



DISPELLING *Myths*



DISPELLING *Myths*

Graco products impact the world everyday—in quiet, but substantial ways. Discover all that Graco really is...

Corporate Mission


Graco's mission is to generate sustained profitable growth to benefit its customers, employees, shareholders and communities. We will be the world's leading supplier of fluid management products and packages in the markets we target.

Corporate Vision

We will grow revenues by 10% and net earnings by 12% per year. We will grow our sales more significantly outside North America and in new markets, and with new products and improved business processes. Graco's goal is to have at least 30% of each year's revenues from new products introduced in the last three years and to have at least 5% of each year's revenues from sales in markets entered in the last three years. We will actively pursue focused strategic acquisitions where we can add significant value.

Corporate Profile

Founded in 1926, Graco is a world leader in fluid handling systems and components. Graco products move, measure, control, dispense and spray a wide range of fluids and viscous materials used in lubrication, commercial and industrial settings. The Company's success is based on its unwavering commitment to technical excellence, world-class manufacturing and superior customer service. Working closely with specialized distributors, Graco offers products which set the quality standards in a wide range of fluid handling applications, including spray finishing and paint circulation, lubrication, sealants and adhesives and power application equipment for contractors. Graco's ongoing investment in fluid management and controls will continue to provide innovative solutions to a diverse global market. The Company has its corporate headquarters in Minneapolis, Minnesota, and employs approximately 2,300 people worldwide. Graco common stock (ticker symbol: GGG) is listed on the New York Stock Exchange.



“Through unwavering commitment to our core growth strategies: expansion into new markets, adding new distribution, introduction of new products, strategic sourcing and well-managed manufacturing practices, Graco has steadily grown from a small Minnesota company to a world leader in the markets we serve throughout the world.”



Letter To *Shareholders*

FACT:

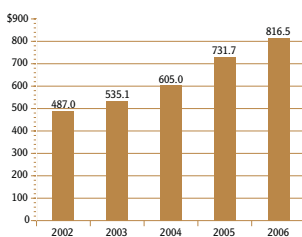
Following our proven strategies for sustained profitable growth has led Graco to another year of record performance in 2006.

With diverse products and a broad geographic presence, our businesses complement each other by sharing common technologies, distribution channels and well-tested global business processes. We leverage these, along with our strong industry knowledge and the execution of Graco best practices, throughout the world. Equally as important, we continue to strengthen our organization by investing in our people and fostering a culture of discipline and continuous improvement throughout the company and throughout the world.

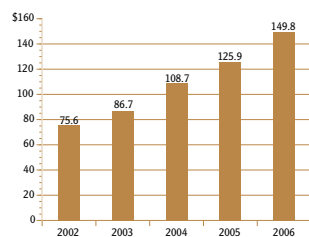
2006 Results

Some of the highlights this year included:

- Record sales of \$816 million, up 12% from 2005
- Record net earnings of \$150 million, up 19% from 2005
- Sales growth in all three geographic regions
- Sales growth in all three segments
- Acquiring Lubriquip, Inc. for cash
- Opening an assembly plant in Suzhou, China
- Expanding operations in Ohio by adding 58,000 square feet of manufacturing and engineering space
- Expanding operations in South Dakota by adding 22,000 square feet of manufacturing space
- Consolidating operations previously in New Jersey and Spain into other Graco facilities
- Paying our shareholders dividends of \$39 million
- Repurchasing approximately two million shares of stock for \$88 million



Net Sales



Net Earnings



In the following pages, we address the myths that Graco faces. We hope the facts will provide you with a better understanding of Graco and what makes us valuable to our shareholders, our business partners, our customers, and our employees.

Organic Growth

Our primary objective is to pursue strategies that drive profitable organic sales. Graco's target, over a complete business cycle, is to achieve 6% to 8% annual organic sales growth on average. This target represents approximately twice the rate of growth of our diverse underlying markets. We are able to target a rate that exceeds underlying market growth rates by investing in new products, developing our distribution channels and expanding into new markets. In 2006, we were able to grow 9% organically and have achieved approximately 9% organic growth, on average, in each of the last five years.

Product Development

To support organic growth, we work tirelessly to deliver improved products to our customers. Product development teams are focused on tangible projects with high rates of success. Project ideas come from Graco's world-class marketing teams, distribution networks and the engineers who work in our segments. We continue to invest record amounts in product development, including \$30 million this year. Our goal is to have at least 30% of each year's sales come from products introduced in the last three years.

Distribution Development

We maximize our revenue potential by adding qualified distributors to sell and service our products throughout the world. We believe that customers, who have access to our products and the support of a distributor nearby, will select Graco over the competition. Each year, we identify areas for distributor development and expansion. Plans are put in place and results are measured. These plans reflect our goal of reaching and serving the customer through the most effective channel to meet both their requirements and our objectives. The relationship between Graco and its distributors is based on respect, trust, mutual economic benefit and the expectation of a long-term relationship.

New Markets

New markets play a role in our growth by expanding our presence into previously unserved industries where we can add value. New market opportunities have arisen from a combination of our product development efforts and through acquisitions. In the past few years, new markets have included specialty texture applicators for both Europe and the home center market, sanitary pumping equipment, automotive refinish applicators, specialty sealant and adhesive equipment, reaction injection molding equipment and others.

Acquisitions

We seek acquisitions that increase shareholder value and contribute to Graco's long-term profitable growth. Acquisition candidates will be companies within our sphere of knowledge where we can add value to their business operations. Specifically, we pursue companies where we can leverage our strengths including: product expertise, meeting customer requirements, channel infrastructure, a deep understanding of relevant fluid technologies, world-class manufacturing and global administration.

Dispelling Myths

The theme for this year's annual report is dispelling some of the myths that are associated with our company. There are probably a lot of things people think of when they hear the name "Graco." Some of them don't fit or are just not true. Let me tell you about Graco: We are a global company. We can remain one of the most profitable companies in the world while manufacturing products in the United States. And, we have not run out of opportunities to improve our business and its profitability. Through the following pages, we hope you come away with a better understanding of Graco and what makes us valuable to our shareholders, our business partners, our customers, and our employees.

Summary

We had a tremendous year in 2006 and enter 2007 with continued confidence in our ability to achieve our long-term financial objectives.

In closing, I want to thank you, our shareholders, for your support and our employees for their ongoing commitment and dedication to making Graco a strong and vibrant company.

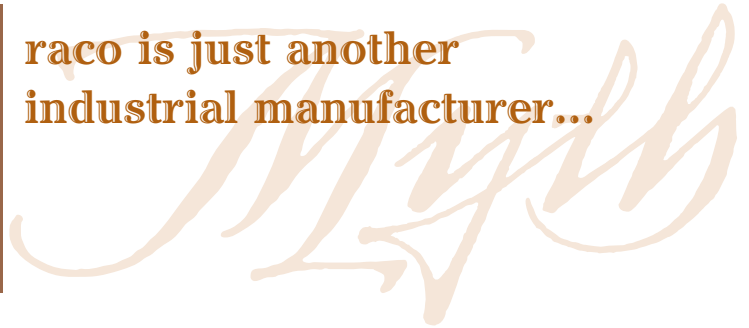
David A. Roberts
Chairman, President and Chief Executive Officer



Introduced many new products in 2006; driving sales growth in all three segments and across all three geographic regions.



Graco is just another industrial manufacturer...



FACT:

Several milestones were reached this year. Graco celebrated its 80th anniversary and 20 years of trading on the NYSE. This year we also exceeded \$800 million in sales. The principal reason for this accomplishment was strong organic growth in all of our regions and divisions.

At-a-glance

Industrial Segment

The Industrial segment designs and markets products for the liquid finishing, process, sealants, adhesives, protective coatings and foam markets. In 2006, this business segment generated 51% of Graco's total sales, or \$416 million, up 13% over 2005 sales. The customers for liquid finishing and process are primarily manufacturers that transfer fluids such as paints and chemicals. Our pumps move the materials from drums and tanks through our proportioning equipment to our spray guns and dispensers. Customers using our protective coatings equipment apply materials used for protecting surfaces like bridges, water towers and ships from the elements, as well as traditional foam insulation in residential, commercial and industrial buildings. In addition, the segment's sealant and adhesive equipment is used by manufacturers to bond and seal assembled parts.

Contractor Segment

This segment experienced growth in 2006, especially in foreign markets. The segment designs and markets sprayers used to apply paint, architectural coatings and texture materials, as well as sprayers for pressure cleaning. Distributors of our products sell to painting, roofing, texture, corrosion control, line striping contractors and trades people. Our equipment is highly regarded for its durability and ease of use, as well as its ability to deliver high-quality finishes at rapid production rates. In addition, the Contractor segment designs and markets a line of sprayers for the non-professional through the home center market. In 2006, the segment generated \$321 million in sales, 39% of the Company's total sales, up 5% over the previous year.

Lubrication Segment

While being a leader in the lubrication equipment industry for more than eight decades, Graco continues to expand its presence. The Lubrication segment designs and markets products to lubricate and maintain vehicles and in-plant equipment. It supplies products and systems to oil change facilities, service garages, fleet service centers, automobile dealership, mines and manufacturing companies. This segment continued its push to vertically integrate manufacturing with the acquisition of Lubriquip, Inc., a company that supplies products to the industrial and mobile lubrication markets. Sales from the segment have grown steadily and in 2006 the segment generated \$80 million in sales, 10% of the company's total sales, up 34% over the previous year.



Executive Officers (left to right): Pat McHale, Chuck Rescorla, Chris Koch, Fred Sutter, Dale Johnson, Karen Gallivan, Simon Paulis, David Lowe, Mark Sheahan, Jim Graner

Products

Pumps and Sprayers

Air, electric, gas and hydraulic
– Transfer fluids to dispense and spray

Controls

Electronic/mechanical fluid control
– Manage flow, pressure and mix

Applicators

Automatic and manual dispense valves and spray guns
– Spray or dispense fluids

Accessories

Fittings, regulators, hoses
– Auxiliary components for complete product solutions

Key Markets Served

Industrial Products and Applied Fluid Technologies

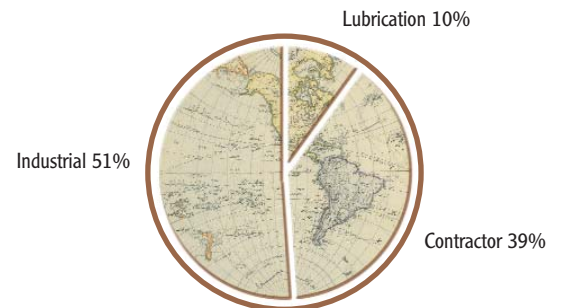
- Aerospace
- Automotive/truck/bus assembly
- Automobile repair shops
- Process industries
- Farm and construction equipment
- General industrial assembly
- Medical/electrical
- Fabrication and molding
- Foam insulation contractors
- Industrial coating contractors
- Marine and rail
- Furniture
- Food

Contractor Equipment

- Painting and specialty contractors
- Ceiling and wall texture
- Remodeling
- Line striping

Lubrication Equipment

- Automobile dealerships
- Fast oil change facilities
- Fleet service centers
- Industrial lubrication
- Mining



Segment Sales



Global Sales



Yes, Graco is a North American-based company, but our presence and impact speaks many languages.



It is a widely held perception that Graco is merely a North American company...

FACT:

Graco is global, with a broad geographic presence that stretches around the world. Our employees, distribution network and customers can be found in nearly every part of the world.

Through unwavering commitment to our core growth strategies: expansion into new markets, adding new distributors, introduction of new products, strategic sourcing and well-managed manufacturing practices, Graco has steadily grown from a small Minnesota company to a world leader in the markets we serve.

Our literature is translated into 23 languages; we have distributors throughout the world and management in place to work with, understand and support cultural differences. From applications that spray protective coatings, to products that support materials in underground mines in Australia, or that paint the walls of the Forbidden City in Beijing, our products are universally recognized for the quality and reliability we proudly build into each piece of Graco equipment.

We expanded our reach

- From key corporate offices in the United States, Belgium and China we have established a strong corporate presence throughout the world –
 - European sales grew 16% in 2006.
 - In India, sales have increased 300% in just three years.
 - Sales in China were up 33% this year, and we reached the \$100 million milestone in the Asia Pacific region, with customers such as Toyota, Nissan, Honda, Hyundai and Chery Automotive recognizing the value of our superior products.
- Our European business had significant success with Contractor Equipment products attracting the attention of several global business partners.
- The Reactor® fast-set foam unit sales grew 80% in Europe. We expect growth in all our high performance coating and foam products to continue in this region of the world.
- As China's construction industry addresses energy conservation, i.e. insulating buildings with foam, our distributors delivered growth by selling Reactor® and Fusion® products.
- In Malaysia, we opened our first national paint account with Seamaster Paints allowing painting contractors nationwide access to Graco products.
- We reached a milestone in 2006 when one of our oldest Asia Pacific distributors, Nagoya IEC, Nagoya, Japan, surpassed the 45-year mark as a Graco customer.



Distributors in Xiamen China representing the growing CED market in the Asia-Pacific RIM.

We changed the way people do business

- Through a series of more than 1,500 end-user demonstrations and Pro Shows in China, we've witnessed contractors converting from brushes and rollers to Graco airless paint spray equipment.
- A road show traveling across Europe made stops in 21 countries, conducted more than 2,400 demonstrations, and generated a 32% average sales increase from participating distributors.

We went deep into the earth and we reached new heights

- We developed and introduced a specialty texture sprayer for the European market. Sales of this unit have been robust throughout Europe.
- The success of Contractor Equipment products in France's Brico Depot stores led to negotiations with similar do-it-yourself chains in other European countries.
- The first reaction injection molding (RIM) unit was installed in China at Shanghai GM and our paint line equipment is prevalent throughout the region as Chinese, Thai and Indian automotive companies begin to emerge.
- In Vietnam, Graco's products for fine finish applications are found in the wood furniture manufacturing industry. These fine finish products are now being installed in that nation's automotive manufacturing plants, such as Ford Hanoi.
- In China's Pearl River Delta, we provide the coating for products such as iPods®, Mac PowerBooks®, cell phones and other consumer electronics.
- The burgeoning mining sector in Australia and New Zealand generated an outstanding regional sales increase of 75% for the Lubrication segment and an increase of 22% for high performance coatings and foam products.



NXT™ Supply Pumps

Newly designed NXT™ high-pressure air-operated airless sprayers set a new standard in performance.



Graco posted record profitability in 2006.



Graco cannot continue to produce strong operating margins over time...

FACT:

Graco has a record of long-term growth. Further improvement in margins can indeed continue because of our disciplined operating processes, growing geographic presence and improved products.

When a company steadfastly adheres to a disciplined strategy that maximizes and reinvests in technology for efficiency and volume, positive margins typically follow. That is exactly the formula Graco has embraced and a philosophy that is championed today from the plant floor to the boardroom.

By stepping forward as the industry leader when it comes to investing in technology, Graco's labor and operating costs are significantly reduced. While the skills and experience of our more than 2,300 employees worldwide are priceless, we recognize that strategic, technology-driven manufacturing is also vital to maximizing our operational efficiency and to delivering world-class products to our customers.

For 9 out of the last 11 years, we have reduced our manufacturing cost to produce. Business year 2006 was no exception, despite higher energy, materials and labor costs. We have achieved this through a culture of disciplined product design focused on capitalizing on the efficiencies of our manufacturing capabilities, manufacturing expertise and continuous improvement, and the execution of well-tested best practices.

Vertically integrating manufacturing

Whenever feasible, we strive for focused factories and product-based cells. We study and develop the most effective processes to make each type of product. Once the process is refined and a focused group of employees is trained, the product manufacturing is consolidated into a single cell.

- All spray gun manufacturing is located in South Dakota with a cell dedicated to producing spray guns for the industrial market worldwide. In 2006, we moved the spray guns acquired through the Gusmer acquisition into the South Dakota cell and realized significant cost reductions.
- We moved automated buffing of spray guns in-house. The robotic buffing reduced both cost and lead-time.

Maximizing efficiency through technology

By incorporating the most advanced technology available, one employee can now simultaneously operate up to three machines in certain operational areas – enhancing both the employee's skill level and overall productivity.

- Graco's personnel are trained to operate some of the most advanced manufacturing equipment anywhere and the resulting increase in productivity contributes to our outstanding margins.
- We have some of the most experienced engineers and machinists in the field. The average tenure of our machinists is 17 years; our engineers have been with us an average of 9 years. Employees who know and understand our systems and procedures routinely suggest cost improvements.



The robotic buffing cell used for Graco's Contractor™ II gun.

Leveraging our strengths in manufacturing

In 2006, we acquired Lubriquip, Inc., a company that supplies products to the industrial and mobile lubrication market. This purchase provided us with the opportunity to integrate the Lubriquip products into our existing focused factories and cells to take advantage of our advanced technology and processes, improving margins on these products. We are transferring production from Madison, Wisconsin, and Cleveland, Ohio, into a newly acquired facility in Anoka, Minnesota, and have invested in equipment upgrades for that factory to bring these assets up to our world-class standards.

In the past year, Graco has not only lowered operating costs as a percentage of net sales, it has also increased volume, diversified its product mix and invested in technology designed to increase productivity and efficiency. Our sustainable, long-term strategy plays out in each decision made – from purchasing, new product development, acquisitions, hiring and more. The opportunities are many and leveraged whenever possible. Yes, Graco can continue to show strong margins across time.



Razor™ Spray Guns

Graco introduces a new era in performance with the Razor™ gun family



Recognized by Forbes
as one of the best
mid-cap companies.



company must manufacture
overseas to be competitive...

FACT

Graco's focused manufacturing strategy and global sourcing capabilities keep us competitive.

As a company founded in the middle of the United States more than eight decades ago, North American sales continue to account for approximately two-thirds of Graco's annual sales. While worldwide sales are a significant part of our future growth, manufacturing operations remain in the United States for a number of significant reasons.

Graco's strategic investments in technology, personnel and in acquisitions means that we do not have to outsource the majority of our manufacturing overseas to enhance profitability. We've posted many years of strong margins through our American manufacturing facilities as proof that this strategy works.

Graco remains committed to having our manufacturing rooted in the United States, with select investments in offshore operations as needed to serve our growing worldwide customer base. By doing so, we retain control over what matters to us – our reputation as having state-of-the-art operations and the highest quality products available to our customers worldwide.

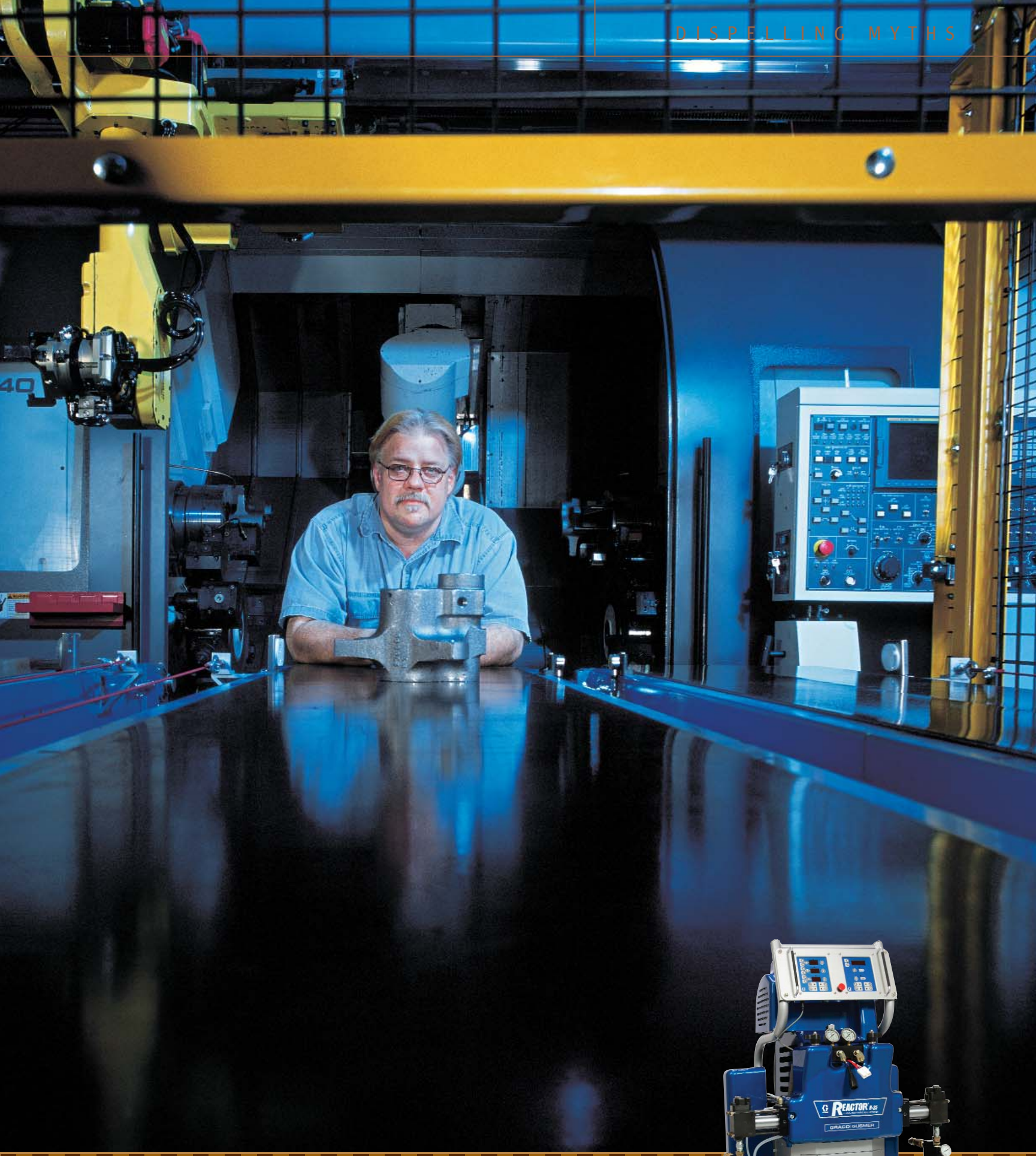
We benefit from manufacturing in North America

- With product design engineering centers close to manufacturing operations, we are able to launch new products rapidly and support manufacturing cost reduction opportunities.
- We continually invest in technologies to improve our product quality.
- We remain cost-competitive through strategic sourcing and vertical integration.
- Graco reduces labor costs through focused factory and cell technology.
- We leverage manufacturing volume to manage and improve margins.

Operating on a global basis

- We continually seek to procure the finest, most cost-effective materials from around the world. By sourcing materials from outside the Americas, we reduce our product costs.
- Recognizing that the Asia Pacific market is the fastest growing region for us, we opened an assembly plant in China to support future growth.

Focusing the foundation of our manufacturing in the United States reflects our commitment to operational excellence – a commitment embraced by our board of directors on down through the organization. It is not a new concept, but rather it is a part of our company's mission and an integral part of our formula for success.



James Schwartz shown with the Nakamura STW-40 CNC dual spindle, multi-tasking lathe used to machine large pump parts.



Reactor® H-25
A new hybrid, entry-level Graco|Gusmer unit for spraying foam and polyurea

Board of Directors Management

David A. Roberts
Chairman, President and
Chief Executive Officer,
Graco Inc.

Robert G. Bohn
Chairman, President
and Chief Executive Officer,
Oshkosh Truck Corporation

William J. Carroll
Principal,
Highland Jebco L.L.C.

Jack W. Eugster
Retired Chairman, President
and Chief Executive Officer,
Musicland Stores Inc.

J. Kevin Gilligan
Chief Executive Officer,
United Subcontractors, Inc.

Lee R. Mitau
Executive Vice President
and General Counsel,
U. S. Bancorp

Marti Morfitt
President and
Chief Executive Officer,
CNS, Inc.

Mark H. Rauenhurst
President and
Chief Executive Officer,
Opus Corporation

William G. Van Dyke
Retired Chairman,
Donaldson Company, Inc.

Robert W. Van Sant
President and Chief
Executive Officer,
Paladin

David A. Roberts
Chairman, President
and Chief Executive Officer

Karen Park Gollivan
Vice President, General
Counsel and Secretary

James A. Graner
Chief Financial Officer
and Treasurer

Dale D. Johnson
Vice President and
General Manager,
Contractor Equipment Division

D. Christian Koch
Vice President and
General Manager,
Asia Pacific

David M. Lowe
Vice President and
General Manager,
Industrial Products Division

Patrick J. McHale
Vice President and
General Manager,
Lubrication Equipment Division

Simon J. W. Paulis
Vice President and
General Manager,
Europe

Charles L. Rescorla
Vice President,
Manufacturing and
Distribution Operations

Mark W. Sheahan
Chief Administrative Officer

Fred A. Sutter
Vice President and
General Manager,
Applied Fluid Technologies Division

Directory

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George Aristides Riverside Center
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David A. Koch Center
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Rogers, Minnesota 55374

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THE PEOPLE'S REPUBLIC OF CHINA

Graco Fluid Equipment (Suzhou) Co., Ltd.
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KOREA

Graco Common Stock

Graco common stock is traded on the New York Stock Exchange under the ticker symbol "GGG." On December 29, 2006, there were 66,804,781 shares outstanding and 2,663 common shareholders of record, with another estimated 25,900 shareholders whose stock is held by nominees or broker dealers.

Quarterly Financial Information

(In thousands, except per share amounts)	2006				2005				2004			
Quarter	1	2	3	4	1	2	3	4	1	2	3	4
Net sales	\$192,216	\$218,632	\$202,199	\$203,421	\$170,944	\$198,221	\$176,934	\$185,603	\$134,982	\$160,165	\$149,066	\$160,819
Gross profit	103,227	116,946	106,611	107,173	85,866	102,292	94,722	96,470	73,404	85,142	82,120	87,744
Net earnings	35,422	41,335	37,392	35,617	27,039	35,638	30,898	32,279	22,327	29,979	28,817	27,558
Diluted net earnings Per common share	0.51	0.60	0.54	0.52	0.38	0.51	0.44	0.46	0.32	0.43	0.41	0.39
Stock price												
High	\$45.43	\$48.95	\$46.37	\$43.60	\$40.68	\$40.25	\$38.23	\$37.55	\$29.11	\$31.05	\$33.66	\$37.70
Low	36.50	42.50	37.00	38.61	34.00	31.83	33.89	32.05	26.43	27.12	29.96	33.76
Close*	45.43	45.98	39.06	39.62	40.36	34.07	34.28	36.48	29.11	31.05	33.50	37.35
Volume (# of shares)	19,428	21,925	24,882	26,326	18,642	31,776	17,328	25,149	12,095	13,801	15,972	16,348

* As of the last trading day of the calendar quarter.

For financial information, please
refer to the Graco Inc. 2006 Form 10-K

Annual Meeting

Shareholders are cordially invited to attend the Annual Meeting, which will be held at 1:00 p.m., April 20, 2007, at Graco's:

George Aristides Riverside Center
1150 Sibley Street Northeast
Minneapolis, Minnesota 55413

Corporate Inquiries

Investors may obtain the Graco Inc. annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports by visiting the Graco website at www.graco.com. Requests for financial publications can also be addressed to:

Graco Inc.
Attn: Investor Relations Coordinator
P.O. Box 1441
Minneapolis, Minnesota 55440-1441

Or call: (612) 623-6659

Shareholder Inquiries

Questions regarding dividend checks, dividend reinvestment, lost stock certificates, change of address or consolidation of accounts, should be directed to the Company's Transfer Agent and Registrar:

Wells Fargo Bank, N.A.
Shareowner Services
161 North Concord Exchange Street
South St. Paul, Minnesota 55075-1139
Or call: (800) 468-9716.
In Minnesota: (651) 450-4064.
Monday – Friday, 7 a.m. – 7 p.m. CT.

Graco is an equal opportunity employer. Graco's EEO policy is on the Company's website at www.graco.com

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