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EDITED TRANSCRIPT

GGG.N - Q2 2023 Graco Inc Earnings Call

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OVERVIEW:

Company reported Cash provided by operations of $282 million.

REFINITIV

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Mark W. Sheahan *Graco Inc. - President, CEO & Director*

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PRESENTATION

Operator

Good morning, and welcome to the Second Quarter Conference Call for Graco Inc. If you wish to access the replay for this call, you may do so by visiting the company's website at www.graco.com. Graco has additional information available in a PowerPoint slide presentation, which is available as part of the webcast player. (Operator Instructions)

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 the purpose 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 2022 Annual Report on the Form 10-K and in Item 1A of the company's most recently 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 they are made. The company undertakes no obligation to update these statements in light of new information or future events.

I will now turn the conference over to Chris Knutson, Executive Vice President, Corporate Controller.

Christopher Knutson

Good morning, everyone, and thank you for joining our call. I'm here today with Mark Sheahan and David Lowe. I will provide a brief overview of our quarterly results before turning the call over to Mark for additional discussion.

Yesterday, Graco reported second quarter sales of $560 million, an increase of 2% from the second quarter of last year. The effect of currency translation decreased sales by 1 percentage point or approximately $3 million. Reported net earnings increased 14% to $134 million for the second quarter. Diluted net earnings per share was $0.78, an increase of 15% over last year. After adjusting for the impact of excess tax benefits from stock option exercises, diluted net earnings per share was $0.75. Based on current exchange rates, currency translation should have no effect on full year net sales or earnings. We expect the unfavorable effects of currency that we saw in the first half of the year will be offset by favorable impacts in the second half.

The gross margin rate increased 310 basis points in the quarter. Strong price realization plus favorable product and channel mix, mainly in the Contractor segment, was more than enough to offset higher product costs. While material cost increases have moderated compared to what we experienced last year, headwinds from lower factory volumes and increased factory spending have put pressure on the gross margin rate for the quarter and year-to-date. Factory volumes have softened as the year progressed, as lead times, supply chains and customer order trends start to normalize.

Total operating expenses increased $14 million or 12% in the quarter, primarily from rate-based increases of $6 million and incremental share-based compensation of $4 million. Gross margin rate improvement more than offset these increased operating expenses during the quarter, resulting in operating margin rate growth of 1 percentage point. Contractor operating margin increased 1 percentage point compared to the second quarter last year. Sequentially, Contractor operating margin decreased 3 percentage points from the first quarter, largely due to new product development spending, unfavorable channel mix and unfavorable factory volume related to inventory reduction initiatives.

For the full year, we expect unallocated corporate expenses to be approximately $34 million to $37 million, but timing can vary by quarter. Nonoperating expenses decreased $5 million as a result of increased interest income on cash held and the favorable effect of market valuation changes on investments held to fund certain retirement benefits. The adjusted tax rate was 19% for the quarter, which is consistent with our expected full year tax rate of approximately 19% to 20% on an as-adjusted basis.

Cash provided by operations totaled $282 million for the year, an increase of $147 million from last year, mostly driven by higher net earnings and a reduction in inventory purchases. Cash provided by operations as a percent of net earnings is 107% for the year. Significant uses of cash year-to-date were dividend payments of $79 million and capital expenditures of $92 million. We estimate capital expenditures for the year to be $200 million, with $130 million related to facility expansion projects.

Finally, subsequent to quarter-end, we repaid $75 million of our private placement debt, including a prepayment fee of $700,000, which will be recognized as interest expense in the third quarter of this year.

I'll now turn the call over to Mark for further segment and regional commentary.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Thank you, Chris, and good morning, everybody. All of my comments this morning will be on an organic, constant currency basis. Sales were up 3% for the quarter. We achieved record second quarter revenue and operating earnings, driven by strong results in both the Process and Industrial segments. Contractor performance remained mixed, with growth in pavement, protective coatings and spray foam unable to offset softer sales in the home center and pro paint channels. EMEA was a bright spot during the quarter, growing 5% compared to last year, with growth in all reportable segments. Incoming order rates in many key product categories have been solid, and sales have improved as many of the adverse component and product availability issues that impacted EMEA last year have improved.

Operating margins were strong for the quarter, as we continue to benefit from our pricing actions in 2022 and 2023. Price realization in the businesses and regions accounted for nearly all of our revenue growth and significantly contributed to our company-wide incremental margins of 75%. With similar volumes and costs for the rest of the year, we expect to continue to see solid margin performance for the remainder of 2023. Our consolidated backlog, was $330 million at the end of the quarter, down $20 million from the end of last quarter. Issues with supply chain and component availability have improved modestly. Better component availability has allowed us to increase our customer service levels, although we still have room for improvement.

Now turning to some commentary on our segments. The Contractor segment experienced a low-single-digit revenue decline in the second quarter, driven by less demand in the home center channel, slowing construction markets in China and softer demand in the North America pro paint channel. Somewhat offsetting these headwinds were growth in our pavement and high performance coatings and spray foam businesses. New product introductions were also incrementally favorable for both the quarter and on a year-to-date basis. We believe that the current inventory levels within the home center channel are reflective of foot traffic in the stores and out-the-door sales. The decline in the North America pro paint channel compares to strong second quarter sales last year, when we made a significant dent in our backlog -- back orders to key customers after component shortages started to ease.

Growth in EMEA during the quarter was largely due to improved product availability and strong price realization. Asia Pacific, on the other hand, declined 6% as the shipping container business and construction markets were weaker than a year ago, especially in China. Despite the soft quarter, we are optimistic for the balance of the year as contractor activity remains solid, and we are seeing improvement in key economic data related to U.S. housing starts and existing home sales, along with continued strength in commercial construction spending.

The Industrial segment grew 4%, resulting in record second quarter revenue and operating earnings. Activity in key end markets such as alternative energy, electronics and battery has been robust. Incoming orders in our Liquid Finishing and Sealants and Adhesives businesses remained solid, but were somewhat offset by continued softer demand in our Powder Finishing business, especially in Asia Pacific. However, backlogs in powder equipment and systems remain elevated, giving us confidence for a better second half of the year.

The Process segment grew sales 14%, resulting in second quarter records for both revenue and operating earnings. This is the tenth consecutive quarter that Process has set these records. We saw continued broad-based sales growth in all product categories. However, vehicle service, automatic lubrication and semiconductor were the key drivers of the impressive performance this quarter. Steady volume, strong pricing and good expense management resulted in incremental margins of 76% for the quarter and operating earnings of 31%, which is another record for the segment. At similar volumes, we believe the current operating margin rate is sustainable, and we are pleased with the strong margin progression that has occurred in this segment the last 2 years.

Moving to our outlook. Our results for the first 6 months were essentially in line with our expectations. End market activity can be broadly characterized as having pockets of both strengths and weaknesses. Overall, we're seeing modest sales growth drive strong earnings leverage. Current order rates, along with elevated backlogs, give us confidence that we will attain our full year revenue guide of low-single-digit organic growth on a constant currency basis.

That concludes our prepared remarks. Operator, we're ready for questions.

QUESTIONS AND ANSWERS

Operator

And thank you. (Operator Instructions) And our first question comes from Deane Dray from RBC Capital Markets.

Deane Michael Dray - *RBC Capital Markets, Research Division - MD of Multi-Industry & Electrical Equipment & Analyst*

Could you expand on the point on the pro paint channel? It sounded like there was a lot of back order inventory that you were finally were able to ship. Did that have an impact on this quarter, that there was more product availability and so forth? It just -- it sounded like that was kind of either like a rubber banding of the product going into the channel. Just some clarity there, please.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I think -- and David and Chris can comment, too. But I think what we were trying to highlight was that a year ago, we had a lot of back orders. And we did free up some components in the factory to get product out the door in Q2. That might have been a little bit higher than normal, just because we had such a huge amount. And so when you're looking at a comparison to last year, that was really why I think we saw a little bit tougher comp.

David M. Lowe - *Graco Inc. - CFO & Treasurer*

Yes. And I would just add this is David. I would just add that I think it's also true in the mindset of the buyers in the Contractor channel generally, both pro paint and home center, we have our most sophisticated point-of-sale systems and people. And a year ago, studying our fulfillment rates, I think it's safe to conclude -- and I've confirmed this with our factory people -- they were submitting extra orders because of anxieties about when we and other vendors would get product to them. So I think it's a combination of orders were exceptionally aggressive, probably over and above out-the-door sales last year, along with Mark said, it was about a year ago when we really saw a meaningful free-up in some of the key components that were blocking shipments.

Deane Michael Dray - *RBC Capital Markets, Research Division - MD of Multi-Industry & Electrical Equipment & Analyst*

All right. That's really helpful. And then just to clarify on the home center, it sounds though, the destocking, has that run its course? So selling versus sell-through is now more balanced?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I think when we had talked to the teams that actually are in the field and they're looking at what inventories are in the stores, they feel like, right now, they're in a good spot given the level of activity that they're seeing in foot traffic and activity within the stores. So you never really know, Deane, right? I mean, things can change. But at least for now, we think that the major home centers are at an inventory level that's acceptable, given what they're seeing.

Deane Michael Dray - *RBC Capital Markets, Research Division - MD of Multi-Industry & Electrical Equipment & Analyst*

Right. And then just lastly, on the traffic light slide, on -- it looks as though the Asia conditions have worsened a touch, but that was not enough to have you change the outlook for the year for sales? Total [company]?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

I think that's accurate. I think you got -- one thing that -- when we look at Asia, I mean, the majority of it is really the Industrial business. I mean, we do some -- we do have CED, it's meaningful. But when you think about all the activity that's going on in Industrial, with all the alternative energy stuff. And if you look outside of China, we saw a nice activity in Korea, in Japan and Southeast Asia. And also Australia. So I think we're pretty comfortable with what we've got there.

Operator

(Operator Instructions) And our next question comes from Michael Halloran from Baird.

Michael Patrick Halloran - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research & Senior Research Analyst*

So following up 1 of Deane's questions. Just if you look at the back half of the year, is the thought process then on the Contractor side sequential stability from current levels, kind of following normal seasonality? Or is there some other assumption I should be thinking about?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I think when we look at the level of incoming orders that we have and the backlogs that we still have, our backlogs are down, but they're still higher than what they would normally be. We feel pretty good that the outlook should hold up for the back half of the year.

David M. Lowe - *Graco Inc. - CFO & Treasurer*

Yes. And I would just add, maybe -- this is my own view, that absolutely, we have back orders and -- if you think about our segments, I would say that the Process and the Industrial segments have backlogs at this juncture elevated to a somewhat higher degree than what we see in Contractor. My view on the Contractor side -- I'm reluctant to use the word normal after the experience of the last couple, 3 years. But in talking with our field people, as Mark indicated, and our operating people, my sense is, in the major product categories for pro paint, home center, and increasingly, the protective coating space, we are enjoying backlogs that are much closer to the historical model than what we've seen any time since 2019.

Michael Patrick Halloran - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research & Senior Research Analyst*

Okay. Process side, obviously, the margins have been tremendous. Can you help a little bit on the drivers of the strength on the top line side of things? It's a lot of moving pieces and not a ton of visibility from our side of the fence on a lot of those moving pieces. The vehicle services, you highlight as a strong point, seems stronger than the environment would necessarily indicate. So if you could just give some more context, not just on vehicle services, but all the things going on underneath the hood. How much is Graco? How much is the markets? How much is -- just really dynamic pricing? And just give some more context on that overall picture.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I'll take that. I appreciate the question because I do believe that it's just been a wonderful success story within Graco, what's happened within that segment over the last couple of years. I mean, it wasn't that long ago, I remember the operating margins were in the teens. So they're at 31%. And it looks like we still got some runway there to expand beyond that. But it's been good growth across really multiple different business units and product categories, including a number of the ones that we've acquired over the last 5 years or so. So our White Knight Semiconductor business has remained strong, and the outlook for semiconductor at least next year looks to be fairly good. So that's been a nice development there.

Our environmental businesses, where we're moving fluids around in landfills, they are spending more money this year than what we've seen over the last couple of years. So if you look at the Republic Services, waste management, they are a little bit more inclined to make investments. And so we're realizing some of those benefits.

Lubrication has been a really nice business for us. The team there is executing extremely well. It's not just the vehicle service side, it's also our industrial lubrication business, which competes in about a $1 billion revenue market, and we are growing nicely in that market by expanding our product line and improving our service levels. And hopefully, we can continue to gain OEM presence and drive that business higher. I feel like there's a fair amount of runway for growth there that team has.

And vehicle service, all I can tell you is that dealers make money on getting people into the dealership. And the best way they can do that is to have you come in for an oil change. And when you go in, they want to make sure that the amount of oil that they put into your vehicle is tracked, it's monitored and it's put in accurately, because a lot of these oils are pretty expensive. And so they're driving more customers into the dealership doing an oil change and then, of course, hopeful that they'll be able to find other things to sell you as well.

So again, I appreciate the question. I think that our Process segment is really a great story within Graco. We're really excited about it, and all the teams there are executing extremely well.

Michael Patrick Halloran - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research & Senior Research Analyst*

No, that was great. Last one. Maybe just talk to what your inventory levels are, Graco's inventory levels are. And how you see that trending and what it means for cash flow as it will go over the next 6 to 18 months?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

I'm going to let Chris take this one.

Christopher Knutson

So our inventory level currently is pretty flat with where it was at the beginning of the year. We do have some inventory reduction initiatives that are underway, which has started to drive down some of that inventory, especially within the legacy businesses. I think you'll see for the rest of the year, we'll continue with less of the inventory purchases as we continue to drive that inventory down to a lower level than we've seen historically as we've seen improvements in both the supply chain and product component -- or component availability.

Operator

(Operator Instructions) And our next question comes from Saree Boroditsky from Jefferies.

Saree Emily Boroditsky - *Jefferies LLC, Research Division - Equity Analyst*

I just want to kind of focus a little bit more on the margins. Gross margin stepped down sequentially despite the higher dollar. So like, what drove that? And what do you need to see for margins to accelerate from here?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Well, I mean, there's a couple of things. I think that for sure, mix, particularly in Contractor wasn't as favorable as it was in Q1, for example. So a little bit higher coming out of the home center as a percentage of their total revenue. The price realization has been good. We are offsetting our cost. I will tell you that Chris' comments upfront about factory volumes being down is something that's putting a little bit of pressure on the gross margin.

And if you look sequentially at what happened between Q1 and Q2, we did drive inventory down by about $20 million. And the factories are very cognizant that our inventory levels have grown by quite a bit over the last 2 years as we wrestled with all the supply chain. So we are really pushing the teams there to make sure that we're producing what we're selling and take concerted action to try to pull some of that inventory back. And I think you see that showing up on the cash flow statement, where our cash flow is dramatically better than it was last quarter and a year ago.

So overall, margin rates are decent, and I feel like we're in a good spot for the rest of the year to maybe put some more points on the board there.

Saree Emily Boroditsky - *Jefferies LLC, Research Division - Equity Analyst*

And then just -- not to beat this, but on the incremental margin in Industrial, they came in lower than I think we would have expected. I don't know if that's with the factory volumes, but was that factory volumes, lower growth in APAC? Or just, what drove that?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

I think that the overall Industrial results were down like 100 basis points for the quarter-over-quarter. And what I would tell you is that in any 13-week time period, there's going to be some volatility in there. I don't think there's anything systematically different in terms of what's going on in that business than others. So again, I feel like, overall, absolute levels of profitability there are really good. There might be a little bit of variation from time to time, but no problems.

Operator

(Operator Instructions) And our next question comes from Matt Summerville from D.A. Davidson & Company.

Matt J. Summerville - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Mark, I just -- I want to get back to Process a little bit and maybe just talk about how sustainable you think the demand is there, looking out over the next few quarters in the context of where do you feel this segment is in the cycle, if you will? And when you look at the second quarter, should we consider this to be a new kind of base run rate of business, the $140 million you did in the quarter? If I look back, this business -- and it's been phenomenal. To your point, 7 straight quarters of quarter-on-quarter growth. So I guess I'm just trying to get a feel for what the go-forward view is relative to this second quarter performance you guys turned in?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I really like what we're doing there across really all of the different product categories, the ones that I've mentioned in particular. The one I didn't mention, which is also exciting, is the big push by every factory in the world to reduce energy costs. And as a result of that, moving to electric drive diaphragm pumps is an area where we think we have a very good competitive advantage. We launched a product called Quantum. It's on our website. You can look at it. Nobody else has that technology, because we own the motor technology that goes into that pump. And so that is a trend that's going to play out for several years. And I think we're really, really well positioned there.

And also, that segment, whether it's in the industrial applications or the lubrication applications, or really all the sanitary food and beverage, all the stuff they get into, it's probably the most fertile ground for us when it comes to M&A hunting. And we've built a business there now that I think can be leveraged to the extent that we find attractive targets that we can bolt into the operations there.

Very pleased with the team. We built a new factory for them last year. They've moved up there. It's up in Dayton, I'd encourage anybody to come and visit that wants to see it. A lot of good things happening in Process.

Matt J. Summerville - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Appreciate that color. And then I just want to put a finer point on Contractor to make sure I have the picture, right? So can you talk about the relative performance of the pro paint business versus home center in North America? And I think you mentioned sell-through looked like it was kind of matching sell-in with home centers. Is the same true in the pro paint side of things?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I think that to the latter question, yes, I think that the inventory levels on the pro paint side are at a level that's reflective of the business that they're seeing. Both were down in the quarter, so I don't want to sugarcoat that. But both pieces of the business, both pro and home center were down. What I will say is that when we talked to the pro painters and the contractors that are out there doing jobs, they still have business. They still are pretty busy. And anybody that's involved in commercial is particularly busy these days.

So despite all of the potential for doom and gloom that came along with interest rates going way up and housing activity slowing down, we're hanging in there pretty good. And we've got these other nice niches that we're in, like line striping and texture and spray foam and protective coatings that -- that really help kind of smooth out maybe some of the more volatility that you might see in the businesses that just relates to residential housing. So all in all, not too bad.

David M. Lowe - *Graco Inc. - CFO & Treasurer*

I should leave well enough alone, because I agree with everything in Mark's summary. The way I'm thinking of it is certainly, when we talk about construction and contractor activity here in North America, the macro data, both on the commercial side and frankly, on the residential side is coming through stronger. And the forecast that we've seen as recently as coming through in the last couple of weeks, virtually every category of investment in the commercial space and also in the residential space is better than the previous forecast.

And I guess on the second point, reiterating -- because I think it is important. At the point of sale, the channel partners and our own salespeople on their checks really, for the most part, believe that -- I'll say, this is what they want -- wholesale and retail or inventory levels, stocking points are in line. And I think that this would be -- this is important, because it means if so or if mostly true, then we have largely seen our model revert back to where it was 3 or 4 years ago. And Contractor being -- and this is a good thing, by the way, because this is one of Graco's strategic advantages, our ability to have very high fulfillment levels. And if that's the case, we're back to -- we're indeed back to the old model of, if you will, you eat what you kill. And the short-cycle nature of the business will be what drives results in that business over the balance of this year and going into '24. But the underlying fundamentals are positive enough. I feel pretty good about that.

Operator

(Operator Instructions) And our next question comes from Jeff Hammond from KeyBanc Capital Markets.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Just -- I think you gave a backlog number and said it was down $20 million sequentially, I think $330 million. Just wondering what you think is more reflective of a normal backlog and how long of a period where we start to -- where we see these kind of lower orders to get back to normal? And then along the same lines, I think you said you were kind of underproducing to bring inventories down and that impacted the gross margin. Just wondering how much is left? Does that carry through the second half? Or you've kind of reset at this point?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I think on the backlog question, it's hard for us to peg a number, but I will just tell you that there's room to go there. We still have lead times with certain customers that we need to get better on. And the biggest wildcard within any given time period on our backlog is really the Powder Finishing business that we have, where they do book large projects. And so their backlog can kind of move around significantly. So I don't have a number for you, but I would say that we've still got a substantial amount that we can take out of the backlog to get back to our normal, I guess, customer -- customer service levels.

On the inventory front, we have really built up a bunch of inventory over the last couple of years. So as a management team, we want to make a dent into that, and we've actually got some initiatives going on in the factories with targets and incentives and things of that nature to pull inventory back. And that's a good thing. I think it makes a business more efficient and more effective to be a little bit leaner on inventory. And obviously, the cash flow implications are very nice.

We're not doing anything to sacrifice our ability to deliver product that our customers' need. We're really just making sure that when it comes to buying components and being smart about what we do put on the shelf, that we're doing it with a mindful eye. We just went through this period where, for the last couple of years, it's been crazy. If you find a component, you're not just buying the 1 or 2 that you need, you might buy 10. So it's a little bit of a reset there. Again, it's not going to really impact our ability to deliver the products that our customers need.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Okay. And then good color on Contractor and the moving pieces and kind of the activity. But I'm just trying to think about third quarter, because you have -- you had tremendous growth there last year. And just better understanding the moving pieces last year, so we understand maybe the comp dynamics.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Well, again, I think that what we have tried to do with our outlook, rather than try to nail a quarter is really give a global outlook for the business for the full year. And we take a hard look at what the order rates look like. What we've been able to deliver out of the factory, reasonable assumptions there. Some reasonable assumptions on backlog reduction. And then we also overlay that with the forecasts that we get from our business units and what they expect from customers in the marketplace. When we put all of those things together, again, I think we feel confident in our guide for the full year.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Okay. But within that, do you -- is Contractor grow for the year? Or obviously, your process is blowing and going and -- versus the low single digit, just to tighten up Contractor.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. So we don't -- I don't -- we don't do that. We give a global revenue outlook for the full company. We don't give specific revenue outlooks by segment.

Operator

(Operator Instructions) And our next question comes from Lawrence De Maria from William Blair.

Lawrence Tighe De Maria - *William Blair & Company L.L.C., Research Division - Group Head of Global Industrial Infrastructure*

You took some price [increase] earlier in the year. Can you update us on what your expectation is for the year and your ability you think to drive further price increases? And especially with respect to Contractor and then into 2024, considering some of the weakness that you've seen.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. So this year, we did increase prices early in the year in some of our segments. And of course, we're still -- we haven't lapped some of the larger increases that we did last year in the third quarter. So overall, price realization, I don't think we have a target for the full year, but I would just tell you it's going to be similar to what you've seen so far this year would be a pretty good gauge for you.

Going into next year, obviously, we're -- the teams are just starting to look at the data now. And in terms of future pricing, we do expect to raise prices again early in 2024. I would expect it to be a more normal year than what we've seen in the past. But what I will say is that inflationary pressures are still there. And so it's not like inflation has gone away. Yes, it's lower than it was and some of the component shortages are better than they were. But we fully expect that we'll need to move our pricing again in early 2024.

David M. Lowe - *Graco Inc. - CFO & Treasurer*

Yes, I would just add to that, that it would be -- I'll speak for myself as a former field guy, it would be our hope -- my hope that we'll take costs and market conditions into account when we do that. And the price adjustments that we would implement at the beginning of the year would be, in an ideal world -- from my perspective would be the ones that would be in place for the balance of the year for the reasons that we've talked many times with you over about giving our channel a real good window into their costs as they sign up their customers and make arrangements with them throughout the year.

However, what we learned last year was with the precedent that we took then that we will always, now and in the future, keep all of our options open.

Lawrence Tighe De Maria - *William Blair & Company L.L.C., Research Division - Group Head of Global Industrial Infrastructure*

That's great. And then as it relates to -- I think you mentioned maybe new products in Process. And how do we balance accretive new products versus start-up costs and marketing costs? Because I believe you also said that margins in Process are sustainable. So can you just walk us through that a little bit?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Well, at any given time in any business, we've got new products coming out in different categories. And of course, they all have different margin rates depending upon which business you're in. And then, of course, the level of demand that we get out of a product in terms of incremental growth is something that we pay attention to. So I think what we've just said publicly is that through a cycle, we expect to grow at about twice what the underlying growth is of the markets that we're in. And a big part of that is coming from the new products that we launch. Not only are we driving new technology in a lot of cases, like I've mentioned the transition from -- to electric pumps from air pumps, a big energy savings.

But in addition to that, we can also realize some pricing and potentially some incremental margin expansion as we're launching new products. So the company has a really nice organic growth profile to it. But -- and it's really driven by our engineering teams and our marketing teams identifying the right types of products to launch. And every single business unit at Graco has nice, robust 5-year product plans that they're executing on a regular basis.

So I'd like to be able to give you a little bit more clarity, but it is a fairly niche-y, complicated business across multiple segments. But I think you should know that things are -- we have a lot of good stuff in the pipeline when it comes to our product ideas.

Lawrence Tighe De Maria - *William Blair & Company L.L.C., Research Division - Group Head of Global Industrial Infrastructure*

Okay. But I guess where I was going with it was -- and whether they would be dilutive at all the margins in Process, but you've also noted that those are sustainable. So -- thank you.

Operator

(Operator Instructions) And I am showing no further questions. I would now like to turn the conference back to Mark Sheahan for closing.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Okay. Well, thank you very much for your participation today on today's phone call, and we hope to see you soon.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.