REFINITIV STREETEVENTS

EDITED TRANSCRIPT

GGG.N - Q3 2021 Graco Inc Earnings Call

EVENT DATE/TIME: OCTOBER 21, 2021 / 3:00PM GMT

OVERVIEW:

Co. reported 3Q21 sales of $487m and reported net earnings of $104m or $0.59 per diluted share. Expects mid- to high-teen constant-currency organic revenue growth for full-year 2021.

CORPORATE PARTICIPANTS

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

Kathryn L. Schoenrock *Graco Inc. - Executive VP, Corporate Controller & Principal Accounting Officer*

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

CONFERENCE CALL PARTICIPANTS

Andrew Edouard Buscaglia *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Bryan Francis Blair *Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst*

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

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

Joseph Alfred Ritchie *Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst*

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

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

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

Walter Scott Liptak *Seaport Research Partners - MD & Senior Industrials Analyst*

PRESENTATION

Operator

Good morning, and welcome to the Third Quarter Conference Call for Graco Inc. If you wish to access the replay for this call, you may do so by dialing 1 (855) 859-2056 within the United States or Canada. Dial-in number for international callers is (404) 537-3406. The conference ID number is 9251859. The replay will be available through 2:00 p.m. Eastern Time, Thursday, October 28, 2021.

Graco has additional information available in a PowerPoint slide presentation, which is available as part of the webcast player. At the request of the company, we will open the conference up for questions and answers after the 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 the purposes of the safe harbor provision 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 2020 annual report on Form 10-K and in Item 1A of 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 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 Kathy Schoenrock, Executive Vice President, Corporate Controller.

Kathryn L. Schoenrock - *Graco Inc. - Executive VP, Corporate Controller & Principal Accounting Officer*

Good morning, everyone. I'm here this morning 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.

Our conference call slides and our third quarter Form 10-Q are on our website and provide additional information that you may find helpful.

Yesterday, Graco reported third quarter sales of $487 million, an increase of 11% from the third quarter of last year. The effect of currency translation added 2 percentage points of growth or approximately $6 million in the quarter.

Reported net earnings were $104 million for the third quarter or $0.59 per diluted share. After adjusting for the impact of excess tax benefits from stock option exercises and certain nonrecurring tax adjustments, net earnings were $100 million or $0.57 per diluted share.

Gross margin was down 110 basis points from the third quarter of last year as the favorable effect from realized pricing, increased factory volume and currency translation were not enough to offset the unfavorable gross margin rate impact of higher product costs. These higher product costs, such as material, labor and freight, decreased our gross profit by $14 million in the quarter with $10 million of this impacting the Contractor segment.

At current cost and volumes, we estimate that on a dollar basis, realized price and increased factory volumes will offset higher product costs for the full year; however, these costs will continue to be decremental to the gross margin rate.

Supply chain constraints, such as logistics capacity and component availability, also had an unfavorable impact on our factory's ability to deliver in the quarter and will likely persist for the remainder of the year. These challenges were predominantly felt in the Contractor segment as this is our highest volume business.

Operating expenses increased $20 million or 19% in the quarter. Sales and volume-based expenses increased $9 million, new product spending increased $2 million and changes in currency translation rates increased operating expense by $1 million in the third quarter. The adjusted tax rate for the quarter was 18%.

Cash flows from operations are $357 million for the year compared to $263 million last year. This increase is due to the improvement in earnings, partially offset by increases in working capital that reflects the growth in business activity. Significant uses of cash are dividend payments of $95 million and capital expenditures of $83 million, including $33 million for facility expansion projects.

A few comments as we look forward to the fourth quarter. Subsequent to the end of the third quarter, Graco entered into an agreement, in which approximately $63 million of pension obligations were transferred to an insurance company through the purchase of an annuity contract. The annuity contract purchase will be funded with existing plan assets. This arrangement is part of the company's effort to reduce the overall size and volatility of its pension plan obligations. We expect to recognize a noncash pretax pension settlement charge of approximately $12 million in other nonoperating expense in the fourth quarter.

Based on current exchange rates, the full year favorable effect of currency translation is estimated to be 2% on sales and 4% on earnings, with the most significant impact having occurred in the first half of the year. Also for the remainder of 2021, we expect unallocated corporate expense to be approximately $26 million to $28 million. The decrease from prior estimates is due to lower stock compensation expense for the year. Our full year adjusted tax rate is expected to be 18% to 19%. Capital expenditures are estimated to be $150 million, including $80 million for facility expansion projects. Finally, 2021 will be a 53-week year with the extra week occurring in the fourth quarter.

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

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

Thank you, Kathy, and good morning, everyone. All of my comments this morning will be on an organic constant currency basis.

Sales in the third quarter grew high single digits, driven by the continued recovery in both our Industrial and Process segments. Contractor North America had difficult comparisons from last year's record third quarter. Contractor demand was solid in Europe and Asia with double-digit gains in both regions.

Heading into the fourth quarter, business remains robust. For the first 3 weeks of October, our global orders continued to outpace billings in all 3 segments. Normally, we don't talk about backlog since most of our business is book and ship. However, given the current environment, which is rife with component shortages and logistical disruptions, backlogs are worth mentioning. At the end of the third quarter, our consolidated backlog was approximately $280 million, which is $25 million higher than what it was at the end of the second quarter, and $121 million higher than our backlog at the end of last year.

Orders are abundant; however, our biggest challenge is getting the materials and components we need and then navigating the logistical challenges inherent in today's environment. We expect conditions to remain this way for a while, and there is nothing unique to what Graco is experiencing when it comes to these issues.

One more thing before commenting on our segments. It's anticipated that our planned pricing actions in 2022 will be enough to fully offset current cost pressures. Our annual pricing cadence has been appreciated by our channel partners and has tangible commercial value in the marketplace.

Now turning to some commentary on our segments. I'll start with Contractor equipment. The residential construction and home improvement markets remain strong globally. On a dollar basis, incoming order rates have been relatively stable and overall demand has exceeded our expectations, given the surge that we experienced last year.

Contractor backlogs are elevated at $46 million, which is up $6 million from June and up $22 million from the same time last year. The overall pace of business, including out-the-door sales, is robust.

The Industrial segment grew at high teens for the quarter, with year-to-date sales exceeding previous high set in 2018. We experienced broad-based growth in all major end markets and reportable regions, which is a nice bounce back from what we faced a year ago.

Consistent with our other businesses, the biggest challenge in this segment is getting product out the door. End user demand is very strong, and we anticipate this to continue for the balance of the year.

Process segment sales grew 21% for the quarter, with year-to-date sales exceeding previous high set in 2019. Similar to Industrial, broad-based growth continues in all major end markets and reportable regions. The recovery of both our lubrication and process pump businesses drove sales and earnings growth for the quarter in the segment.

Moving to our outlook. With demand persisting, we confirm our full year outlook of mid- to high-teen organic revenue growth on a constant currency basis for the full year 2021. While we expect continued headwinds from raw material costs, logistics, component availability in the fourth quarter, we believe we are positioned to deliver a record year.

In closing, I'd like to thank all of our employees, suppliers and distributor partners, who continue to work hard, keeping up with customer demand in this challenging operating environment.

Shannon, we're ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Saree Boroditsky with Jefferies.

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

I guess can you just talk about what you saw on Contractor through the quarter from a demand perspective, just given the significant drop in August? I mean, was there anything outside of the tough comparables? And how should we think about demand going forward given the 8% increase in bookings?

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

Yes, I think, we were favorably pleased with how the order cadence came in throughout the quarter. Of course, we had to put up huge numbers last year. So there was a concern that maybe we'd see a drop off. But you always have some weekly volatility here and there, but overall, [order] (corrected by company after the call) rates throughout the quarter on a weekly basis were actually pretty consistent. And like I said in the opening remarks, at least, so far, it's a really short data point. But over the last 3 weeks in October here, our order rates are actually exceeding our ability to get product out the door. So I think things have remained on pretty solid footing in Contractor.

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

And just sticking with Contractor, there was a pretty steep drop in the margins with higher costs and expenses. Does this higher cost headwind continue into the fourth quarter? And how do we think about margins going into 2022, given the expected increase in pricing that you'll be taking?

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

Yes. So the biggest business we have is Contractor and a lot of the components and input that we have, the things that we're getting pressure on steel, motors, electronics, those types of components really go into a lot of our product there. So they had an outsized proportion of the overall negative impact that we saw in Q3. And I think our expectation is that's going to continue here in Q4. We haven't really seen any kind of a change in terms of what we're getting from cost pressures in all those different categories. So I think it's going to be with us here for a while. Of course, we do implement our pricing in early 2022. And we think that the actions that we got in place will be enough to offset the pressures that we're currently experiencing here today.

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

And should we think about overall pricing in 2022 as being 1.5% to 2% above what you're seeing from a cost perspective?

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

I am not really going to flag what the pricing is going to be right now because we haven't really gone out and communicated it to our channel partners yet, but I think they all are expecting that we're going to be pushing more pricing than what we've done historically on an absolute basis. And of course, we hope to realize some of that into our P&L as well, like we usually do.

Operator

Our next question comes from Andrew Buscaglia with Berenberg.

Andrew Edouard Buscaglia - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

So in your Contractor segment, obviously, margins struggled in the quarter. I'm trying to get a sense when it comes to pricing, I know you -- it sounds like you can offset it and especially as you raise next year as well. But at what point do your customers -- at what point, do you run into a wall where you can't necessarily raise prices where you're starting to get some pushback from those customers?

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

Well, I guess, theoretically, at some point, that could happen. But really, all we're doing is we're more or less trading dollars with the costs that we're seeing and having those go through into our product costs. I think most people in today's environment are experiencing that in virtually everything that they purchase, whether it's a paint sprayer at Home Depot or a dishwasher. I think that the environment is such that people expect it, nobody really likes it, but it's the way we are.

We have some things going for us that are helpful. We have a strong brand. We have the best quality products. We do the best job taking care of the customer when it comes to technical service, support, warranty, all the things that they need to do an effective job with our equipment. So I think from our standpoint, we feel like we're positioned well to be able to get our price increases across the line.

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

Could I add something? This is David Lowe. I've been involved in annual price adjustments at Graco for quite a few years longer than I care to admit. And I think Mark really touched on the fact that we're approaching the especially challenging characteristics that we've been seeing in the market this year with a lot of care, and we've done a number of deep dives on product costs. And they're really trying to balance the points that you're talking about as we understand there is a market and there is some price elasticity at some point. The challenge in CED relates to both the volumes of stuff they buy, which is typically a lot greater than the other divisions. It also relates to a lot of products that are more commonly used in the industrial marketplace, motors, sensors, tires, carts, things like that, that there is a broader market.

So we're trying to, with care, with some deeper analysis, make sure that we do a fair job recapturing some of the costs that are currently penalizing us, but still makes sense to an end-user customer that's making a decision at the point of sale.

Andrew Edouard Buscaglia - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Okay. Got it. That's helpful. Maybe one other one along the lines of margins. So Contractor, I get the dynamics there were -- it's your highest volume business. I was surprised how well Industrial and Process kind of hung in there? So what -- I guess, what gives you confidence you can maintain those margins? What are the dynamics going on in Industrial where you think that, that strong margin performance can continue.

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

Well, they got the same input cost pressures that the other businesses have, but they just don't have as much volume. And of course, the component mix and other things are a little bit different there as well. So I think what you've seen and what you see in this market right here is something that we'd be comfortable saying that we kind of expect to continue to be seeing similar things in the future, at least, in the near-term future. Of course, the wildcard here is none of us really has a good crystal ball when it comes to what these input costs are going to do over the next 9 to 12 months or something like that. But as we sit here today, I feel pretty good about where we're at.

Operator

Our next question comes from Joe Ritchie with Goldman Sachs.

Joseph Alfred Ritchie - *Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst*

So maybe just touching on this whole like price cost equation and for how long the current environment kind of impacts your results, I guess as you kind of think about it, I would imagine that this quarter, you were negative from a price cost standpoint, probably continue to be negative in 4Q. I guess, how quickly do you think you can put through, I guess, pricing in the early part of next year that the equation turns positive for you?

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

Well, I'll make a couple of comments, and I'll let Kathy talk more about the details in terms of how things shook out in the quarter from a price cost standpoint. But my view of it is that when it comes to pricing, we like to play the long game. And we think that our approach of putting prices through on an annual basis really goes over very well in the marketplace with our customers and our distributors.

So you can have periods of time, where we're in right now, where maybe you're not as far ahead as you'd like to be. But in the end, we get our pricing. And if you're a long-term shareholder and a long-term investor in Graco, things will shake out in the long run. And again, I think it has a lot of benefit in the markets that we're in. But I'll let Kathy talk a little bit about -- more about what we actually saw in the quarter when it comes to price cost.

Kathryn L. Schoenrock - *Graco Inc. - Executive VP, Corporate Controller & Principal Accounting Officer*

Yes. I think when we look at price cost in the quarter, if we look at what we realized in price, along with the favorable volumes that we had mainly across the Industrial and Process segment factories, it did offset on a dollar basis in the quarter. It was pretty neutral, but it was decremental to our overall gross margin rate in the quarter. And that we project will continue into the fourth quarter.

Joseph Alfred Ritchie - *Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst*

Okay. Helpful. And I guess just maybe, Kathy, on Contractor, you guys called out the 600 basis point impact from product cost and channel mix. I imagine that the negative price cost situation is sitting in that number. When I think about who you're selling into and selling into big box being a little bit more difficult customers, I guess, like, is it reasonable to think that you're going to be able to go price cost positive in -- some time in 2022 in Contractor?

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

So your question upfront on the decline, I think, is accurate, that a lot of that was due to the pricing cost pressures that we were talking about in CED for Q3. When it comes to how we're going to do with the home centers or our big channel partners and pricing and can we get it to stick and get it realized, I would just tell you to look at our history. And we have been able to do that historically. I don't think anything has really changed. Conversations happen all the time. We have good partners, they understand. We give them facts and they're generally reasonable in those discussions that we have.

Joseph Alfred Ritchie - *Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst*

Okay. That's great to know. Maybe one quick question also on just the demand environment. There's a lot of discussion right now around making sure you have enough inventory on hand, maybe over ordering in the near term just to try to meet demand levels. Can you maybe just talk about what you guys are doing to make sure you've got your inventory levels where they need to be to try to keep up with what seems to be a pretty robust backdrop?

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

Yes. We've been doing everything we can for quite a while. We've been very aggressive in buying some of the components that we knew were going to be problematic. And in some cases, we got ahead of the curve. But in other cases where we really didn't see the huge increases in demand coming, we probably were a little bit behind where we would normally like to be. But Obviously, we've got a balance sheet that's unlevered, and we have a lot of cash to deploy. So the inventory and purchasing it and making good decisions about what we buy and having enough on hand has never really been a problem for us.

Our biggest issue really is that when you think about Graco, we've got, I don't know, 60,000 or 80,000 SKUs. And among those SKUs, we got multiple components and parts that make up each one of them. And all you need is like a little fire on one of those components. And all of a sudden, everything gets slowed down and delayed. So our teams are working really hard. I have a lot of confidence in our purchasing group and our manufacturing group that they're prioritizing appropriately, but it is pretty tough right now.

I don't know, David, if you have anything else you'd like to add?

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

Yes. I think that we're willing -- historically and even in this environment, willing to invest a bit aggressively in certain categories of inventory, including the mythical golden screw that you have to have to ship the unit complete is, I would say, this is a general comment, but especially true in our Industrial and Process markets that there isn't really a great deal of stocking going on at the channel. And I would say over any reasonable short to intermediate term, wholesale equals retail.

And so we know that when a distributor puts an order of any substance, especially for units on Graco, they've made a commitment. They need to get products into the market for a real need on the part of an end user. And we think that's a -- we think that that's an important part of our value proposition. And I think it's one of the reasons why that the partnership that Mark alluded to with the channel partners overall very strong and have lasted over a long time. Our delivery levels have slipped, I would say, by historical standards. We're not proud of them. But what our channel tells us formally and informally, we're doing as well or better than other partners that they work with that round out their line card.

Operator

Our next question comes from Matt Summerville with D.A. Davidson.

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

Quick question. Just back to pricing, assuming what you're going to go out within '22 is going to be materially or meaningfully above trend line. Would you expect that to drive any sort of prebuy on the part of your customers given the magnitude may be a bit unprecedented, at least relative to what you've had to go out with historically? And in that question, I guess, I'm leaning more towards the Contractor business as opposed to the other 2 segments.

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

Yes, it's a good question. It's something we've talked about internally, Matt, and we've got the radar up. We sort of know what people order on a normal basis, and we'll make sure that we flag it with a distributor if they look like they're doing something like that and, of course, with our large retail partners. I think right now, all they really care about is us getting product out the door. I don't think they're really playing any games on pricing. And I don't think that they will either. I think that they're good partners, and we have open communication with them. I'm sure there will be things that pop up, but I think we can handle them.

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

And then just with respect to the impact from material shortages overall in the third quarter, have you been able to frame up how much revenue was maybe missed, for lack of a better word, or slipped into a future period because of the general inability and, again, this isn't just a Graco thing obviously, but the general inability to just get product in the door so you could actually get it out the door?

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

Really hard to know. I mean we haven't had anybody canceled orders. So I guess I'd go back to the backlog and just look at, where we built $120 million of additional backlog this year over where we were at at the beginning of the year, and all of that really is due -- the vast majority of that is due to the fact that we are having trouble getting product out the door. It's a big number.

Operator

Our next question comes from Bryan Blair with Oppenheimer.

Bryan Francis Blair - *Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst*

If we could spend a little more time on the headline risks of today, is there any way to quantify the top line hit in the quarter from material shortages, logistics challenges, et cetera? Obviously, most pronounced in Contractor, but any detail across segments would be helpful.

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

Not really sure I understand other than the backlog comments that I just made. It's hard for us to really gauge how much the top line would have been different if we had a perfect supply environment where we got everything in the door and we're able to ship it. I think we're that good at fine-tuning the math at this point. Safe to say, though, that results would have been a lot different and better have we been able to get everything that we needed and get them out at the time that we need them to.

Bryan Francis Blair - *Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst*

That's fair. And the backlog commentary does help in framing that. With regard to Contractor, is there anything in terms of the macro backdrop, at least assuming supply chain issues can be resolved that you see as a major risk to your greenlight outlook? And that's irrespective of comps. We know they're challenging for the time being, just thinking about underlying trends.

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

I think it's pretty good. I mean we talk with the group regularly. We just had a meeting with them a couple of weeks ago where we went through some of the external data, the markets that we serve, the residential, the commercial side is -- commercial is firming up a little bit. Residential is still pretty hot. Remodeling activity is good. Housing starts are good. So I don't see any real negatives in the future. No storm clouds on the horizon, I would say, from our viewpoint.

Order rates are good. The levels of inventory at our big channel partners are not where they want them to be, which is probably a favorable thing. They still would like to see their own inventory levels higher than where they are today. So I don't anticipate any major detrimental inventory actions here between now and the end of the year or into the first part of next year. So I think we're pretty bullish on Contractor.

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

Yes. And if I could add, I've been impressed with the strength of the Contractor business in the regions outside of North America. They exhibited good growth in the quarter and good performance year-to-date. And as Mark alluded, in talking with the managers in those regions, I think that the general view is that sort of notwithstanding the headlines and the challenges around the world, people demand for these products and are feeling good that it's going to follow through in the current business cycle for the time to come.

Bryan Francis Blair - *Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst*

Okay. Good to hear. And Mark or David, perhaps you can provide a quick update on the M&A environment, Graco's deal funnel and confidence level and being able to deploy some of your dry powder over the coming quarters?

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

Yes. So I would say that the current environment is pretty similar to what we talked about last time. It's still kind of challenging from a valuation standpoint. I think the low interest rate environment is really driving that, and I don't really see a whole lot of movement there, here in the near term. But nonetheless, we are committed to having good strategic acquisitions as part of our growth profile.

I've been spending a fair amount of time with my team on the topic. I think that we all recognize that we have some opportunities there that we would like to pursue and have M&A be a little bit more active component in our overall growth. We're looking at doing some things structurally to maybe help fortify that a bit, and we'll see how it plays out. I don't know, David, if you got any other comments?

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

I think that we're certainly committed. And with that said, we're mindful building on Mark's comment of what the current environment is like. We have -- in my prior job, I participated in a couple of projects in the Process space that -- where transactions that subsequently got done and won by a large public company. And the multiples remain daunting, and the desire for growth, the desire to build a business in some of these interesting and niche markets is appealing to Graco, but not at any price.

And I believe that Mark and the entire management team will continue to insist that we take a -- yes, we want to grow and we want to be strategic in how we think about the business, but having a good ROI profile was going to be central to projects that we take across the finish line.

Operator

Our next question comes from Jeff Hammond with KeyBanc Capital.

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

Just wanted to go on Matt's question a little bit differently on price. How have you seen your competitors handle price this year in terms of -- did they go once like you or are they going multiple times? And if they kind of acted differently, does that drive any kind of share shift or behavior change?

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

Yes, that's something I really pay a lot of attention to. Of course, anecdotally, I'll have some people send me notes once in a while that so and so is raised their price this amount. So I'm aware of it. I think it's happened in our end markets with some of our competitors where they have raised prices midyear.

Our approach has been really consistent. We believe in it. So what others are doing really doesn't impact my thought on it a whole lot. Again, I like to play the long game on this one and I like to put them in and then I want them to stick. And the concern is that if you start doing midyears or surcharges or things like that, then it makes the conversation a little bit harder in terms of having the pricing that you have be permanent or sticky in nature. So that's where my head is at.

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

Okay. And then just on Contractor, I mean, I guess the thought was stay at home was a big thing last year. Any kind of feedback on that waning and as things kind of reopen? And then just around kind of all the paint supply and negative commentary there, is that kind of impacting order patterns or anything?

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

No. We haven't seen it in our data. So we try to be transparent and give you the actual numbers in terms of what we're seeing in the business. So when I look at order rates and across multiple regions and across the 2 big product categories that we have, again, they've been pretty consistent, which, as I said in my opening remarks, is actually a positive development for us because we were concerned that there is this risk about working from home, being working on home and then having that have an impact on our results here, but we just haven't seen it. So things appear to be in really good shape.

Operator

Our next question comes from Deane Dray with RBC Capital Markets.

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

Just start with a comment on pricing, not a question, is, I think if you just have to replay any of the second half 2018 conference calls when the biggest issue we were dealing with was Chinese tariffs. And just the exact same questions and the same answers about waiting for the annual price increases, and we've seen it come through time again. So applaud you for your consistency, and we've seen it prove out over the longer period. So that's the comment, but now I've got some questions.

All right. So in -- and I really appreciate all the specifics on price cost and supply chain, but I was a little curious maybe you can get some more color on labor because when you roll the clock back a couple of quarters, you all benefited from having your campus manufacturing, you shifted workers over to Contractor and that kind of filled the gap. But you've cited labor and labor costs, is this different from your labor flexibilities? Just is it -- you have any trouble finding workers and having to pay them more? And some color there would be helpful.

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

Yes. I think the labor market for us has been pretty good. We're able to get people that we need. We're a good shop. We take care of our people. People like working here. We've been able to flex some of this increase in demand that we've seen by bringing some temporary folks in. We like that approach because it's almost like a try before you buy to a certain extent. If we like somebody, we usually make them a permanent employee within a reasonably short period of time.

We'll keep our eye on wages and benefits and all that stuff as we always do. We do a lot of detailed work around this. We benchmark a lot of our local peers and competitors in all of the markets that we participate in, whether that's here in Minnesota or in South Dakota or Ohio or Pennsylvania here in the U.S. and of course, across the globe. And our philosophy is that we want to be competitive when we look at the full package, which includes not only like hourly wages, but benefits and those types of things.

So I am -- we're keeping an eye on the labor market. Obviously, there's a lot of headline stuff. But at least for Graco, I think that given that we're a good company and we take care of people, it hasn't really been a problem.

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

Yes, I would add that in terms of the in-house labor situation, it has been, I'd call it, a relatively neutral to even positive situation for the reasons that we've alluded to, maybe in part because in the markets that we're in, they're not necessarily big famous manufacturing markets. It's a diversified population base, and we do have a really good long-term pipeline of bringing people into the company in frontline manufacturing operations. And it is a try before you buy. And very frequently, those people become permanent employees with the compensation and benefits that we offer.

I have heard talking with some of our sourcing people that when they talk about some of the key components that were running down, it is fair to say that some of our vendors, I think, are suffering from some degree of labor stress along with probably getting raw inputs that they're looking for. So it probably -- it plays some role in the overall dynamic, but I would be thinking at the moment more about vendors than I would be about our in-house capabilities.

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

That's good to hear. Let's pivot over to Industrial and Process. And if you think back a couple of quarters ago when there were questions, what happens when work-from-home begins to slack in, which you really haven't seen that, but at least the tough comps are here, the expectation was that Industrial and Process would start to recover meaningfully, and it looks like that's happening now. So just highlight for us, which are the key end markets and/or regions in both segments are really beginning to move the needle there?

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

Yes. So on the Industrial side, I mean, we have seen a really nice rebound in pretty much all product categories there. So things like our liquid finishing business, our powder coating business, our sealant and adhesive equipment business and our protective coatings equipment businesses have all been really good for us this year. And that has played out both here in North America and really across the regions.

On the Process side, similar story, I would characterize good solid demand and growth across all the major product categories. So process pumps, our environmental business, our semiconductor business continues to do very well. And our lubrication business has actually rebounded quite nicely this year as well. So it's kind of across the board. It's across multiple geographies. And as we thought would happen last year, these things come back and they come back pretty quickly and they usually run for a while once they do. So it's been good.

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

Yes. The only thing I would add to that is, yes, the geographic strength of both businesses has impressed me. Europe has been -- Europe has recovered nicely, which was good to see after a slow 2020. And Asia has been very dramatic, especially in the Process space the last couple of quarters and can't extrapolate endlessly into the future, but the team there is feeling good about the current environment.

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

Got it. And just last one and appreciate all the color on the backlog and the significance of the backlog. Do you expect at this point to be building backlog in the fourth quarter?

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

Well, as I said, for the first 3 weeks of October, we are. Our bookings have actually exceeded our billings. So I don't know how all that's going to play out, but that's the state of the union right now.

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

Are you doing any of these half completed products and aligning them up in the hallways? Or is that just waiting for the golden screw, as David said?

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

We do some of that. I was up in CED not that long ago, and there were a bunch of sprayers on their floor waiting for wheels to come in. But for the most part, we try to not have a bunch of stuff laying around, and we're pretty good about getting stuff put together when we actually get the products we need in here.

Operator

Our next question comes from Michael Halloran with Baird.

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

So 2 ones here. One, a little bit of a follow-up on that question. You kind of already answered this for the Contractor piece. But are there any cracks that you're seeing in the Process and Industrial side? Obviously, orders are really good, ubiquitously good geographic commentary. But any areas of concern at this point?

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

None that are meaningful. I mean, like I said, I think it's kind of across the board, across all the categories and across all the regions. So I don't want to look at the world with rose-colored glasses, but right now, things look pretty good.

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

Good. And then just to put a ball on all the price cost headwinds, commentary, et cetera, is the implication here that when you get to next year, all else equal, that you're going to see more normalized incremental margins through the portfolio? Or are there other headwinds out there that you think can maybe soften what those incremental margins look like?

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

I don't think there are any other headwinds other than the cost issues that we're dealing with. And again, we don't have a good crystal ball to know where things are going to wind up. But based on the math that we've done, the homework we've done, the analysis by segment and by business unit, we think our pricing actions are going to be able to take care of it for us.

Operator

(Operator Instructions) Our next question comes from Walt Liptak with Seaport.

Walter Scott Liptak - *Seaport Research Partners - MD & Senior Industrials Analyst*

I've got a follow-up. So I wanted to ask first about -- you mentioned the lube business starting to pick up again. It's been a couple of years. I wonder if there's a recapitalization cycle yet? Is there visibility on any large programs from some of the service providers?

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

No, I'd characterize it as just a general pickup in demand, nothing special there in terms of big customers.

Walter Scott Liptak - *Seaport Research Partners - MD & Senior Industrials Analyst*

Okay. And then when you guys were talking about Contractor, I think there were some prior questions about that we're kind of getting to the DIY versus the pro market. And it was so strong over the last year. Do we know yet if it was the pro painter or the DIY or a combination of it? As you look at your different channels, can you see any differences between the box stores versus the pro paint channel?

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

In terms of like what we saw in Q3, I think North America was down, you saw that. I think that the declines were kind of similar in both of those categories from a percentage standpoint.

Walter Scott Liptak - *Seaport Research Partners - MD & Senior Industrials Analyst*

Okay. All right. Fair enough. And since the Contractor has been really good coming out of the bottom of the pandemic, should we expect that maybe there's going to be more volatility in terms of like unit volume growth over the next year? Are those comps tough enough where -- or is there something that could pick up internationally that could keep that business growing?

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

We like it. We think the macros are really solid. None of us really knows what's going to happen. But for now, when I just think about demographics and all the other things that we mentioned with housing starts and the absolute level of activity there, I think, we're in a good spot.

Operator

If there are no further questions, I will now turn the call over to Mark Sheahan.

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

Okay. Well, thank you very much again for your participation today, and we look forward to chatting with you down the road.

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

Thank you.

Operator

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

REFINITIV