774	$20,537
Less dividends on preferred stock	--	19	--	56
	$10,157	$ 6,550	$25,774	$20,481
Average number of common and common equivalent shares outstanding:				
Average number of common shares outstanding	17,181	17,245	17,282	17,181
Dilutive effect of stock options computed on the treasury stock method	229	279	236	228
	17,410	17,524	17,518	17,409
Net earnings per common and common equivalent share	$ .58	$ .37	$ 1.47	$ 1.18

Primary and fully diluted earnings per share are substantially the same.

This schedule contains summary financial information extracted from Graco Inc. and subsidiaries consoldiated statements of eaarnings and consolidated balance sheets for the quarterly period ending September 27, 1996 and is qualified in its entirety by reference to such financial statements.

0000042888
GRACO INC.

1,000
U.S. DOLLARS

9-MOS
DEC-27-1996
JUN-29-1996
SEP-27-1996
1
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76,744
5,181
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87,586
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79,113
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284,932
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140,697
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25,774
1.47
1.47