

**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 24, 2004**

Commission File Number: 001-9249

**GRACO INC.**

(Exact name of Registrant as specified in its charter)

Minnesota

(State of incorporation)

41-0285640

(I.R.S. Employer Identification Number)

88 - 11<sup>th</sup> Avenue N.E.

Minneapolis, Minnesota

(Address of principal executive offices)

55413

(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  \_\_\_\_\_

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes  X  No  \_\_\_\_\_

69,132,000 common shares were outstanding as of October 19, 2004.

# GRACO INC. AND SUBSIDIARIES

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### **EXHIBITS**

## PART I

### GRACO INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

(In thousands except per share amounts)

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	Sept 24, 2004	Sept 26, 2003	Sept 24, 2004	Sept 26, 2003
Net Sales	\$149,066	\$133,788	\$444,213	\$399,812
Cost of products sold	66,946	62,385	203,547	189,474
Gross Profit	82,120	71,403	240,666	210,338
Product development	5,231	4,464	15,798	13,265
Selling, marketing and distribution	24,449	23,794	73,976	71,979
General and administrative	9,195	9,111	29,208	27,680
Operating Earnings	43,245	34,034	121,684	97,414
Interest expense	115	146	384	386
Other expense (income), net	113	377	277	360
Earnings Before Income Taxes	43,017	33,511	121,023	96,668
Income taxes	14,200	10,800	39,900	31,300
Net Earnings	\$ 28,817	\$ 22,711	\$ 81,123	\$ 65,368
Basic Net Earnings				
Per Common Share	\$ .42	\$ .33	\$ 1.17	\$ .94
Diluted Net Earnings				
Per Common Share	\$ .41	\$ .32	\$ 1.15	\$ .93
Cash Dividends Declared				
Per Common Share	\$ .09	\$ .06	\$ .28	\$ .17

See notes to consolidated financial statements.

**GRACO INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

(Unaudited)  
(In thousands)

	<u>Sept 24, 2004</u>	<u>Dec 26, 2003</u>
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 56,273	\$ 112,118
Accounts receivable, less allowances of \$5,600 and \$5,700	102,488	98,853
Inventories	39,108	29,018
Deferred income taxes	15,791	14,909
Other current assets	<u>1,961</u>	<u>1,208</u>
Total current assets	215,621	256,106
Property, Plant and Equipment		
Cost	225,920	221,233
Accumulated depreciation	<u>(134,948)</u>	<u>(126,916)</u>
	90,972	94,317
Prepaid Pension	27,027	25,444
Goodwill	9,199	9,199
Other Intangible Assets	9,253	10,622
Other Assets	<u>2,648</u>	<u>1,702</u>
	<u>\$ 354,720</u>	<u>\$ 397,390</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities		
Notes payable to banks	\$ 5,883	\$ 4,189
Trade accounts payable	18,096	15,752
Salaries, wages and commissions	17,180	16,384
Accrued insurance liabilities	8,750	9,939
Accrued warranty and service liabilities	8,972	9,227
Income taxes payable	9,584	5,981
Dividends payable	6,452	110,304
Other current liabilities	<u>20,993</u>	<u>16,171</u>
Total current liabilities	95,910	187,947
Retirement Benefits and Deferred Compensation	31,864	30,567
Deferred Income Taxes	8,927	9,066
Shareholders' Equity		
Common stock	69,103	46,040
Additional paid-in capital	98,335	81,405
Retained earnings	51,618	43,295
Other, net	<u>(1,037)</u>	<u>(930)</u>
Total shareholders' equity	218,019	169,810
	<u>\$ 354,720</u>	<u>\$ 397,390</u>

See notes to consolidated financial statements

**GRACO INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)  
(In thousands)

	Thirty-nine Weeks Ended	
	Sept 24, 2004	Sept 26, 2003
<b>Cash Flows from Operating Activities</b>		
Net Earnings	\$ 81,123	\$65,368
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation and amortization	13,333	13,568
Deferred income taxes	(985)	(764)
Tax benefit related to stock options exercised	5,500	3,200
Change in:		
Accounts receivable	(3,740)	2,077
Inventories	(10,112)	957
Trade accounts payable	2,353	(1,539)
Salaries, wages and commissions	800	(547)
Retirement benefits and deferred compensation	(777)	2,173
Other accrued liabilities	7,015	47
Other	(152)	223
	94,358	84,763
<b>Cash Flows from Investing Activities</b>		
Property, plant and equipment additions	(9,184)	(10,934)
Proceeds from sale of property, plant and equipment	126	109
Capitalized software additions	(856)	—
Acquisition of business	—	(13,514)
	(9,914)	(24,339)
<b>Cash Flows from Financing Activities</b>		
Borrowings on notes payable and lines of credit	20,943	12,588
Payments on notes payable and lines of credit	(19,186)	(21,217)
Common stock issued	14,075	9,427
Common stock retired	(32,773)	(55,496)
Cash dividends paid	(123,460)	(11,460)
	(140,401)	(66,158)
Effect of exchange rate changes on cash	112	(1,606)
Net increase (decrease) in cash and cash equivalents	(55,845)	(7,340)
Cash and cash equivalents		
Beginning of year	112,118	103,333
End of period	\$ 56,273	\$ 95,993

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 24, 2004, and the related statements of earnings for the thirteen and thirty-nine weeks ended September 24, 2004 and September 26, 2003, and cash flows for the thirty-nine weeks ended September 24, 2004 and September 26, 2003 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 24, 2004, 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 2003 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. On February 20, 2004, the Board of Directors declared a three-for-two split of the Company's common stock. The split was distributed on March 30, 2004 to shareholders of record on March 16, 2004. Share and per share amounts for all periods presented reflect the stock split.
3. The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	<u>Thirteen Weeks Ended</u>		<u>Thirty-nine Weeks Ended</u>	
	<u>Sept 24, 2004</u>	<u>Sept 26, 2003</u>	<u>Sept 24, 2004</u>	<u>Sept 26, 2003</u>
Net earnings available to common shareholders	\$28,817	\$22,711	\$81,123	\$65,368
Weighted average shares outstanding for basic earnings per share	69,176	68,777	69,167	69,374
Dilutive effect of stock options computed using the treasury stock method and the average market price	1,067	1,240	1,089	1,116
Weighted average shares outstanding for diluted earnings per share	70,243	70,017	70,256	70,490
Basic earnings per share	\$ .42	\$ .33	\$ 1.17	\$ .94
Diluted earnings per share	\$ .41	\$ .32	\$ 1.15	\$ .93

4. The Company accounts for stock option and purchase plans using the intrinsic value method and has adopted the "disclosure only" provisions of Statement of Financial Accounting Standards (SFAS) No. 123, as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." No compensation cost has been recognized for the Employee Stock Purchase Plan and stock options granted under the various stock incentive plans.

Had compensation cost been determined based upon fair value (using the Black-Scholes option-pricing method) at the grant date for awards under these plans, the Company's net earnings and earnings per share would have been reduced as follows (in thousands, except per share amounts):

	<u>Thirteen Weeks Ended</u>		<u>Thirty-nine Weeks Ended</u>	
	<u>Sept 24, 2004</u>	<u>Sept 26, 2003</u>	<u>Sept 24, 2004</u>	<u>Sept 26, 2003</u>
<b>Net earnings</b>				
As reported	\$ 28,817	\$ 22,711	\$ 81,123	\$ 65,368
Stock-based compensation, net of related tax effects	<u>878</u>	<u>970</u>	<u>2,594</u>	<u>3,044</u>
Pro forma	<u>\$ 27,939</u>	<u>\$ 21,741</u>	<u>\$ 78,529</u>	<u>\$ 62,324</u>
<b>Net earnings per common share</b>				
Basic as reported	\$ .42	\$ .33	\$ 1.17	\$ .94
Basic pro forma	.40	.32	1.14	.90
Diluted as reported	.41	.32	1.15	.93
Diluted pro forma	.40	.31	1.12	.88

5. The components of net periodic benefit cost for retirement benefit plans were as follows (in thousands):

	<u>Thirteen Weeks Ended</u>		<u>Thirty-nine Weeks Ended</u>	
	<u>Sept 24, 2004</u>	<u>Sept 26, 2003</u>	<u>Sept 24, 2004</u>	<u>Sept 26, 2003</u>
<b>Pension Benefits</b>				
Service cost	\$ 982	\$ 886	\$ 3,067	\$ 2,658
Interest cost	2,193	2,051	6,554	6,153
Expected return on assets	(3,524)	(2,498)	(10,571)	(7,493)
Amortization and other	<u>5</u>	<u>213</u>	<u>263</u>	<u>638</u>
Net periodic benefit cost (credit)	<u>\$ (344)</u>	<u>\$ 652</u>	<u>\$ (687)</u>	<u>\$ 1,956</u>
<b>Postretirement Medical</b>				
Service cost	\$ 193	\$ 171	\$ 578	\$ 514
Interest cost	375	370	1,126	1,112
Amortization of net loss	<u>113</u>	<u>90</u>	<u>339</u>	<u>269</u>
Net periodic benefit cost	<u>\$ 681</u>	<u>\$ 631</u>	<u>\$ 2,043</u>	<u>\$ 1,895</u>

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. The Company's retirement medical plan is not eligible for the Medicare subsidy under the Act.

6. Total comprehensive income in 2004 was \$28.8 million in the third quarter and \$80.8 million year-to-date. In 2003, comprehensive income was \$22.7 million for the third quarter and \$65.6 million for the nine-month period. There have been no significant changes to the components of comprehensive income from those noted on the 2003 Form 10-K.
7. The Company has three reportable segments; Industrial/Automotive, Contractor and Lubrication. The Company does not identify assets by segment. Sales and operating earnings by segment for the thirteen and thirty-nine weeks ended September 24, 2004 and September 26, 2003 were as follows (in thousands):

	<u>Thirteen Weeks Ended</u>		<u>Thirty-nine Weeks Ended</u>	
	<u>Sept 24, 2004</u>	<u>Sept 26, 2003</u>	<u>Sept 24, 2004</u>	<u>Sept 26, 2003</u>
<b>Net Sales</b>				
Industrial/Automotive	\$ 67,305	\$ 57,276	\$ 197,027	\$ 167,378
Contractor	68,620	65,316	209,205	197,060
Lubrication	<u>13,141</u>	<u>11,196</u>	<u>37,981</u>	<u>35,374</u>
Consolidated	<u>\$ 149,066</u>	<u>\$ 133,788</u>	<u>\$ 444,213</u>	<u>\$ 399,812</u>
<b>Operating Earnings</b>				
Industrial/Automotive	\$ 22,612	\$ 16,981	\$ 63,980	\$ 46,253
Contractor	18,670	17,493	54,150	48,186
Lubrication	3,446	1,549	9,096	7,136
Unallocated Corporate expenses	<u>(1,483)</u>	<u>(1,989)</u>	<u>(5,542)</u>	<u>(4,161)</u>
Consolidated	<u>\$ 43,245</u>	<u>\$ 34,034</u>	<u>\$ 121,684</u>	<u>\$ 97,414</u>



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

	<u>Sept 24, 2004</u>	<u>Dec 26, 2003</u>
Finished products and components	\$ 30,160	\$ 25,548
Products and components in various stages of completion	16,760	16,464
Raw materials and purchased components	<u>19,437</u>	<u>15,408</u>
	66,357	57,420
Reduction to LIFO cost	<u>( 27,249)</u>	<u>( 28,402)</u>
	<u>\$ 39,108</u>	<u>\$ 29,018</u>

9. Information related to other intangible assets follows (in thousands):

	<u>September 24, 2004</u>			<u>December 26, 2003</u>		
	<u>Original Cost</u>	<u>Amorti- zation</u>	<u>Book Value</u>	<u>Original Cost</u>	<u>Amorti- zation</u>	<u>Book Value</u>
Customer lists and distribution network	\$ 3,765	\$ 1,354	\$ 2,411	\$ 8,336	\$ 4,980	\$ 3,356
Trademarks, trade names and non-compete agreements	1,494	606	888	2,803	1,622	1,181
Patents and other	<u>1,241</u>	<u>567</u>	<u>674</u>	<u>1,241</u>	<u>436</u>	<u>805</u>
	6,500	<u>\$ 2,527</u>	3,973	12,380	<u>\$ 7,038</u>	5,342
Not Subject to Amortization: Brand name	<u>5,280</u>		<u>5,280</u>	<u>5,280</u>		<u>5,280</u>
	<u>\$ 11,780</u>		<u>\$ 9,253</u>	<u>\$ 17,660</u>		<u>\$ 10,622</u>

Amortization of intangibles was \$0.3 million in the third quarter of 2004 and \$1.4 million year-to-date. Estimated annual amortization is as follows: \$1.7 million in 2004, \$1.1 million in 2005, \$0.9 million in 2006, \$0.9 million in 2007, \$0.4 million in 2008 and \$0.3 million thereafter.

10. A liability is established for estimated future warranty and service claims that relate to current and prior period sales. The Company estimates warranty costs based on historical claim experience and other factors including evaluating specific warranty issues. Following is a summary of activity in accrued warranty and service liabilities (in thousands):

	Thirty-nine Weeks Ended <u>Sept 24, 2004</u>	Year Ended <u>Dec 26, 2003</u>
Balance, beginning of year	\$ 9,227	\$ 6,294
Charged to expense	5,531	9,490
Margin on parts sales reversed	2,065	4,697
Reductions for claims settled	<u>(7,851)</u>	<u>(11,254)</u>
Balance, end of period	<u>\$ 8,972</u>	<u>\$ 9,227</u>

11. The Company has been named as a defendant in a number of lawsuits alleging bodily injury as a result of exposure to asbestos or silica. None of the suits make any allegations specifically regarding the Company or any of its products. Management does not know why the Company was included in the suits along with hundreds of other defendants. Management does not expect that resolution of these matters will have a material adverse effect on the Company, although the ultimate outcome cannot be determined based on available information.

## Item 2.

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

**Results of Operations**

Increased sales and higher gross margin rates resulted in a 27 percent increase in net earnings for the quarter and a 24 percent increase year-to-date. Factors contributing to the improved results include better economic conditions, controlled spending increases, and favorable foreign currency translation rates. Translated at consistent exchange rates, third quarter and year-to-date net earnings increased by 21 percent and 17 percent, respectively.

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

	<u>Thirteen Weeks Ended</u>		<u>Thirty-nine Weeks Ended</u>	
	<u>Sept 24, 2004</u>	<u>Sept 26, 2003</u>	<u>Sept 24, 2004</u>	<u>Sept 26, 2003</u>
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	<u>44.9</u>	<u>46.6</u>	<u>45.8</u>	<u>47.4</u>
Gross Profit	55.1	53.4	54.2	52.6
Product development	3.5	3.4	3.5	3.3
Selling, marketing and distribution	16.4	17.8	16.7	18.0
General and administrative	<u>6.2</u>	<u>6.8</u>	<u>6.6</u>	<u>6.9</u>
Operating Earnings	29.0	25.4	27.4	24.4
Interest expense	0.1	0.1	0.1	0.1
Other (income) expense, net	<u>0.1</u>	<u>0.3</u>	<u>—</u>	<u>0.1</u>
Earnings Before Income Taxes	28.8	25.0	27.3	24.2
Income taxes	<u>9.5</u>	<u>8.0</u>	<u>9.0</u>	<u>7.9</u>
Net Earnings	<u>19.3%</u>	<u>17.0%</u>	<u>18.3%</u>	<u>16.3%</u>

## Net Sales

Sales by segment and geographic area were as follows (in thousands):

	<u>Thirteen Weeks Ended</u>		<u>Thirty-nine Weeks Ended</u>	
	<u>Sept 24, 2004</u>	<u>Sept 26, 2003</u>	<u>Sept 24, 2004</u>	<u>Sept 26, 2003</u>
<b>By Segment</b>				
Industrial/Automotive	\$ 67,305	\$ 57,276	\$ 197,027	\$ 167,378
Contractor	68,620	65,316	209,205	197,060
Lubrication	<u>13,141</u>	<u>11,196</u>	<u>37,981</u>	<u>35,374</u>
Consolidated	<u>\$ 149,066</u>	<u>\$ 133,788</u>	<u>\$ 444,213</u>	<u>\$ 399,812</u>
<b>By Geographic Area</b>				
Americas <sup>1</sup>	\$ 100,621	\$ 93,307	\$ 297,663	\$ 278,303
Europe <sup>2</sup>	29,533	24,383	90,525	75,119
Asia Pacific	<u>18,912</u>	<u>16,098</u>	<u>56,025</u>	<u>46,390</u>
Consolidated	<u>\$ 149,066</u>	<u>\$ 133,788</u>	<u>\$ 444,213</u>	<u>\$ 399,812</u>

<sup>1</sup> North and South America, including the U.S.

<sup>2</sup> Europe, Africa and Middle East

Industrial/Automotive segment sales increased 18 percent for the both the quarter and year-to-date. Translated at consistent exchange rates, sales increased 14 percent for the quarter and 13 percent year-to-date. Sales in this segment grew in all three geographic regions and across all major product categories. New product introductions contributed to sales growth, including the ProMix<sup>TM</sup> II and ProMix Easy units, which were launched in the second quarter.

Contractor segment sales increased 5 percent for the quarter and 6 percent year-to-date. Translated at consistent exchange rates, sales were up 4 percent for the quarter and 5 percent year-to-date. Sales increased in all geographic regions, with strong volume increases in Europe and Asia Pacific. In the Americas, sales were higher in both the professional paint store channel and in the home center channel. Sales were aided by demand for new products, including the new Ultra® Max II sprayers and a new texture unit.

Lubrication segment sales were up 17 percent for the quarter and 7 percent year-to-date. Translated at consistent exchange rates, sales were up 16 percent for the quarter and 6 percent year-to-date. Sales increased in all geographic regions, with most of the increase from the Americas. New product introductions include the Mini Fire-Ball oil pump released for sale in August.

## Gross Profit

Gross margin rate was higher for the quarter and year-to-date. The effect of higher material costs on margin rate was more than offset by the favorable effects of production volume, productivity, favorable foreign currency translation rates and pension costs.

## **Operating Expenses**

Operating expenses for the quarter were 4 percent higher than the third quarter last year and 5 percent higher year-to-date. Operating expenses for both the quarter and year-to-date decreased as a percentage of sales. The Company increased spending on product development to meet its stated objective of creating sales growth from new products. Changes in currency translation rates contributed significantly to the increase in selling, marketing and distribution expenses. Year-to-date contributions to the Company's charitable foundation (included in general and administrative expenses) were \$2.7 million in 2004 compared to \$1.1 million last year.

Year-to-date operations include a pension benefit credit of \$.7 million compared to \$2 million of expense in the same period last year. This change resulted from the increase in pension plan assets due to investment gains and the \$20 million voluntary contribution made in the fourth quarter of 2003. Pension income / expense is allocated based on related salaries and wages, approximately 45 percent to cost of products sold and 55 percent to operating expenses.

## **Liquidity and Capital Resources**

Significant uses of cash in the first nine months of 2004 included \$123 million of dividends paid (including \$104 million for a one-time special dividend) and \$33 million for purchases and retirement of Company common stock. Inventories have increased to support higher sales and from actions taken to improve customer service.

The Company has announced that it intends to open a manufacturing facility in the Shanghai region of China sometime in the second half of 2005. The facility will be approximately 50,000 square feet and will require approximately \$4 million in capital investment.

The Company had unused lines of credit available at September 24, 2004 totaling \$48 million. Subsequent to the end of the quarter, the Company obtained an additional \$20 million uncommitted line of credit. Cash balances of \$56 million at September 24, 2004, internally generated funds and unused financing sources provide the Company with the financial flexibility to meet liquidity needs, including its capital expenditure plan.

## **Outlook**

Management has not been able to identify economic indicators that predict future Company results. The Company has experienced sales growth from favorable economic conditions and has leveraged fixed costs to improve profitability. Management is encouraged by these results, especially given the substantial price increases the Company has experienced for raw materials like steel. Management will attempt to protect the Company's margins by increasing prices in 2005 and continuing to reduce manufacturing costs and improve efficiencies. While management is uncertain as to the duration of the economic recovery, it is cautiously optimistic that favorable conditions will remain for the balance of 2004 and into early 2005. Management is looking forward to further growth as it pursues its strategies of developing new product, entering new markets, expanding distribution and making strategic acquisitions.

## **SAFE HARBOR CAUTIONARY STATEMENT**

A forward-looking statement is any statement made in this report and other reports that the Company files periodically with the Securities and Exchange Commission, as well as in press or earnings releases, analyst briefings and conference calls, which reflects the Company's current thinking on market trends and the Company's future financial performance at the time they are made. All forecasts and projections are forward-looking statements.

The Company desires to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 by making cautionary statements concerning any forward-looking statements made by or on behalf of the Company. The Company cannot give any assurance that the results forecasted in any forward-looking statement will actually be achieved. Future results could differ materially from those expressed, due to the impact of changes in various factors. These risk factors include, but are not limited to: economic conditions in the United States and other major world economies, currency fluctuations, political instability, changes in laws and regulations, and changes in product demand. Please refer to Exhibit 99 to the Company's Annual Report on Form 10-K for fiscal year 2003 for a more comprehensive discussion of these and other risk factors.

Investors should realize that factors other than those identified above and in Exhibit 99 might prove important to the Company's future results. It is not possible for management to identify each and every factor that may have an impact on the Company's operations in the future as new factors can develop from time to time.

## **Item 4. CONTROLS AND PROCEDURES**

### **Evaluation of disclosure controls and procedures**

As of the end of the fiscal quarter covered by this report, the Company carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures. This evaluation was done under the supervision and with the participation of the Company's President and Chief Executive Officer, Vice President and Controller, Vice President and Treasurer, and Vice President, General Counsel and Secretary. Based upon that evaluation, they concluded that the Company's disclosure controls and procedures are effective in gathering, analyzing and disclosing information needed to satisfy the Company's disclosure obligations under the Exchange Act.

### **Changes in internal controls**

During the quarter, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II**

### **Item 1. Legal Proceedings**

The Company is engaged in routine litigation incident to its business, which management believes will not have a material adverse effect on its operations or consolidated financial position. The Company has also been named as a defendant in a number of lawsuits alleging bodily injury as a result of exposure to asbestos, and a number of lawsuits alleging bodily injury as a result of exposure to silica. All of these lawsuits have multiple (most in excess of 100) defendants, and several have multiple plaintiffs. None of the suits make any allegations specifically regarding the Company or any of its products. A substantial portion of the cost and potential liability for these cases is covered by insurance, although the exact extent of insurance coverage cannot be determined at this time because the cases are in the early stages of the litigation process and the allegations are so indefinite. Management does not expect that resolution of these matters will have a material adverse effect on the Company, although the ultimate outcome cannot be determined based on available information.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

#### **Issuer Purchases of Equity Securities**<sup>1</sup>

On February 22, 2002, the Board of Directors authorized a plan for the Company to purchase up to a total of 2,700,000 shares of its outstanding common stock, primarily through open-market transactions. This plan effectively expired upon approval of a new plan on February 20, 2004, authorizing the purchase of up to 3,000,000 shares and expiring on February 28, 2006.

In addition to shares purchased under the plan, the Company purchases shares of common stock held by employees who wish to tender owned shares to satisfy the exercise price or tax withholding on stock option exercises.

Information on issuer purchases of equity securities follows:

<u>Period</u>	<u>(a) Total Number of Shares Purchased</u>	<u>(b) Average Price Paid per Share</u>	<u>(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (at end of period)</u>
Jun 26, 2004 – Jul 23, 2004	—	—	—	2,471,200
Jul 24, 2004 – Aug 20, 2004	245,678	\$30.60	236,800	2,234,400
Aug 21, 2004 – Sep 24, 2004	47,800	\$31.00	47,800	2,186,600

<sup>1</sup> All share and per share data reflects the three-for-two stock splits distributed on June 6, 2002 and March 30, 2004.

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

None



**Item 6. Exhibits**

- 31.1 Certification of President and Chief Executive Officer pursuant to Rule 13a-14(a)
- 31.2 Certification of Vice President and Controller pursuant to Rule 13a-14(a)
- 31.3 Certification of Vice President and Treasurer pursuant to Rule 13a-14(a)
- 32 Certification of President and Chief Executive Officer, Vice President and Controller, and Vice President and Treasurer pursuant to Section 1350 of Title 18, U.S.C.

# 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: 10/22/04

By:   
David A. Roberts  
President and Chief Executive Officer

Date: \_\_\_\_\_

By: \_\_\_\_\_  
James A. Graner  
Vice President and Controller

Date: \_\_\_\_\_

By: \_\_\_\_\_  
Mark W. Sheahan  
Vice President and Treasurer

# 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: \_\_\_\_\_

By: \_\_\_\_\_

David A. Roberts  
President and Chief Executive Officer

Date: October 22, 2004

By:  \_\_\_\_\_

James A. Graner  
Vice President and Controller

Date: \_\_\_\_\_

By: \_\_\_\_\_

Mark W. Sheahan  
Vice President and Treasurer

# 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: \_\_\_\_\_

By: \_\_\_\_\_

David A. Roberts  
President and Chief Executive Officer

Date: \_\_\_\_\_

By: \_\_\_\_\_

James A. Graner  
Vice President and Controller

Date: 10/22/04

By:  \_\_\_\_\_

Mark W. Sheahan  
Vice President and Treasurer

## CERTIFICATIONS

I, David A. Roberts, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date:

10/22/04

David A. Roberts

David A. Roberts  
President and Chief Executive Officer

## CERTIFICATIONS

I, James A. Graner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date:

October 22, 2004

James A. Graner

James A. Graner  
Vice President and Controller

## CERTIFICATIONS

I, Mark W. Sheahan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Graco Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: \_\_\_\_\_

10/22/04



Mark W. Sheahan  
Vice President and Treasurer

CERTIFICATION UNDER SECTION 1350

Pursuant to Section 1350 of Title 18 of the United States Code, each of the undersigned certifies that this periodic report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in this periodic report fairly presents, in all material respects, the financial condition and results of operations of Graco Inc.

Date: 10/22/04

  
\_\_\_\_\_  
David A. Roberts  
President and Chief Executive Officer

Date: \_\_\_\_\_

\_\_\_\_\_  
James A. Graner  
Vice President and Controller  
Chief Accounting Officer

Date: \_\_\_\_\_

\_\_\_\_\_  
Mark W. Sheahan  
Vice President and Treasurer  
Principal Financial Officer



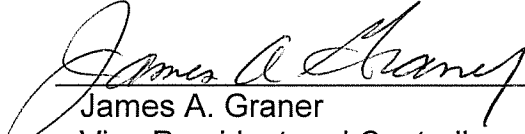
CERTIFICATION UNDER SECTION 1350

Pursuant to Section 1350 of Title 18 of the United States Code, each of the undersigned certifies that this periodic report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in this periodic report fairly presents, in all material respects, the financial condition and results of operations of Graco Inc.

Date: \_\_\_\_\_

\_\_\_\_\_  
David A. Roberts  
President and Chief Executive Officer

Date: October 22, 2004

  
\_\_\_\_\_  
James A. Graner  
Vice President and Controller  
Chief Accounting Officer

Date: \_\_\_\_\_

\_\_\_\_\_  
Mark W. Sheahan  
Vice President and Treasurer  
Principal Financial Officer

CERTIFICATION UNDER SECTION 1350

Pursuant to Section 1350 of Title 18 of the United States Code, each of the undersigned certifies that this periodic report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in this periodic report fairly presents, in all material respects, the financial condition and results of operations of Graco Inc.


Date: \_\_\_\_\_

\_\_\_\_\_  
David A. Roberts  
President and Chief Executive Officer

Date: \_\_\_\_\_

\_\_\_\_\_  
James A. Graner  
Vice President and Controller  
Chief Accounting Officer

Date: 10/22/04

  
\_\_\_\_\_  
Mark W. Sheahan  
Vice President and Treasurer  
Principal Financial Officer



October 25, 2004

**Electronically Filed**

Securities and Exchange Commission  
Judiciary Plaza  
450 Fifth Street NW  
Washington, DC 20549

Re: Graco Inc.  
Third Quarter Report on Form 10-Q  
File No. 001-9249  
CIK No. 0000042888

Gentlemen/Ladies:

Enclosed for filing is the Graco Inc. Quarterly Report on Form 10-Q for the Quarter ended September 24, 2004.

Sincerely,

A handwritten signature in black ink, appearing to read 'Robert M. Mattison', with a stylized flourish at the end.

Robert M. Mattison  
Vice President, General Counsel and Secretary

Enclosure

RMM/nas