Company: GRACO INC.

Conference Title: 4th Quarter/Year-End 2017 Earnings Call

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Moderator: Caroline Chambers:

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Operator: Please stand by. Good day, and welcome to the Fourth Quarter 2017 Conference for Graco Inc. If you wish to access the replay for this call, you may do so by dialing 1888-203-1112 within the United States or Canada. The dial-in number for international callers is 719-457-0820. The conference ID number is 1103121. The replay will be available through February 3, 2018.

Graco has additional information available in the PowerPoint slide presentation, which is available as part of the webcast player. At the request of the company, we will open the conference for questions and answers after opening remarks from management.

During this call, various remarks may be made by management about their expectations, plans and prospects for the future. These remarks constitute forward-looking statements for purposes of the safe harbor provisions of the Private Securities Litigation Reform Act.

Actual results may differ materially from those indicated as a result of various risk factors, including those identified in Item 1A of the Company's 2016 annual report and on Form 10-K and the Item 1A on the Company's most recent quarterly report on Form 10-Q. These reports are available on the company's website at www.graco.com and the SEC's website at www.sec.gov.

Forward-looking statements reflect management's current views and speak only as of the time that they are made. The company undertakes no obligation to update these statements, in light of new information or future events. As a reminder, this conference is being recorded.

I will now turn the conference over to Caroline Chambers, Vice President, Corporate Controller and Information Systems.

Caroline Chambers: Good morning, everyone. I'm here this morning with Pat McHale: and Christian Rothe. During my discussion, I'll refer several times to the conference call slides that we've posted on our website and provide additional information that you may find helpful.

Cut through some of the items of our quarter, I'll start by running through a few of those items, and would like to refer you specifically to Page 6 of our slide deck. We have included a reconciliation of all the items from GAAP to non-GAAP earnings, detailing out all the differences between reported net earnings and adjusted net earnings.

At the top of the page, we've started by reconciling operating earnings. And you'll see the fourth quarter pension settlement loss of $12 million pretax related to the restructuring of some of our US pension plans.

Pausing here for a moment for some additional explanation. This $12 million expense was classified in our G&A line. And if you're looking at segment results, the expense is included in unallocated corporate. Individual segment results are not affected by the pension settlement charge.

The next item on the reconciliation is the impairment, which as you know, was a fourth quarter 2016 event, and we're adjusting this out from prior year results. These two items comprise the adjustments to operating earnings for 2017 and 2016.

Next, there are four items included in the reconciliation of the tax provision. First, there is the excess tax benefit related to the exercise of stock options that we've been calling out all year since the adoption of the new accounting standard in the first quarter of 2017. You can see that we've had another large quarter for option exercises, resulting in a benefit of $16 million.

Moving on, we see the effect of US tax reform totaling $36 million. Similar to the reporting you're seeing from others, the effective tax reform is made up of two factors, including $29 million for the reevaluation of our net deferred tax assets to reflect the change from 35% to the new lower rate of 21%, which is a non-cash item. The other factor from tax reform is $7 million for the total charge related to unremitted foreign earnings.

We also saw the completion of various non-recurring tax planning items started earlier in the year, with a benefit of $4.5 million in the quarter. While the revaluation of the deferred taxes is a noncash item, the total charge does affect the cash, but is partially offset by these other nonrecurring tax planning items. The final item in this category simply is the tax effect related to the pension settlement in 2017 and the impairment in 2017.

In summary, 2017 adjusted net earnings include the post-tax effect of the pension settlement, the tax benefit for option exercises, the effective tax reform and the effective other tax planning benefits. Continuing on this page, you will notice that we now have approximately 176 million diluted shares outstanding after the three-for-one share split that was completed on December 27, 2017.

Before moving on to more detail around our performance, I would also like to call out that we prepaid the first tranche of private placement notes that were due in March 2018. The result of the prepayment was net expense of approximately $400,000 that was charged to interest expense in our P&L this quarter, and the removal of $75 million of short- term debt from our balance sheet.

Operationally for the quarter, I'm pleased to note that we saw strong sales in all segments and regions, with an increase of 5% at constant exchange rates from the prior year, and especially strong revenue growth in the Contractor segment. This was against a strong comparable from 2016 that included an extra week in our fiscal fourth quarter.

Gross margin rates improved from the prior year, primarily due to favorable currency translation in the fourth quarter. Outside of FX, strong factory efficiencies and volumes and favorable realized pricing, were offset by unfavorable product mix. As we look forward, we anticipate ongoing commodity cost pressure, though we estimate that the effect will be offset by realized pricing, as well as continued strong factory operating performance and volumes.

Since we're already referring to the slide deck, I'd like to call your attention to Page 9, which shows the walk year-over-year in operating earnings. In particular, the effect of volume and earnings-based incentives, reduced operating earnings by one percentage point for the company in the fourth quarter. By segment, the increased level of incentives affecting operating earnings by one percentage point as compared to the prior year for the Industrial and Process segments and by two percentage points for the Contractor segment.

The full segment year-over-year operating earnings walk are on the later pages of the slide deck. These plans reset annually, and we support rewarding growth through these programs. We also saw a slight increase in expense of $1 million related to regional and product growth initiatives this quarter, and you will see this in the operating earnings walk for the Industrial segment.

Full year cash flows from operations totaled $338 million, and changes in working capital were in line with volume growth. In 2017, capital expenditures totaled $40 million. We paid dividends and completed share repurchases totaling $134 million, and made a pension contribution of $20 million.

Looking forward to 2018. At current rates, the effective currency exchange will be a tailwind for us. At today's exchange rate and assuming the same volumes, mix of products and mix of business by currency, we expect to see a favorable effective currency translation of approximately 3% on sales and 7% on earnings, with about two thirds of that happening in the first half.

We expect unallocated corporate expense to be approximately $32 million to $34 million in 2018, and interest expense is expected to be approximately $13 million to $14 million. Our 2018 full year tax rate is expected to be 21% and 23%.

We expect 2018 capital expenditures for machinery and equipment to be consistent with the past couple of years at about $40 million. In addition, though we do not yet have specifics on timing or amounts, we are in the planning and design phase for expansion projects in several of our manufacturing and distribution locations, and we will provide further updates in coming quarters.

I'll turn the call over to Pat now for further segment and regional discussions.

Pat McHale: Thank you, Caroline and good morning, everyone. All my comments this morning are on an organic, constant-currency basis. Since Caroline has hit the details on our fourth quarter and full year earnings adjustments, any references to profitability will be on an as- adjusted basis.

This was the fourth consecutive quarter where we had growth in every segment and every region of the world, and outstanding performance by our worldwide team. This was particularly true in the fourth quarter as it was our toughest comp for the year, where we were up against the extra reporting week from Q4 of 2016.

Demand levels around the world continue to be broad- based. I'll focus my comments on a few of the areas that I think are notable. The Industrial segment posted their lowest growth for the year in the fourth quarter, with just a 1% sales increase. This is not reflective of underlying demand levels.

Shipments of finishing systems were down in the fourth quarter against the tough comp from the prior year, but incoming orders were strong and steady throughout the fourth quarter and were higher than shipments.

Contractor Americas continued to see good demand from the home center and paint store channels, with both channels contributing nicely to the double-digit growth for the business in the fourth quarter. Out-the-door sales remained solid in both channels. Our EMEA Contractor team posted their sixth consecutive double-digit growth quarter.

The Process segment had solid sales growth for the quarter in all product applications and around the world, capping off a year of double-digit top line growth.

Our Oil and Natural Gas operations grew in the fourth quarter, making up ground and ended the year flat for 2017. Regionally, I want to recognize our Asia Pacific team, which posted high single-digit growth in the fourth quarter and high-teens growth for the full year 2017.

Moving on to profitability. As Caroline discussed earlier, our continued strong financial performance during 2017, resulted in increased expense provisions for growth-related rebates and incentives, particularly in the second half, putting temporary pressure on our flow-through margins.

As a reminder, Graco incentive programs generally reward growth over prior year. Strong growth results in higher incentive expense in the year earned, but the bar is reset the following year at the new higher level. We like this formula and think it's a win-win for our people and for our shareholders.

Additionally, as Caroline mentioned, we had unfavorable mix, which dampened gross margins a bit during the quarter. Price/cost has remained favorable. Our factories are running very efficiently, and expenses outside of growth-related rebates and incentives are levering nicely.

You'll note that we mentioned regional and product growth initiatives in our slides regarding the Industrial segment, which reduced segment operating margins by one percentage point in the fourth quarter.

Many of our long- term shareholders know that Graco will periodically pursue growth opportunities and product adjacencies or geographic gaps, and we try to call out those investments when they put some pressure on segment performance.

In 2017, we kicked off a couple of initiatives to pursue sales opportunities, one of which is in the Asia Pacific region, where we're ramping up our technical and service support capabilities within the region, focusing on a few key application areas.

These initiatives impacted our Industrial segment operating margins by one percentage point in the fourth quarter, and will continue to put modest spending pressure on the segment into 2018, although I don't expect the headwind to be more than $1 million in a quarter.

Moving on to our outlook. Incoming order rates were strong every month of the quarter in every region and business segment. Orders through the first four weeks of January continue to be solid. As we turn to look at the full year of 2018, after having posted double-digit organic growth in 2017, we know that our comps are difficult throughout the year.

That being said, underlying demand is holding strong and the capital equipment environment is stable to improving. I like our lineup of new products for 2018, and our sales and operations teams are hitting the ground running.

With that backdrop, we're looking for mid-single- digit sales growth for the full year 2018, with growth from every region and reportable segment. Our outlook assumes mid-single-digit growth from each region.

Operator, we're ready for questions.

Operator: Thank you. Question-and-answer session will begin now. If you'd like to ask a question, that is star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that is star one for any questions. Your question will be taken in the order it is received. Please stand by for your first question.

Our first question comes from Joe Ritchie from Goldman Sachs. Please go ahead.

Joe Ritchie: Thanks. Good morning everyone.

Pat McHale: Good morning.

Caroline Chambers: Good morning.

Joe Ritchie: So Pat, I wanted to touch on that rebate commentary because it looks like it was roughly a $13 million headwind this year to earnings. And if you're rebasing on a new growth level with an expectation of mid-single-digit growth, is the right way to think about it that if you guys achieve mid-single-digit growth, you really shouldn't see much of a headwind from rebates in 2018? Is that fair or is there - or should we be thinking about it differently?

Pat McHale: Yes, and I want to clarify that we have rebates and incentives are all lumped together in terms of those line items for us. But yes, at a mid-single-digit growth rate, we would not have any pressure on rebates and incentives. Actually, we should – we pull back a little bit.

Joe Ritchie: Okay. All right. That's fair. And then maybe touch on the commentary around Industrial coming in at 1%, but it sounds like the outlook is better. If you can maybe just provide a little bit more color where you guys - where there's a little bit of a disconnect this quarter on growth versus bookings, and then what gives you that confidence you're going to see that reacceleration in '18.

Pat McHale: Yes. I mean, I don't really see a deceleration, to be honest with you. We were up against a 14-week quarter last year versus 13 weeks this year, and we were still able to end in positive territory. And on top of that, our book-to-bill ratio is better than one.

So from my standpoint, I don't see a problem with the underlying demand that we see in Industrial, and I don't see a significant change from what we've been seeing as we've gone throughout the year. I think it's more of an optics issue for you guys, frankly.

Joe Ritchie: Got it. That's helpful. And I guess maybe, since you touched on the extra week is, how should we think about the impact? Was it roughly like a three to four point impact on growth? Or how much did that impact the comparison year-over-year?

Pat McHale: Yes. We could have a big debate over that. We had our own internal debates, I think I've mentioned previously. But it was somewhere between probably 3% and 8%, depending upon who you talk to. And nobody will know, right? There are some extra days, and it's difficult. But just say it's somewhere in that range and you'll be close.

Joe Ritchie: Got you. And then maybe one last one for me. You talked about oil and gas getting back to flat as the year ended. Like what's the outlook for oil and gas then for 2018? And if you could sprinkle any comments on China, that would be helpful as well.

Pat McHale: Yes. I think it's likely we've seen the bottom on oil and gas. It's always risky to predict a bottom. But certainly with what we're seeing with oil prices and some of the quoting activity that we've been doing in our direct oil and gas business, I'd say that that bodes well for a better 2018.

And we have a lot of other business in other segments that is not direct oil and gas business that we get indirectly through painting and coating projects, and I think that that's going to be a positive for us going into 2018 as well. So I'm feeling pretty good about that.

China had a strong year. We don't see any reason why our opportunities aren't going to be good in China in 2018 as well. So again, from our standpoint, looking at demand patterns through the quarter and into January across our business segments and across the world, we're feeling like we've got a nice opportunity in 2018 to have another good year.

Joe Ritchie: Got it. Thanks guys.

Operator: Our next question comes from Jeff Hammond from KeyBanc. Please go ahead.

Jeff Hammond: Hey, good morning guys.

Pat McHale: Good morning.

Jeff Hammond: Just, so on a full year basis, it looks like incrementals were kind of mid-40s on a full year basis, and you had some noise in 4Q. How should we think about incrementals into 2018 as you look at puts and takes on that mid-single-digit growth?

Pat McHale: Yes. We should be in the high 30s to low 40s. That's kind of typically where we're at. And if we do better on volume, we can exceed that. And if we do worse, then we'll do probably on the low side of that.

Jeff Hammond: Okay. And then you're saying kind of mid-single digit across geographies. How should we think about maybe the growth curve in Contractor? The lights are still green there. Maybe just touch on new products and kind of the pipeline and rollout timing there.

Pat McHale: Yes. Contractor is ready to go. We launched most of the products here the first of the year, which is maybe a month or two earlier on average than we have had in the past. That did drive some expense into Q4 as we launched here in January.

But we feel like we've got a good product lineup for the Contractor group going into 2018, and the end markets globally are in good shape. So again, feeling positive about the momentum we've got in 2018 on Contractor.

Jeff Hammond: Okay. Thanks guys.

Operator: Next question comes from Charles Brady from SunTrust Robinson Humphrey. Please go ahead.

Charles Brady: Hey, thanks. Morning.

Pat McHale: Morning.

Charles Brady: Pat, on the Contractor business, you know, again on kind of mix, is it just kind of - nothing unusual about that, right, between sort of paint store - pro paint and the home center as far as what caused the mix, kind of what you've seen in the past on that?

Pat McHale: No. Quarter-to-quarter, things can move around. And I don't really take anything away from what happened in mix in Contractor in the fourth quarter between parts and accessories or units with higher or lower margins. I think it's just noise.

Charles Brady: Given the strength that the residential market has had and Contractor obviously has had, I'm just wondering, from a painter perspective and the products that they're buying, are you seeing any more of a shift towards that higher-margin product out of the paint press, the pro paint store channel? Or is the mix out of that part of the channel about the same?

Pat McHale: No. I mean, over the course of the last five or six years, that mix has been trending back to what I would call more of a normal mix, and I think we're probably getting pretty close to what I would consider a normal mix.

Charles Brady: Okay, thanks.

Operator: The next question comes from Matt Summerville from D.A. Davidson. Please go ahead.

Matt Summerville: Thanks. Good morning. Just a follow-up to Jeff's question. Based on kind of the organic growth cadence you experienced in Contractor throughout '17 and layer that in with the timing of your launches this year, I guess, Pat, your toughest comp, I mean it's a big comp, it's 23%, I think in Q1. Given the dynamics you've talked about, do you feel like the Contractor business has enough momentum to overcome that comparison and post positive volume gain in Q1?

Pat McHale: Yes. I mean it's always hard to tell when you're at this time of the year. January is obviously a cold month and a lower month in terms of our overall Contractor sales, and we make or break Contractor in March.

So I'd be sticking my neck out of ways to say. But again, I feel good about the new products we have. We've got good momentum to start the year. The factory up there is doing a good job and running efficiently. So assuming the volume comes, I think that at least on an annual basis, you should see nice operating earnings performance out of Contractor.

Matt Summerville: And then just a follow-up on this. What is your expectation for your global automotive markets in 2018? And maybe talk about how your business performed in '17. And if you can add in some regional color there, both thinking about '18 and reflecting on '17, that would be helpful as well. Thank you.

Pat McHale: Yes. Global automotive demand was pretty decent in 2017. You could probably find some markets where we're past peak in terms of production output. But in general, if you take a look at global output, it's pretty healthy. We see that continuing into 2018.

And with decent overall production, you're going to see our parts and accessories business should continue to do well. That really depends on how many units that they're making. In terms of project activity, that can jump around quarter-to-quarter, but I would anticipate that 2018 should be a similar year to 2017 in terms of global automotive project activity for Graco.

Matt Summerville: Thanks, Pat.

Operator: Our next question comes from Saree Boroditsky from Deutsche Bank. Please go ahead.

Saree Boroditsky: Good morning. So you put out a really strong growth year, and I just wanted to see how you were thinking about market growth versus outperformance in 2017. And then as you think about the guidance for mid-single-digit growth, how are you thinking about end-market performance versus company-specific drivers?

I guess what I'm trying to better understand is, based on your growth framework, if there's a reason that growth should decelerate if industrial production picks up next year.

Pat McHale: Yes. So, you know, that's a tough question. In most of our business units, there's not direct competitive data that will allow us to gauge in any kind of real time what our market share gains or losses might have been.

Generally, if you look at our overall organic growth performance over the course of the last few years, I think we compare pretty favorably to other industrial equipment manufacturers. So from my standpoint, I believe that we're doing just fine in terms of share.

We invest quite a bit in different kinds of growth initiatives, and that could be our new product development projects or geographic expansion. Those aren't necessarily straight market share gains. Those oftentimes are building Graco's revenue into new spaces where we hadn't played before.

We'll continue to do that going into 2018, and I think that helps support some of our good top line growth that we've seen over the course of the last few years. Going into 2018, we're going to run the same playbook that we always run. We make investments when we see that we have opportunities.

We've got an engaged team. I think we've got good incentive programs. We've got great channel partners. And looking at some of the numbers that are coming out from other companies that are reporting, they look pretty good. So I think that that bodes well for our opportunities to sell into a lot of different end markets going into '18, and I feel pretty positive overall.

Saree Boroditsky: Thank you. Then focusing on APAC Industrial, could you provide more color on any of the key drivers of the full year growth? And then what would cause it, if anything, to decelerate to the mid-single digits that - just given that you raised some of the outlooks for a few of the end markets to favorable?

Pat McHale: No. I think it's Page 18 in our slide deck, we break down some of the - it's not Page 18.

Caroline Chambers: The industrial page, Page 15 for industrial.

Pat McHale: Page 15 in our slide deck, we'll break down some of the end markets for you, so you can take a look at that. In terms of the deceleration, we just put out big growth rates in AP. And it just doesn't seem to make a lot of sense for me to sit here in January and say that yes, we're going to grow teens again in Asia Pacific. I mean, I'm sure everybody would like to hear that and we'd love to do it. But we'll put a number out there that we think is reasonable, and we'll go out there and we'll try to beat it.

Saree Boroditsky: Okay. I appreciate it. Thank you.

Operator: Our next question comes from Deane Dray from RBC Capital Markets. Please go ahead.

Deane Dray: Thank you. Good morning everyone.

Pat McHale: Good morning.

Deane Dray: I was hoping you could recap for us how tax reform ended up benefiting you all. I think you all have got to be one of the biggest beneficiaries of the multi-industry group, especially versus expectations. I think a big swing factor is how much of your revenue base is exported, given your manufacturing concentration. Was that a big factor here? Because it really was a pleasant surprise to see how much you're benefiting.

Christian. Rothe: Yes, Dean. Good morning. This is Christian. So overall, yes, you - we do have a big portion of manufacturing that happens in the United States, and we export it around the world. So the result of that is that we have upwards of three quarters of our earnings happens in the United States. And so the result of that is, with the reduction of the tax rate, it's going to have a nice benefit for us and our shareholders.

Deane Dray: I think you're probably the poster child for how and why tax reform was enacted, for exactly your manufacturing exposure, so congrats there. And then second question on price/cost. It got mentioned a couple of times being favorable. And I recall last earnings call, we had a whole discussion of why you actually liked seeing commodity - rising commodity inflation environment. And maybe just take us through which businesses where you saw the most price/cost favorability.

Pat McHale: Yes. So let me go back, and I'm not going to dissect the quarter for you. But in general, when you think about the way the formula at Graco works, you can bake in say 1.5% to 2% of an annual price increase. And if we achieve that, and we normally do, it's pretty hard to conceive of ever having enough commodity cost pressure to completely offset that, particularly given good factory performance.

If we get volume in our factories, we continually invest in technologies and automation and cost reduction and quality improvement and service projects, that give us the chance to achieve a favorable price/cost. So I don't think that formula has changed. As commodity costs rise, end markets become favorable for us to sell into, and I think that's a plus. And the price/cost with good factory performance is not something that normally I spend a lot of time sweating.

Deane Dray: And just last question. Caroline pointed out where you had some negative mix. Where would you highlight where that was most negative, you know, across the businesses?

Caroline Chambers: We called that out in Contractor a little bit. We saw some of that there. Some of that is just - as Pat mentioned, a little bit of noise in some lower-margin products that were sold. We also saw a little bit of that in Industrial putting a little bit of pressure on earnings in that segment as well.

Deane Dray: Got it. Thank you.

Operator: Our next question comes from Mike Halloran from Robert W. Baird. Please go ahead.

Mike Halloran: Hey, good morning everyone.

Pat McHale: Good morning.

Mike Halloran: So Pat, not hearing much negativity in the demand environment. It certainly seems like even some of the markets that were struggling to recover came back in the fourth quarter, like the oil and gas side. When you look to 2018, any points of concerns out there right now?

Pat McHale: Yes. No, not really. Things feel pretty good. I read all your write-ups last night and when I landed from 10 days of travel in all sorts of places and all the disappointment oozing out of all of them and I was like, wow. I feel pretty good about the year. We had good flow-through profitability.

Organization, operationally is running well. End markets are strong. Bookings are good. I think there's a lot to feel good about. And we're going to go and we're going to run our playbook in 2018, and I'm hoping it's going to be a good year.

Mike Halloran: Yes. I mean certainly not any disappointment on the top line, Pat. But the follow-on to that is, as you look at this year tax reform, I'm guessing it's not having a big impact on your internal investment curves. But any thoughts there? But more broadly, any thoughts on how you think the extra cash is going to impact people's demand decisions and how that helps your business potentially on the demand side?

Pat McHale: Sure. I'll take the external piece, and then I'll just let Christian talk to you for a second about what we're doing internally due to the tax reform. But it should be good externally particularly with what we're hearing from companies in terms of actually taking that cash and driving it back into the economy and making some additional investments for growth and other things like that. All that provides a nice backdrop for Graco sales opportunities into to our various end markets.

So if it all came back and it all went to share buyback, I'd be concerned, but I'm not hearing that in the marketplace. I'm hearing people talk about doing some things with that cash that should drive sales opportunities for us. So externally, I think it's going to be a plus for us going into 2018. And I'll have Christian just comment with what we've done here internally to make sure that we're taking full advantage.

Christian Rothe: Yes. Sure. Good morning, Mike. So the way we're revising our ROI model, and as everybody knows in Graco, we look at pretty much everything be on our ROI model. And so that model has been updated to reflect the new tax rates and gain on capital equipment.

All in all, our investments are driven, first and foremost, by strategy and that is always going to be the primary driver. Beyond that, it's really just - it's math and execution. And so we're continuing to make those adjustments to the model. But at the same time, again we're going to focus on the strategy more than anything else, and the rest is math.

Mike Halloran: Yes, that makes sense. And then last one, particularly with the tax changes, you're already very strong. Free cash flow is probably going to get a lot better in 2018. What do you guys thinking about uses of it? Obviously it's fund internally first, healthy dividend levels. But what are you guys thinking of with the excess cash that you guys are going to have now?

Christian Rothe: Yes. I mean from that perspective, we're not going to make any public comments at this point. Obviously, again, we are focused on internal investments. We continue to look at M&A transactions. Interested to see if there are changes that happen with regard to multiples in the marketplace around that. But all in all, we're sticking to the same kind of strategies we've had.

Mike Halloran: Appreciate the time.

Operator: Our next question comes from Brett Kearney from Gabelli. Please go ahead.

Brett Kearney: Hi guys. Thanks for taking my question.

Pat McHale: Good morning.

Brett Kearney: I think most of my questions on Contractor have been answered. I just want to ask on the acquisition in Q4. It sounds like a smaller one, but if I could hear just kind of what drew you guys to that business. And perhaps related, do you see any additional opportunities for the company if we start to get some increased infrastructure spending here later this year and into 2019?

Pat McHale: Yes. So first, I'll take the acquisition question. Yes, it was a small acquisition that is a nice fit with our Contractor business. We're the worldwide leader in what I'll call short-line line striping, putting stripes on parking lots and other things. We do have a product for removing lines, but it is, I'll say, a very high end and a very narrow product offering.

This company that we bought has got a full line of products for doing line removal. So we think that that's a nice fit and that we'll be able to take this company and globalize its product offering and sell it to other customers that we have around the world. So we think there's an ROI there for our shareholders.

Second part of your question was regarding infrastructure spend. And yes, anytime there's infrastructure spend, that's good for Graco. And it's not always direct if they're building roads. But if they're building roads, they're selling all sorts of other things and those companies then get busy, and then they're buying Graco product.

Brett Kearney: Thank you.

Operator: Next question comes from Walter Liptak from Seaport Global. Please go ahead.

Walter Liptak: Hi, thanks. Good morning guys.

Pat McHale: Good morning.

Walter Liptak: I wanted to ask about industrial finishing. And I understand the difficult comp - the extra week, the difficult comp, et cetera. But I think I heard you say that there was a little bit of, you didn't use this word, but I thought of an air pocket in finishing in the fourth quarter. Did I hear that right? And it sounds like it's back on track, whatever it is. But just wondering if finishing was consistent throughout the quarter.

Pat McHale: Yes. So no, I wouldn't call it an air pocket, but the finishing systems that we sell, they can jump around quarter-to-quarter. We can have a few hit in the quarter, and then we look like we have a big quarter. And then we can have - not have a shipment in the next quarter. They tend to have some lead time associated with them. They're project based.

And over the course of the year, you're going to probably get a certain amount of them, and it just depends on when they come. So I was just a finishing system shipments issue Q4 versus Q4 of last year. I don't think that you should read anything into it.

Walter Liptak: Okay, good. So whatever visibility you gather, pipeline on systems looks pretty good for the year?

Pat McHale: Yes. Bookings and the quote activity is fine. Again, I wouldn't read anything into it.

Walter Liptak: Okay. All right, great. Thank you.

Operator: Next question comes from Jim Giannakouros from Oppenheimer. Please go ahead.

Jim Giannakouros: Hey, good morning everyone.

Pat McHale: Good morning.

Jim Giannakouros: A follow-up question on incrementals. Is the way we should be - the way we should understand your expectations for 40-ish percent on mid-single digits organic, is that what you were messaging? Or does your - Pat, your high 30s, low 40s comment include FX benefits?

Pat McHale: No. Without FX benefits, the high 30s to low 40s, if we're doing mid-single, is what you should expect.

Jim Giannakouros: That's on core. Okay. And sorry if I missed it on CAPEX. That $40 million you guided in '18, is that maintenance CAPEX and excludes that facility expansion plan that might move forward later this year? Am I understanding it correctly?

Pat McHale: Yes. That $40 million does not include bricks-and-mortar, and we do have several bricks-and-mortar projects. A lot of them right now are in the design phase. And as the year progresses, we'll probably have better clarity in the numbers. It will just be one more way we'll use some cash that we get from the tax benefit.

Jim Giannakouros: Okay. And one last one, if I may. We tend to talk and think about you guys, your sales as equipment sales. But historically I believe, you've dubbed aftermarket sales made up about 40% of total. Is that still the case? And how would you cut your organic growth expectations, original equipment versus aftermarket?

Pat McHale: Yes. Our - on our legacy business, the aftermarkets remain - aftermarket percentage remains incredibly consistent over super long periods of time. So I would anticipate that as we go into 2018, we're likely to see that continue. Whatever our sales are, you're probably going to see in our legacy business, about 40% of that is going to be - continue to be parts and accessories.

Jim Giannakouros: Thank you.

Operator: As a reminder, that is star one for any questions. Our next question comes from Jeff Hammond from KeyBanc. Please go ahead.

Jeff Hammond: Hey guys. Just a couple of quick follow-ons. Just share count kind of creeped this year. You guys are usually pretty good at knocking that down. How should we think about buyback? And then also, the $40 million in CAPEX, what could that number flex to if you get some of these projects underway? Thanks.

Pat McHale: Sure. So in terms of the share buybacks, historically I think I'd call us opportunistic. If you took a look at a longer time horizon, you'd see that we step into the market and we buy lumps at different points in time. And we did do a lump last year in January. Well, I should say we didn't accelerate a program that we kicked off early in 2017. But we're remaining - excuse me. We're remaining …

Christian Rothe: Opportunistic.

Pat McHale: Yes, opportunistic – excuse me, remaining opportunistic now, and we've had discussions with the board. And Christian and I, we continue to have discussions in terms of what's the right thing to do. Obviously the stock market is soaring, and we want to make sure that we use our cash in a way that's most favorable for shareholders. So we're going to continue to figure that out as we go through the year and we generate cash.

Christian Rothe: As far as the $40 million in CAPEX number and where we'd flex up to, when you include the bricks-and-mortar aspect of it, yes, I think as Pat said, we're continuing to develop that right now. And it's kind of spread between '18 and '19 and maybe trickle a little bit into '20, hopefully not though. But - so we'll probably keep you updated as those plans come together later on this year.

Jeff Hammond: Okay. Thanks guys.

Operator: Our next question comes from Liam Burke from B. Riley FBR. Please go ahead.

Liam Burke: Yes, thank you. Pat, as automation comes rolling out, you've designed products to address that market. Are you seeing any incremental lift yet? Or is it still early in the game?

Pat McHale: No, I'd say that that continues to be a focus on our new product development projects. And the automation products that we've got out there in the market continue to do well, and we see a lot of interest in that. So I think that that's a trend that's going to go for quite some period of time.

And even in the markets where labor rates continue to be low, we see a lot of interest in automation, not only in terms of labor savings, but also for quality improvement and throughput and consistency and other things. So I think it's a good trend, and we're seeing it and it's going to continue.

Liam Burke: Okay. And in Contractor, on - in EMEA, you mentioned or there was - emerging markets had a good quarter. Are you seeing any accelerated adoption in Contractor of systems versus the traditional roller? Or is it just the end market lifting?

Pat McHale: Well, you know, our EMEA group has had really a tremendous year and a half in terms of overall growth rates, and certainly some of that has got to be adoption. That's nothing that I can push a button and get a report on. That's more field-based data. In AP, in China in particular, I'm going to tell you, it's - we're still working hard on that, and we're not seeing great swings in the adoption level.

Our business in AP Contractor in the emerging markets grew nicely for the year. But it continues to be a challenge for us, and we think that there's a lot of opportunities on that front. So I'd say it's a little bit of a mixed bag around the world. But as labor rates continue to go up, that trend should continue.

Liam Burke: Great. Thank you, Pat.

Operator: There are no further questions. I'll now turn the conference over to Pat McHale.

Pat McHale: All right. So I just want to say opportunistic. Since I had a brain cramp, I got stuck on that and I feel better now that I can actually say it on the call. But anyway, hey, thanks everybody for joining us. We're headed off into 2018, and we're going to work hard and try to put up another good year. So thanks.

Operator: This concludes our conference for today. Thank you all for participating, and have a nice day. All parties may now disconnect.