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Q3 2020 Graco Inc Earnings Call

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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, may be so by doing 1 (855) 859-2056 within the United States or Canada. The dial-in number for international callers is (404) 537-3406. The conference ID number is 8334616. The replay will be available through 1:00 p.m. Eastern Time, Wednesday, October 28, 2020.

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 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 2019 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 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. I'm here today with Pat McHale and Mark Sheahan. Our conference call slides have been posted on our website and provide additional information that may be helpful.

Sales totaled \$439 million for the third quarter, an increase of 10% from the third quarter last year and an increase of 9% at consistent currency translation rates. Acquisitions added 1 percentage point of growth in the quarter. Net earnings totaled \$114 million for the quarter or \$0.66 per diluted share. After adjusting for the impact of excess tax benefits from stock option exercises and other nonrecurring tax items, net earnings totaled \$102 million or \$0.59 per diluted share.

The sale of the company's U.K.-based valve business, Alco, was finalized in July of 2020. Impairment charges totaled \$300,000 in the quarter and \$35.2 million year-to-date. No additional impairment charges are expected from the sale.

Our gross margin rate was up slightly compared to the third quarter last year. Improved factory volumes, lower material cost, the favorable impact of currency and realized pricing more than offset the unfavorable effect of product and channel mix, as sales in the Contractor segment increased, while sales in the Industrial and Process segments declined.

Given the growth in certain products in the Contractor segment, particularly products for the home center channel, factory capacity is strained. We've managed the increase in demand levels by investing in additional production lines, moving employees from other factories, increasing contract labor and working overtime. We are making progress towards meeting current demand levels and continue to monitor the situation closely.

Operating expenses in the quarter were comparable to the third quarter last year as reductions in volume and earnings based expenses offset higher product development costs. The reported tax rate was 6% for the quarter, down 7 percentage points from last year. On an adjusted basis, the rate in the quarter was 16% as compared to 20% in the first half of 2020. The decrease in the rate from the first half is due to the impact of lower foreign earnings and earnings in countries with lower tax rates than the U.S. rate.

Excluding the effects from excess tax benefits related to stock option exercises and other onetime items, our tax rate is expected to be 18% to 19% for both the fourth quarter and the full year.

Cash flow from operations totaled \$263 million year-to-date as compared to \$299 million last year, primarily due to lower operating earnings and increases in working capital. Capital expenditures totaled \$46 million year-to-date as we continue to invest in manufacturing capabilities as well as the expansion of several locations. For the full year 2020, capital expenditures are expected to be approximately \$85 million, including approximately \$50 million for facility expansion projects.

A few final comments looking forward to the rest of the year. On Page 11 of our slide deck, we note our 6-week booking average through October 16 by segment. I would point out that there is an inherent volatility in order rates reflected in such a short period of time. Nonetheless, we thought it would be helpful to provide current order rate data, so you can see what we are experiencing heading into the fourth quarter.

Similar to the last 2 quarters, our Industrial and Process businesses are still experiencing declines from a year ago, although less severe than they were in Q2, while our Contractor business remains strong.

As the U.S. dollar continues to weaken, the effect of currency translation will continue to be favorable. At current rates, the impact would have been negligible on sales and earnings for the full year and have a favorable impact to the fourth quarter of approximately 2% on sales and 3% on earnings assuming the same mix of business as the prior year.

I'll turn the call over to Pat now for further comments.

Patrick J. McHale Graco Inc. - President, CEO & Director

Thank you, Kathy. Good morning, everyone. All of my comments this morning will be on an organic constant currency basis. Despite the unusual operating environment, we achieved record quarterly sales, driven by the strength of the North American construction market and a gradually improving Asia Pacific region.

The Contractor segment single-handedly accounted for the company's sales growth for the quarter. I want to thank our employees who've been working tirelessly to meet this unprecedented demand, a special thanks to the management, shop floor and temporary employees who have been working incredibly long hours, along with all the employees from other Graco factories who relocated to the Contractor factory to assist. It's been Graco team work on full display.

Contractor grew in all regions during the quarter as customers have responded favorably to our new product offerings, residential construction activity has been solid and the home improvement market has been robust.

The Industrial segment declined low single digits for the quarter, although improved from Q2, business activity remains muted across

most of our major end markets. Access to Industrial facilities is limited, factory demand in many industries remains well below last year and appetite for capital spending is constrained. Some specific areas showing signs of life, such as spray foam, electronics and battery, aren't large enough to offset declines elsewhere.

Asia Pacific improved during the quarter, although it was up against an easier comp from last year, as you'll recall, that Industrial demand softened in the second half of 2019. Reduced spending on travel, sound discretionary expense management, good factory performance and solid price realization resulted in improved Industrial operating earnings for the quarter despite the lower sales.

The Process segment declined low teens for the quarter and for the year. Demand in this segment varies significantly by end market with growth in our semiconductor and environmental businesses, more than offset by declines in our diaphragm pump and lubrication businesses.

While it's difficult to predict near-term economic conditions, we expect things to remain challenging for the short term. As we've done throughout 2020 and through prior downturns, we intend to continue to fully execute against our strategies. We're full steam ahead on our new product development initiatives, continue to make solid ROI capital investments in our factories, are adding channel globally and are focused on finding profitable growth opportunities in attractive niche markets, whether organically or by acquisition.

We've kept our workforce intact, morale is good, and we expect to do well as economic conditions improve.

Operator, we're ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first 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 to start off with an observation that Graco's concentration of manufacturing purposely in Minnesota as opposed to spread all over the globe, like many of your manufacturing counterparts, really gives you the option and the flexibility this quarter as you've explained that you shifted employees around. So I really like seeing that.

But here's the question. What's your take on the monthly -- the cadence of monthly slowing? Is this segment volatility? Are there comps issues? Because we've been seeing a steady -- within the Industrials monthly improvement, but there's a bit of slowing in your numbers here. I'd love to get some context.

Patrick J. McHale Graco Inc. - President, CEO & Director

So I wouldn't read too much into it. As we've talked about in the past, we have variability even quarter-to-quarter in our Industrial business as we've got a fair number of projects that can influence the timing of sales and the timing of incoming orders. I think it's more just reflective of the fact that you should be thinking that the industrial activity is still challenging and that going into the fourth quarter, we're not seeing the kind of strong rebound in industrial like we're seeing -- like we saw in our Contractor business here in Q2.

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

That's helpful. Just on that point, what's your expectation of this contractor strength? I mean, we really have seen this work from home, work on home mega trend but can you address the sustainability of this?

And then the 2021 outlook in terms of new product introductions, are you still going to do your pricing increase? Typically, you would get that in the first quarter, but some color there would be helpful.

Patrick J. McHale *Graco Inc. - President, CEO & Director*

Yes. In terms of our own internal initiatives, I think it's going to be business as usual in terms of pricing and cost control, investments in our factories, new product launches, we haven't went and cut anything that's going to be an impact on us in 2021. It's full speed ahead. So I don't see internally any real changes there.

The external environment for Contractor looks okay going into 2021. Obviously, we're putting up really huge numbers right now, and there's probably some influence on pent-up demand from that slowdown that we saw in that kind of April, May time frame. But it's hard to ascertain what the magnitude of that is. And I think we feel pretty good about the external data points that we're seeing in terms of the construction market going into 2021.

So hopefully, that business is going to hang in there and keep carrying us.

Operator

Our next question comes from the line of Mike Halloran with Robert W. Baird & Company.

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

So a couple of things here. One, CapEx side, obviously, you guys did a pretty well-timed in retrospect build-out of the contractor facilities. What's the plan from here? You guys are running pretty full speed? You're doing a lot of maneuvering just to make sure you can meet that demand. Is there incremental CapEx that needs to happen? Or is this we can float around for a while until we get a better understanding what the core demand looks like throughout all the 3 segments?

Patrick J. McHale *Graco Inc. - President, CEO & Director*

So CapEx is done here on, I'll call it, a decentralized basis. So anybody that comes in with a good idea that's gotten ROI is going to get CapEx. So if we just say, look, machines and other factory investments are going to be more or less business as usual, perhaps a bit muted in some areas because demand is lower. And we just talk about bricks and mortar. We do have a couple of projects that are teed up. Those are reflected in the CapEx spending outlook that Kathy gave for you.

But given the size of the company and our expectations that we continue to grow, I think adding some bricks and mortar on a fairly regular basis here and there around the world is going to be part of the program.

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

So a clarification then from an earlier question. The Industrial cadence through the quarter, I was assuming there was going to be some pent-up demand in the early part of the quarter that probably washed through later in the quarter. Is there a feeling internally there that you've reached some level of stability at a bottom? I mean it's still choppy month-to-month, but at least kind of within a band.

And then secondarily, how are you guys thinking about mix in the Industrial segment on a forward basis?

Patrick J. McHale *Graco Inc. - President, CEO & Director*

It feels to me like we're not likely to return to the kind of numbers that we saw in Q2. However, there's still a lot of people working from home, and I think there is going to be less capital spending on the Industrial side until all the engineers get back to work and things get back to normal. So I think our view is, while we've probably seen the lows. It's not back yet, and I think it's kind of undetermined when it is going to come back, especially given the fact that the COVID increases in Europe are resulting in some more work-from-home kind of orders that are being implemented here in the last few weeks in some of the geographies, and that's maybe likely to continue here for a while.

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

And then the next question?

Mark W. Sheahan Graco Inc. - CFO & Treasurer

I don't see any major changes in the mix, Mike. I think last year in Q4, we did have some project business that shipped that we probably won't see again in Q4 of this year. And so that could have, obviously, an impact on the top line as well as our profitability. But overall, I think Pat's right. What we're seeing in terms of incoming order rates and mix has been fairly consistent here for the last few months.

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

Great. Well, appreciate it, very good execution, guys.

Operator

Our next question comes from Jeff Hammond with KeyBanc.

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

Just on Contractor, maybe just speak on what you're hearing anecdotally about the commercial contract. I know there's a lot of concerns about kind of the nonres cycle, and it seems like a lot of the a lot of the drivers, this stay at home and residential?

Patrick J. McHale Graco Inc. - President, CEO & Director

Yes, it's going to be interesting to see how this all plays out. My view on it is, is that the office space is probably going to be pretty dampened, particularly in the big cities going forward. However, warehousing and other sorts of segments are looking really strong. There's also some talk about potential for conversion of some of the office buildings and some of these metros into more housing units.

So there's a dislocation happening here. I think part of it is all going to depend on if there's a vaccine and how good is it and when is it, I think that picture could look different. If there was a good vaccine early in the beginning of next year, I think it could look different, if there's a half baked vaccine that's available later next year. So I think it's -- everybody's going to have to kind of watch and we're going to have to figure this out as we go.

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

Okay. And then can you just speak to what you're seeing in Asia? I know you were kind of seeing a big slowdown and challenges around some of the trade tariffs. And it seems like you're starting to see growth there. I don't know if it's just easy comps or if you're starting to see some real demand uptick.

Mark W. Sheahan Graco Inc. - CFO & Treasurer

Yes, Jeff, I'd say it's definitely improved from what we were seeing earlier in the year. You're right, we had a really -- fairly easy comparison in Q3 versus what we did last year. We were down close to 30% in Q3 last year, so it was an easier comp. And the growth rates that we're seeing, we're not seeing a hockey stick bounce back here. We're really kind of seeing some underlying growth and improvement, and we're hopeful that, that will play out here for the rest of the year and put us in a decent spot as we get into next year, of course, all dependent upon whether future lockdowns happen, that type of thing.

Operator

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

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

Just one for me here. Maybe just a little bit more end market color on the industrial business. You mentioned a couple of the brighter spots. I'm curious as to what end markets are still maybe among the hardest hit? What might be showing signs of inflection? And then maybe a little more specificity around what markets did -- are driving that improvement that Jeff was referencing with respect to Asia?

Patrick J. McHale Graco Inc. - President, CEO & Director

Yes, I'll make a couple of comments, and then I'll let Mark chime in. I mean, obviously, aerospace is a nice market for Graco, and that's pretty much on its back. Automotive has been challenged. I think the rebound in automotive is going to depend on some other factors. So we're going to have to watch and see how quickly the automotive market around the world can recover. Oil and gas, while it's not directly

in our Industrial space, definitely influences a lot of other industries and oil and gas is challenged right now. So those are some big ones that certainly are negative.

When I kind of step back and look at the big picture on the general industrial side, it really seems like most of the markets that are -- for us that are true implant. If it's a factory and it's running, it's not easy to get into. They don't want visitors. A lot of their technical staff may be working from home. And I think some of that really needs to clean up before we start testing new highs again.

I'll let Mark chime in with any other end market comments he wants to make.

Mark W. Sheahan *Graco Inc. - CFO & Treasurer*

Yes, I agree 100% that until we can get back into the plants. It's going to be tough sledding for our industrial group and our process group, especially in the diaphragm pump side of that business. The markets that we called out, we called out spray foam. Obviously, that's more of a contractor-based market. So we are seeing some growth there. We also called out battery, and some of that activity is happening in the Asia Pacific region. We're getting involved in some projects in and around that space. I think we mentioned that the growth that we're seeing, though, isn't quite enough to offset some of the declines that we're experiencing in other parts of the business.

Asia, overall, as I said before, is better, but again, it's slow growth, it's not rapid growth. And hopefully, that continues here for us throughout the rest of the year.

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

And then maybe just one quick follow-up. Maybe speak to actionability with respect to your M&A pipeline and if you've seen any change in valuations, multiples, et cetera, in the last few months?

Mark W. Sheahan *Graco Inc. - CFO & Treasurer*

Yes. I'll just say that we need a couple of things to happen on the M&A side for us. One is that we have to find high quality businesses. And right now, I don't think we're really seeing a whole lot of that. We've seen a few that are more fixer uppers and maybe a couple that are benefiting from the pandemic, which may not be sustainable.

So -- and then secondly, we are very disciplined. We need to see pricing that rewards our shareholders. And with this depressed interest rate environment that we have and low taxes and things like that. It's really driven valuations up into a zone where we find it pretty difficult to generate the kinds of returns that we like to see.

For example, when we invest in our factories, we feel very confident that we're going to get good rates of return on those investments or if we invest in our product development projects, we also feel like we're going to get good rates of return on those projects. And we still believe that and our investors are of the mindset that they want us to deploy capital smartly. And I don't really see that changing going forward here. So let's hope that maybe those dynamics move in our favor. But for right now, it's pretty tough.

Operator

Our next question comes from Saree Boroditsky with Jefferies.

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

Congratulations on the quarter. The 6-week average booking rate for Process was down 3%. I believe that implies slightly positive results in October. So could you just provide some color on the end markets and geographies that are driving this improvement? And do you think this is sustainable?

Patrick J. McHale *Graco Inc. - President, CEO & Director*

Yes. Again, it's a little bit like our industrial business. It can -- a 6-week run rate is, I would say, an indicator, but it's certainly not a predictor in any fashion. And what we've seen is we've seen some of the end markets, for example, our White Knight semiconductor business, has been doing well. We've got -- our environmental business has been showing some growth. We see opportunities on the sanitary side where food production is still strong.

The real industrial, oil and gas, classic process business along with our lubrication equipment, which focuses heavily on things like mining, oil and gas and car dealerships that's pretty depressed. So it's a little tough to sort out. As I mentioned, it's a mixed bag, and we do have growing businesses in there, and then we have some that are in some really challenging environments. So we'd like to see an overall improvement in the economy, so that the growth stories that we have aren't washed out by the negatives.

Saree Emily Boroditsky Jefferies LLC, Research Division - Equity Analyst

And then just back on Contractor, obviously, orders remained very strong. But could you just touch on how we should think about the comp for next year? Would you expect sales to decline in the back half of 2021, excluding the extra week?

Patrick J. McHale Graco Inc. - President, CEO & Director

Well, we never expect sales to decline. So I'm the last guy that you're going to get sitting here in October saying that I'm expecting a sales decline in the last half of next year. We've got an active group up there. They're very strong in product development. We've got a strong channel. We have growth opportunities outside North America. The data going into 2021 looks pretty decent for us. So I'm hoping that we're going to put up another W in the column for a Contractor for next year.

Operator

Next question comes from Bryan Blair with Oppenheimer.

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

Pat, you've mentioned for a while that the team is banked on a return to more normalized 1.5 million housing starts. Obviously, years of lower build rates. I'm just curious how the pandemic and its impact on suburban sprawl effects your views? We're obviously approaching that level now and demand seems to be quite robust.

Patrick J. McHale Graco Inc. - President, CEO & Director

Yes. I don't really believe that in the short-term here, the pandemic has influenced the construction market to the extent that it's changed people's -- the amount of paint sprayers, people are buying. I think really that's more of a question what happens over the course of the next 2, 3, 4 years. And does this suppose an exodus to the suburbs really materialize, and then they have to get land and they've got to get all that kind of stuff approved and roads and then the contractors have to start building.

So I think that's more of a forward guess or bet that people are going to make. And again, I'm still in a wait-and-see mode. Because I think that if things are resolved quickly, the world might go back to normal faster than people think. And if they drag on, then some of these changes that we have could potentially go on and become permanent changes to society. So I don't know. We're not going to change our strategy right now for either way. We're launching new products and what's going to happen with that whole part of the world is, I think, a big question mark.

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

Okay. Appreciate the color. And Mark, given the surge in Contractor demand, how close is the business requiring meaningful brick-and-mortar CapEx? I imagine the team is thankful for the recent expansion that you put in place.

Mark W. Sheahan Graco Inc. - CFO & Treasurer

No, we're in great shape in Contractor. That factory is up and running, and we're glad that we made the investments last year, gave us the space that we needed. And in hindsight, we're probably a little bit lucky that we did it when we did it, to be honest with you, but we feel really good about capacity up there right now.

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

Okay. Excellent. And one kind of clarification point with Alco out of the portfolio, what's your remaining exposure to oil and gas, at least on a direct basis? I think it was only 4% or 5% of sales previously.

Mark W. Sheahan *Graco Inc. - CFO & Treasurer*

Yes. It's pretty small. I mean, we got a little bit of exposure in our Industrial business, where we're putting protective coatings on pipelines, and we get involved in offshore oil rigs and those types of things. And then we also have an internal initiative going on here, we've developed a line of products that are designed to go into that end market, too. It's pretty small.

And then we had acquired a business a while back called High Pressure Equipment in Erie, Pennsylvania, and they also sell some high-pressure valves into oil and gas. But our exposure is pretty miniscule now at this point.

Patrick J. McHale *Graco Inc. - President, CEO & Director*

I would say that when oil and gas is busy, lots of other businesses get busy, and there's a pretty nice trickle down effect. But then that's indirect, and it's hard to measure. But over the years, definitely, we benefit from a strong mining and oil and gas market.

Operator

Our next question comes from Walter Liptak with Seaport.

Walter Scott Liptak *Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst*

I wanted to ask about the quick lube market. And some of the miles driven has come back. So I kind of thought maybe you might start to see some of those quick lube spending. What are you hearing from those customers? Is there a project funnel for replacement or any new store openings?

Patrick J. McHale *Graco Inc. - President, CEO & Director*

Yes. So the -- I'll say the project list is looking a little bit better as we look forward. I think we're not going to be getting worse from this point on. But there's still, I think, hesitancy to make CapEx investments in that space right now. And until I actually see the orders coming in the door, I'm not going to get overly excited by a little bit better, I would say, quote list.

But if you want to look at it from an optimistic standpoint, our quoting looks a little bit stronger than it has. And so maybe we'll see some recovery there.

Walter Scott Liptak *Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst*

Okay. Great. And then the Industrial end. If I'm not mistaken, with industrial, you guys sell quite a bit through kind of distribution reps and engineering rep groups. And is that where the issue is, where they're having trouble getting out and working with engineers and getting down to the factory floor? Because even in Industrial, there should be a nice ROI on replacing the equipment with the new products. Is it you guys being able to get interest at the rep groups and there's something that you can do to get the rep groups back out into those plants or pushing to get back in?

Patrick J. McHale *Graco Inc. - President, CEO & Director*

Yes. So we -- generally, in Industrial, we sell, not direct. We do have some segments that we sell direct. But we don't really use rep groups in our Industrial. They are our own salespeople, and then they manage a territory, and they set up and they manage the distribution channel. And then we make a lot of joint sales calls with our distributor partners. So we do have some opportunity to try to influence to make sure that our distributors are getting out there and pounding the pavement and doing the job and trying to get in where they can get in.

But frankly, our factories aren't any different. Our factories here -- our factory employees are not interested in having anybody come in unless they absolutely need to be here. Having somebody come in and then having an exposure event and then having 15 people out because they got their on quarantine, would be really negative, particularly when you think about our factories that are busy. And so our customers really aren't any different.

And so the opportunity to come in and sell them a new product or an upgraded product or something that's got an ROI is really dampened in an environment where we can't make proactive calls. Now when they need us, they call us and we get in, and our distributors do make milk runs. And there -- certainly, there are some customers that are allowing us in the door, as you can see by the

fact that our Industrial business isn't terrible, but it's really not a great environment.

We have been spending a fair amount of time trying to find other ways to effectively reach our industrial customers using social media, using the Internet, using email campaigns, using the web to try to make sure that to the extent that we can, we get our message on cost savings projects and quality improvements that they could consider in front of them. But it isn't a great environment, and we can't totally fix it. We can influence, we can't fix it.

Walter Scott Liptak Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst

Okay. Got it. And then just a follow-up on the CapEx. Just so I make sure I understand this. So it sounds like about \$35 million of maintenance CapEx and \$50 million incremental. And that's going into machines in bricks and mortar. Is that right?

Mark W. Sheahan Graco Inc. - CFO & Treasurer

Yes. That's -- I mean, it's about, right. We're looking to finish the year around \$85 million in total CapEx, and we do have some projects, brick-and-mortar here in the back half of 2020 that we'll be funding. That will be a big chunk of the increase from what you've seen here year-to-date.

Walter Scott Liptak Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst

Okay. All right. And what are you thinking about for CapEx next year?

Mark W. Sheahan Graco Inc. - CFO & Treasurer

I don't know that we're at a spot yet where I feel good about giving you a number, but we'll definitely fine-tune that and get something out here by the time we report after Q4.

Operator

(Operator Instructions)

Our question comes from Joe Ritchie with Goldman Sachs.

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

Pat, maybe just kind of following up on that point regarding access to sites on the Industrial side. Did that change at all throughout the quarter? We've obviously had a little bit more of a surge here with COVID cases. I'm just wondering if, as things got worse, that impacted your sales at all intra quarter?

Patrick J. McHale Graco Inc. - President, CEO & Director

So the surge that we've seen here, like, let's say, the last 3 or 4 weeks, I can't say that I've seen a change. I think we did see definitely a positive change coming out of Q2 for a while there, nothing was happening. And so that really reversed itself over the course of the summer. And now some things are happening.

I haven't seen it regress backwards at this point. However, there's new stories every day. And we've got states and countries that are taking further actions. So I guess it's TBD.

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

Got it. Okay. No, that's helpful. And I think maybe just following back up on Contractor. It is interesting, you guys to talk a little bit about your capacity being strained and how strong things were this quarter. But notably, look, your incremental margins were really strong, and so you're able to offset what I would imagine was higher cost this quarter. I guess how do I -- how should we be thinking about that going forward from a margin perspective? Was there potentially some negative headwinds because of the increased costs this quarter?

And then secondly, are we through really kind of like the capacity issues on Contractor? And I know it's a good issue to have.

Patrick J. McHale *Graco Inc. - President, CEO & Director*

Well, I'll take a shot, and then I'll let Mark weigh in as well. First, on the Contractor side, we are still busy, and we're still trying to dig out. And the team up there is still working really hard. So we've still got some work to do. Where we're sitting here today in October, we're definitely not out of the woods yet.

In terms of -- the Graco model is high incremental margins and high decremental margins. And when we get volume in a factory or a business unit, generally, we perform. And when we don't get volume, then generally, it's challenging. And we're not out there cutting headcount because we're going to have a bad quarter or a bad year. So our costs tend to be more fixed.

One of the squirrely things, of course, that we're dealing with here in 2020 is the fact that with a wide variation in business unit performance and with the big drop in Q2, the variable expenses around travel, around incentive programs and around distributor rebates are fluctuating wildly compared to what would happen in a normal year. And of course, in some cases, that helps us on the expense side. Of course, when business comes back, then those are going to come back, too.

So we got a little bit of a bumpy patch that we're going to have to work through here on the variable expense side. But the basic model of Graco, whereas you -- if we get revenue, we make money and we make good money, that's intact and really none of our dynamics around that have changed.

Mark W. Sheahan *Graco Inc. - CFO & Treasurer*

Yes. I would just say that I agree with that. And obviously, in Q3 here, we had a huge ramp-up in revenue. And we still have a lot of our salespeople that are working from home and not able to get into different areas. And we aren't traveling. We aren't going to trade shows. We're not spending as much money airfares way down. So the margin rates that you see in the Contractor in Q3 are really good. They're strong.

In a more normalized environment where we're trying to grow the business within our organic growth target, which is somewhere in that 5% to 7% range, you got people on the road, you got -- doing trade shows, demos, we're spending more money to try to support that type of a growth. So I wouldn't be surprised to see spending tick up as we get back into a normal environment, but we should still be able to drive decent profitability in that business.

Operator

Our next question comes from Andrew Buscaglia with Berenberg.

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

On -- sticking with the Contractor side, so your margins are really high, exiting 2020. How much of it really is a function of that -- I mean, do we have to believe that this do-it-yourself homeowner demand continues for you to maintain those level of margins? Like I wonder how much of it is a product pricing thing versus just cost, too?

Mark W. Sheahan *Graco Inc. - CFO & Treasurer*

Well, I think the demand has been great, right? And of course, we're -- we don't have great visibility on how long it's going to last. I think Pat talked about that. But the macros are still pretty good in this space. I mean, housing starts are decent, permits are up in that 1.5 million range, interest rates are the best I've ever seen in history. The inventory of homes is low. You got 72 million millennials that are hitting the market, looking for housing. So we feel good about where we're positioned there. And I think the market itself is going to remain pretty healthy for us.

On the margin side, of course, if we start to experience pressure on the top line, that could squeeze the margins a little bit. So we're hopeful that it runs for a while, and we continue to drive top line growth in that business. And I think that we have a decent chance of doing that.

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

Yes. Okay. And comparing the Industrial and the Process segment, sort of this cycle is interesting in that subsegments -- kind of they all have somewhat different drivers. So looking out, within Process, you have some pretty interesting, more like sort of cyclical juice with some of these shorter cycle areas, but -- and then you got less oil exposure now. But do you see do you see Industrial or Process as the segment that's going to ramp harder if we do see some momentum in some of these industrial indicators?

Patrick J. McHale Graco Inc. - President, CEO & Director

I'd be surprised if they didn't both go. That would be my view. I'd be -- It would surprise me if one came back strong and the other one didn't, so -- just given the fact that we sell across so many different end markets really out of both of those segments. We make products that can be used in many different applications in many different industries. I think when things get good again, they're both going to be good.

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

And you commented on oil before, but indirect oil exposure, would you say equally helps or hurts both equally? Or is one more a little bit tied to that indirect?

Patrick J. McHale Graco Inc. - President, CEO & Director

Well, that's hard for me to guess. I mean if you just -- off the top of my head, I would say, probably hurt them equally both maybe hurt Process a little bit more.

Operator

Our next question comes from Brett Kearney with Gabelli Funds.

Brett Kearney G. Research, LLC - Research Analyst

Just wanted to ask what you're hearing from some of your channel partners and end users on the SaniSpray line you rolled out earlier this year? And whether that product is now available in all geographies?

Patrick J. McHale Graco Inc. - President, CEO & Director

Yes. So we have that available in most geographies now. There's probably still a few overseas locations that are still waiting to get some product shipped to them. But generally speaking, that's available around the world. That's been a successful product for us. Performance standpoint, it's been good. Really haven't had any kind of quality surprises or performance surprises with the product.

So we're happy with it. It would be nice if it's a long-term new product opportunity for Graco. But I guess that also is a question mark. It could be or it could fizzle out if we get a good vaccine and people stop sanitizing and cleaning. So we're going to ride that horse while we can, and we'll see how far it goes.

Operator

If there are no further questions, I will now turn the conference over to Pat McHale.

Patrick J. McHale Graco Inc. - President, CEO & Director

All right. Thank you, everyone, for your time this morning, and we're going to get back to work, and we'll talk to you again in a few months.

Operator

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

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