GRACO INC

Moderator: Caroline Chambers
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Operator: Good morning, and welcome to the Second Quarter 2016 Conference Call for Graco Inc. If you wish to access the replay for this call, you may do so by dialing 1-888-203-1112 within the United States or Canada. The dial-in number for international callers is 719-457-0820. The conference ID number is 6816490. The replay will be available through July 25, 2016.

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 2015 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 Web site at www.graco.com and the SEC's Web site 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. As a reminder, today's conference is being recorded.

I will now turn the conference over to Caroline Chambers, Vice President, Corporate Controller and Information Systems. Please go ahead, ma'am.

Caroline Chambers: Good morning, everyone. I am here this morning with Pat McHale and Christian Rothe. Our conference call slides are on our Web site and provide additional information on our quarter.

Graco reported second quarter sales of $348 million, net earnings of $51 million and diluted net earnings of 89 cents. Incremental sales from acquired operations contributed one percentage point of growth, while organic sales at consistent translation rates increased by three percentage points as strong growth in the contractor segment more than offset declines in the process segment.

Brief reminder for everyone, second quarter income last year in 2015 included net investment income of $110 million related to the Liquid Finishing businesses that were held separate and sold in April of 2015. Twenty fifteen diluted net earnings per share adjusted for the non-recurring gain were $1.05.

The second quarter 2015 net income also included $9 million or 15 cents per diluted share related to non-recurring tax benefits. A reconciliation of our operating earnings is included on Page 9 of our slide deck. Gross profit margins this quarter were slightly lower than the rates in the prior year.

Favorable effects of realized pricing were offset by changes in product mix, with a strong growth in the contractor segments, and by lower factory volumes this quarter. Operating expenses increased by $10 million as compared to the second quarter last year, of which expenses from acquired operations totaled $2 million.

We continue to invest in new product development and commercial resources, and incremental spending for these initiatives and other corporate items were approximately $2 million in the quarter. Operating expenses also included $1 million related to new product launches in the contractor segment, and $1 million related to warehouse relocation, and factory consolidation and integration costs.

Unallocated corporate expense increased by $2 million, primarily related to stock compensation and pension. For the full year, we currently project unallocated corporate expense to be approximately $3 million higher than the full year 2015, primarily due to increased stock compensation and pension costs.

The effective tax rate for the quarter was 31%, up from 28% last year. The rate in the second quarter 2015 was affected by both the gain on sale of the liquid finishing businesses and the non-recurring benefit related to a change in assertion as to reinvestment of foreign earnings.

Before Pat provides more discussion on our segments and regions, I'll make a brief comment on the effect of foreign currency translation. Foreign exchange headwinds were minimal in the quarter, reducing operating earnings by less than $1 million, and net earnings by approximately a half million.

Foreign exchange rates have gone somewhat against us since our last quarterly call, but at current rates the year-over-year foreign currency translation impact for the second half of 2016 should be close to zero on the net earnings volume.

With that, I'll turn the call over to Pat.

Pat McHale: Thank you, Carol. Good morning everyone. All my comments this morning are on an organic constant currency basis. At 3% organic growth worldwide in Q2, the quarter was slower than expected. Weak top line results in our process segment and Industrial Americas is resulting in a reduction in our outlook for 2016, reducing our overall Graco expectation from low-to-mid single digit growth to low single digit growth for the full year.

Despite the macroeconomic headwinds, we believe that there are good opportunities to grow and to generate a nice long-term return for our shareholders. In order to capitalize on these opportunities and to put ourselves in a strong position for when the macro normalizes, we are continuing to invest.

We have multi-year initiatives underway, and at this point we are continuing to expand in those areas rather than to cut and to try to maximize quarterly results. Let's turn to the process segment to talk about the quarter.

The business declined teens year-over-year in Q2, a further degradation from a weak Q1 performance in this segment. All three Graco divisions that make up the process segment were down in Q2, the worst of which being our direct Oil & Natural Gas business which was off by a third compared to the second quarter last year.

The other Graco divisions in this segment also saw significant declines in sales to oil and gas-related customers. In absolute dollar terms the process segment was up slightly sequentially from Q1 to Q2.

From an operating earnings perspective, as we discussed on this call last quarter, when sales in the segment are off double digits, the decremental margins are going to be high due to manufacturing volume pressures and other inefficiencies.

Process segments comps get easier in the second half, but being off low teens for the first half, we don't expect to be able to get growth in this segment for 2016. It's too much of a hole to make up at this point of the year. If quarterly process segment sales stay in the mid-$60 million range, including acquired businesses, I'd expect operating margins in the low double digits, similar to the first two quarters of the year.

Moving on to the industrial segment, the industrial segment worldwide posted low single-digit growth in Q2, and was able to hold its solid operating margins.

Performance in Q2 was similar to Q1 with growth in Asia-Pacific, strength in EMEA, and a slight decline in the Americas. There was very little variability between product categories in these geographies which indicates a divergence in the Industrial macro environment, particularly between the Americans and Western Europe.

The US is stagnant across product categories, and reflective of weakness in end markets such as heavy equipment, ag, aerospace, and truck and trailer. End markets that have been strong for the last several years, general industry, automotive, and construction markets were better than the segment average but are currently soft.

We're seeing cautious customers, and a general reluctance to invest capital across most of our end markets. Moving on to contractor, as expected contractor had a strong Q2 with high teens growth in the Americas and high single-digit growth in EMEA.

For the first half the business achieved its goal of high single-digit growth in the Americas. And frankly, the EMEA region surprised to the upside by outpacing the Americas for the first half by growing mid-teens. Profitability for contractor in Q2 was light despite the strong revenue growth.

About the half the sales increase in the Americas was new product lowered into the home center channel, which brings the number of loading expenses and essentially zero operating earnings growth. There was also incremental spending on engineering, selling, and marketing to support our other new product launches that occurred in Q2.

Most of the incremental spending for load-ins and product launches are behind us for 2016. So I am expecting incremental contractor margins in the second half to return to the low to the mid-30s, similar to our experience rate for the last year and a half.

Contractor sale were solid at both home center and paint store customers, out-the-door sales held up fine for both channels. And our team is comfortable with the inventory levels in the channel even after the load-in and launches. We continue to expect the contractor Americas business should achieve high single-digit growth for the full year 2016.

Some brief comments on EMEA. We had solid high single-digit sales growth in both the industrial and contractor businesses in EMEA, with declines in process taking the overall regional growth down to low single digits. Western Europe grew a little bit better than the average, while the emerging markets remain flattish.

The industrial and contractor growth was relatively broad-based across product categories within those segments, while the headwinds in Process reflect the factors discussed earlier. As such, we're taking our outlook for EMEA up to low to mid-single digit growth for the full year, from our previous view of low single digit growth.

Asia Pacific is a similar story in the Industrial segment with project activity for technology and automotive as bright spots. China's been driving the performance in 2016. While the trends have been good, I remain cautious. Asia Pacific project activity remained high variable, and the numbers can move around from period-to-period.

The contractor business in Asia Pacific had a weak quarter. Process in Asia Pacific sees similar headwinds as the other regions. At 2% growth year-to-date, and just under flat for the quarter, we are holding our Asia Pacific outlook for 2016, at a low single digit growth rate.

Before I summarize the outlook, a quick note on order trends in Q2; we started strong in April, with orders up double digit year-over-year. In May, orders were flat. In June, orders were up low single digits versus last year. The Americas region held up best during that period, led by contractor, while the EMEA region book to bill was slightly less than one.

While worldwide book to bill was just over one during the quarter, we are bringing about $17 million less in backlog into the second half this year than we did last year, with most of that delta coming from the Industrial segment. Recall that the Industrial segment had a very strong Q4 last year, with a healthy portion of that growth coming from the shipment of projects that were already in our backlog.

Our Industrial team has their work cut out for them in the second half. To summarize our updated outlook for 2016, we're taking down our full year Graco sales growth outlook from low to mid-single digit growth to a new view of low single digit growth.

This reflects ongoing headwinds in the process segment, and a stagnant growth environment in the industrial Americas. It has also reflected in our updated view on the Americas region overall to low single digit growth from a previous view of low to mid-single digit growth.

We're holding outlook for the contractor Americas business to grow high single digits for the full year, a pace they achieved in the first half. The EMEA region outlook is increasing from low single digits to lower to mid-single digits reflecting the strength we saw in industrial and contractor in the first half.

The EMEA Industrial comps get tougher in the second half though so implied in the outlook is a lower rate of growth. We're holding the Asia Pacific outlook at low single-digit growth for the full year. We are on a low growth macroeconomic with all the attributes that you normally see.

Customers are less confident than their businesses and less willing to invest, which is a drag on our ability to grow in the short term. We have a culture of continuous improvement and sound expense management throughout the cycle. But we also have a strong desire to grow over the long term.

As such we will continue to invest in our strategic initiatives that are in the works, and continue to look for more of these opportunities. These initiatives never lend themselves well to working around cyclical upturns or downturns, and that can cause some short-term pinch points similar to what we saw in Q2.

But we are committed to growth and believe that staying the course will generate the best total return for our shareholders over the long term. With that, operator, we're ready for questions.

Operator: Thank you. The question and answer session will begin at this time. If you'd like to ask a question, please signal by pressing star 1 on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star 1 to ask a question. Your question will be taken in the order it's received.

Please standby for your first question. Our first question comes from Jeff Hammond with KeyBanc Capital Markets. Please state your question.

Jeff Hammond: Hi, good morning guys.

Pat McHale: Good morning.

Jeff Hammond: Thanks. So you gave some good color on margin dynamics and mix in contractor. Can you speak similarly to industrial, your margins down there a little bit, and how you're thinking about incremental margins in the second half for industrial?

Christian Rothe: Yes, Jeff, this is Christian. Good morning. So, you know, what we saw in the first half generally with our industrial segment was decent incremental margins, but in the second quarter we did see incremental margins that were at a little bit slower pace.

As we look at the second half it really has more to do with how you're modeling, what's happening with the top line. And we're looking at a very low to low single-digit type growth rate. The incremental margins are going to be tough just due to the volume pressures that we have. So we do think that we can definitely get incrementals off of sales growth, but from the perspective of having a historical 40% to 50%, that all depends on what you're modeling on the top line growth.

Jeff Hammond: Okay. And then just good color on the geographies and your outlook there, can you maybe split it a different way and just talk about how you see those growth rates by the segments?

Christian Rothe: Generally we don't go into that level of detail with regard to our outlook. It's a little bit more than what we want to do.

Pat McHale: Yes, we've already got complex metrics on that, it just gets pretty squirrely if we start cutting it that fine.

Jeff Hammond: Okay, that's fine. But then I guess maybe the focus on process, it sounds like, Pat, from your comments you're kind of expecting similar trends in the second half to the first half or do you still see...

Pat McHale: That's what we're reporting into our outlook for right now. Frankly, I was disappointed in the process in the second quarter. Not so much on the oil and gas business which I figured was going to be down, but we did a little poorer than I expected on our - the other divisions that are within that segment.

Now, they do have some oil and gas exposure and those got hit pretty hard. But overall, the process was a little bit softer than I expected here through the first half, and we've modeled that into our outlook for the second half.

Jeff Hammond: Okay, perfect. Thanks guys.

Operator: We'll take our next question from Matt Summerville with Alembic Global Advisors.

Matt Summerville: Hi, good morning. A couple of questions, just to get back to Jeff's comment on the process side of the business, is there a market share issue, is there a market dynamic that's occurring in the non-oil and gas related businesses that you hadn't been anticipating?

I guess, what 90-days-ago led you to conclude that you were going to see inflections in that business? And I guess, what's changed to lead you to conclude that you're not anymore?

Pat McHale: Yes, we started the year and even though the first quarter we still thought that we could rally the last nine months of the year, and pull us growth in the process segment despite what we were seeing. At that point, I wasn't expecting the weakness that we've seen in some of our, I'll say, standard diaphragm pump type businesses, and in specifically in our PMG business in lubrication.

Those have some exposure to oil and gas, but it's fairly limited and I expected better performance out of those areas than we've seen. Given the fact that the year's half over, I think we would be remiss to communicate to you that we think we can make up the whole in the second half of the year.

Matt Summerville: Got it. And just a follow-up back on industrial Americas, you mentioned, I mean, in your prepared remarks you're basically seeing softness across most product categories here in the US. You even I think sort of mentioned construction in that same sentence, if you will.

I guess, is there a bifurcation between what you're seeing in the construction-related demand or end markets that impact the Industrial business versus what you're seeing in contractor. Can you just kind of close that gap?

Pat McHale: Yes, I'd say there definitely has been a little bit of a bifurcation there. And I don't have an exact explanation for why but I can tell you that on the industrial side the products are generally much more complex and expensive. So we're talking about major - much more major capital investment than on a CD sprayer.

And just given - and again, this is not based on any sort of a market survey, but given what we're seeing with customers being cautious about CAPEX spending, I think that's likely pressuring the higher contractor type construction products that are embedded within our industrial business.

Matt Summerville: Got it. Thanks guys.

Operator: We'll go next to Matt Halloran or Mike Halloran with Robert Baird.

Mike Halloran: Hi, good morning guys. So staying on the industrial side there, is the thought process as you work through the second half of the year in North America just continued stability? Any deterioration baked in? And then also what kind of catalysts are out there, what kind of catalysts would need to come through to start seeing some improvement in those markets from your perspective?

Pat McHale: Yes, so we didn't take any deterioration. And I'd say really our outlook for industrial in the Americas in the second half similar to the first half. You know, there are some things that could swing that either direction. And I think the macro's sort of hard to predict right now. A lot of it that I see I think is confidence-based.

It's not that the pipeline is drying up. There's projects out there, and there's activity. It's just that we just don't see people as eager to spend on capital right now. And I really think that partly I think you're seeing is the companies aren't growing, so when they're not growing that doesn't drive them that they need to put capital in for capacity expansion.

But over and above that, even projects that are cost-reduction and quality improvements when companies are suffering on the top line then tend to take a more conservative view. So I think we're seeing some of that. And I can't really tell you from my contacts and what I read and see out there that there's any clear catalyst that's going to swing that one way or another in the short term. There probably is but I'm not smart enough to see it.

Mike Halloran: Yes, I understand. And then on the contractor side, it sounds like that's playing out as you guys expected. As we get to the third quarter or fourth quarter, maybe just talk a little bit about channel inventory, if there's anything interesting going on in the mix side. And then lastly, if there's any carry through on the new products side, any new product launching in the third quarter if that's mostly behind you in the second?

Pat McHale: Most of the new product launches are behind us, although we're seeing good sell-through on the products that we launched. I'm feeling pretty good about our opportunities in second half.

They need to have a good third quarter. If you remember last year, they had a pretty big fourth quarter.

Mike Halloran: Yes.

Pat McHale: It's all in order to achieve our number for the year. We need to see some decent performance in the third quarter. But again, out-the-door sales in both channels have been good. The new product that we've launched, here in the second quarter, has been well-received, so I'm expecting that we're going to have some sell-through. And that the team is feeling pretty confident that they're going to be able to deliver year here as they expected.

Mike Halloran: Thanks guys.

Operator: We'll take our next question from Kevin Maczka with BB&T Capital Markets.

Kevin Maczka: Thanks. Good morning.

Pat McHale: Good morning.

Kevin Maczka: Pat, I guess, as we look at Slide 9, I'm just trying to get a sense for which of these items that impacted Q2 will also impact the second half and which won't. I think you said product launch is something that's happening all the time, but it sounds like the bigger cost there is behind you and maybe the facility relocation as well.

Can you just touch on those? Are things like this pension and stock comp and some of these other items continuing to the second half to be new headwind?

Pat McHale: So I'll let Carol and Christian comment on the corporate expenses, in terms of the operational and commercial things that we've got going on. We're continuing on with some facility relocation and consolidation. So some of that's going to still spill into the second half.

We've got things happening within the process segment with a couple of the different acquisitions that we've done that we're doing consolidation on. It should be a nice long-term payback on that, but in the short-term that'll continue to put some expense pressure on us.

In contractor, in particular, I'd say the big lump of launch cost associated with 2016 products is behind us. We should still continue to see some engineering expenses in the second half related to 2017 planned launches that we have. So you might be able to take a little bit of that back but I think you'd be you wise to leave some of that in.

Caroline Chambers: When we're looking at some of the corporate costs we're thinking about pension and the stock compensation. And basically, we've seen some of the work coming in as we look at performance on assets and so forth that have just little heavier load in the first half, and we won't be able to make up for that in the second half.

So that was our updated projection on unallocated corporate, about $3 million higher than last year.

Kevin Maczka: Okay, got it. Got it. And then if we just shift over, Pat, to some of the comments you made about some of your, what have been, solid industrial markets softening up, I think you specifically mentioned auto. Can you give a little bit more color around that and the other markets that you mentioned as well?

Pat McHale: Yes, that was just really not a comment necessarily that the pipeline is drying up, and they're not willing to spend any money. But it's just much more caution, and much more I'd say people are taking more time to make decisions on CAPEX projects than they probably would have here a year ago.

And remember we were still seeing pretty good activity in the fourth quarter last year coming out of those segments, and customers with willingness to invest. But it really seems like the last six months things have slowed a little bit.

And, again, it's not dramatic, and I'm not predicting anything to fall off a cliff. But, definitely in the last six months the environment has got a little softer from my standpoint rather than better.

Kevin Maczka: Okay, great. Thank you.

Operator: We'll take our next question from Charley Brady with SunTrust Robinson Humphrey.

Charley Brady: Thanks. Good morning guys. Hi, Pat, just a question on the contractor business, I just want to make sure I understand the margin expectation going into the second half. The load costs, are there additional load costs going into Q3?

And, would you expect - I think you talked about getting back to that mid-30s incremental in the second half. Is that a fair expectation?

Christian Rothe: Yes, so Charley, this is Christian. Yes, that was exactly Pat's comment, which is most of that load cost is behind us. We're not expecting that we're going to have any large incremental spend around that, so that really we got through it in Q2. As we look at the second half we should have things more clean.

We do have a mix that we've been dealing with for, again, the last year and a half or so with more home center, than - not more home center but a higher proportion of home center mix than we had historically, which takes us down into those incrementals that are in the low to mid-30s.

Charley Brady: Can you give us a sense on that mix issue, home center versus pro paint, kind of what that mix looks like today versus maybe what it was a year ago?

Christian Rothe: We don't disclose that level of detail around that business just due to competitive concerns.

Charley Brady: Fair enough. Industrial margins, would you - if you're looking at second-half versus second-half last year and even first-half of this year, given the performance you've seen in the Americas, do you see that margin being up either year over year or sequentially from second half - from first half, sorry?

Christian Rothe: Yes, it really depends on how you look at that growth rate. But I think it's, you know, when we're talking about the growth rate that we're looking at right now it's tough to see much expansion in that margin.

Charley Brady: Thanks.

Operator: We'll take our next question from Joe Ritchie with Goldman Sachs.

Joe Ritchie: Thank you. Good morning guys.

Pat McHale: Good morning.

Joe Ritchie: Maybe touching base on the industrial segment again, EMEA, you guys did have really good growth this quarter. You took up the growth forecast for EMEA for the year as well. So maybe some more color on what you're seeing in that region and whether you have any concerns as it relates to Brexit?

Pat McHale: Other than the impact on currency, I'm not sure I expect anything too dramatic out of Brexit here coming in the second half of the year. The business in EMEA in generally, if you look across the product categories, it's been - in the industrial side it's been pretty broad-based.

It's not just one product category that we are doing well in. We are doing fairly well across the product categories. So I think it's indicative of improving at least improved conditions in EMEA this year over where we were at a couple of years ago.

Joe Ritchie: Okay. And then I guess just maybe sticking on British pounds for second. What's your exposure just to the UK?

Christian Rothe: Four percent of our sales are in British pounds.

Joe Ritchie: Okay. And then maybe one last question just going back to process, clearly the trends have worsened from what we expected earlier this year. Is there anything you can do internally to help drive better performance out of the business just in light of how weak the environment is?

Pat McHale: You know, this is a challenge that we have and of course I don't like delivering numbers like this either. But go back through all of the things that we're working on and I look at them and I say, are these the right things to be doing over the longer term. And I have a list and I go through every single one of them. Some of them are losing money today and I could cut those out and we could quit losing money on them but they're definitely the right things to be doing.

So, we're just going to batter the storm here a while. I think in the end we're going to come out ahead but we're consolidating a number of facilities within the process segment. I suppose we can stop doing that and quarter might look better but the facility consolidation is going to lead quality improvements and cost reductions and lots of benefits down the road.

We've got new equipment going in two facilities, which drives indirect labor and drives tooling cost that new equipment also drives cost reductions, so that the cost and the benefit don't necessarily line up at the same time. We're investing in new sales teams to chase particular products that we launched recently and the sales team and the cost of the sales team is bigger than the initial revenue.

So we're getting a number of things like that, I look at them and say, I could make the quarter look better and I could get some leverage if I cut those things but what that can leave us in two or three years. So right now, given the fact that the world is just a little tough and it's not a disaster, my mindset is that is we're just going to take our beating and we're going to keep going and we're going to come out ahead.

Joe Ritchie: Makes a lot of sense. Thanks for the color, Pat.

Operator: We'll go next to Walter Liptak with Seaport Global Securities.

Walter Liptak: Hi, guys. Want to ask about pricing and maybe starting with your oil and gas exposure and if you think any incremental pricing pressure or how you're dealing with pricing coming in on projects.

Pat McHale: Let me talk it, but pricing in general across vehicle first and then if Christian has any details he wants to share specifically on the oil and gas stuff I can do that. But price cost has been okay this year. When I talk about cost I'm really talking about material cost.

So that equation's working for us in most of our product categories we've got our typical annual price increase and on the material cost side we're still doing fine compared to last year.

Of course there are some projects and things where we get pressure from time to time. But our bigger issue really on the gross margin side isn't a price or material cost issue its more of the fact that we've got some pretty significant reductions in a couple of our business units which is leading to factories that are slow and we have slow factory that puts up fair amount of pressure on our gross margin. So we're trying to manage through that presently.

Christian Rothe: With regard to the pricing in oil and natural gas in particular that portion of our process segment, you're right this is a difficult environment in order to get pricing but we feel like that's stable right now. We are not really for the most part giving up pricing.

Walter Liptak: Okay, great. And pricing in the industrial business, you're talking about taking, you know, customers taking more time. Are they pushing pricing or is this just ROI projects that you're not sure if you're going to happen or not?

Christian Rothe: Now the price environment has been okay in industrial. We haven't seen any real impacts there. Most of the projects that we're selling if they are not for capacity, there is an ROI and of course we always have to cognizant of what our pricing levels are so the customers can get an ROI. But we are not necessarily seeing or expecting any significant pricing issues coming out of the industrial side.

Walter Liptak: Okay, great. And some of those industrial projects more kind of back half has slowed in anyways typically like there is budgets that are put in place and if there is concern about Europe or Brexit or whatever it maybe pushes a little bit. Isn't there still some hope that you could have a better second half?

Pat McHale: I don't want to make it sound like today that we've given up hope but we want to be realistic and we don't' want to sit here and tell you that everything is going to be rosy in the second half. We've got our new products that were launched and we've got our initiatives that we're chasing and we don't know what's going to happen globally in the geopolitical environment in the second half.

So we definitely as a group haven't given up on the second half. What we're trying to do is communicate that from a realistic viewpoint we probably ought to think about the second half on industrial more like the first half than on some hokey stick that is based upon a dream.

Walter Liptak: Okay, fair enough. Okay, then just to follow-up on that productivity question. You know, it sounds like with these new sales investment and new equipment going in, I wonder if you can quantify what those costs are and I am thinking mostly about the factory consolidation with some of the acquisitions that were done. How much flow through the P&L in the second quarter, how much that incremental cost goes through in the back half?

Pat McHale: So I would refer you to Page 9 and we don't really want to break it out in more fine detail than that. If I start taking 10 projects and breaking out the detail in each one then I have to give updates on each one every quarter and we give out information to a variety of folks that we don't necessarily want to give the information to. So I'd refer you back to Page 9.

And, again, in terms of what is going to spill into the second half there are still going to be factory relocation and new machine costs that are going to be in the second half maybe slightly favorable to the first half but I certainly wouldn't zero those out and I think Caroline can restate her comments on the corporate side.

Caroline Chambers: Yes, once again we saw a few coming through but they are basically - we're projecting similar in the second half is to the first half.

Walter Liptak: Okay, thank you.

Operator: We'll take our next question from Jim Foung with Gadelli & Company.

Jim Foung: Hi good morning Pat, Christian. So you talked about the process business that in the second half it's going to be better than the first half. So could you just - are you getting the sense that you might be near the bottom or close to it in the Process business with the oil and gas products?

Pat McHale: So with regard to the bottom Jim I think it's going to be hard for us. We're not the economists that are going to be able to make that call. At the same time when we look at Q1, Q2 sales were essentially flat between the business at the mid-$60 million range.

So again in the process segment overall. So do we think it stabilized? Yes, I think it has stabilized, booking were at a similar level to the billing side. So we're feeling okay about that. The real question is what happens with the comps that we have and the comp is little bit easier in Q3 and it gets a little harder in Q4.

Jim Foung: Okay. And then I guess with the industry, the oil and gas industry continues to be weak but then seeing some improvement in 2017. Maybe you can just talk about your outlook in terms of more properties in this space as you kind of get close to getting out of the downturn as you go into 2017.

Pat McHale: Yes, so when we started our initiatives on building some exposure to oil and gas we took a two pronged approach. One was as we put together an engineering team and we created a business unit and we identified the products that we're interested in and we started on organic development and that continues.

So going into 2017 we will continue to expand product range that we have of products that are designed by Graco, manufactured by Graco. In terms of the acquisition front, we understand the spaces that we want to be in and we have a pretty good list of players in those spaces, we continue to try to keep channels of communication open, whether anything happens next year or not, I have no idea.

At the right price for the right property, we're still in the game.

Jim Foung: All right. And then it seems like anything you buy at current prices would be accretive in a couple of years from now.

Pat McHale: We typically like to buy companies that we believe can be Graco like in the future and companies that can be Graco like generally don't get fire sale. So we have plenty of companies that we'd like to buy at a certain price but just because the market is depressed those owners aren't looking to do a fire sale.

So, I think it'd be great if it happens but I'm not anticipating find great properties at rock bottom prices and getting a short real quick accretive payback on it. It would be nice but I just don't see it for the kinds of niches and assets that we're looking at.

Jim Foung: Okay, great. Thanks, Pat.

Operator: Once again, if you'd like to ask a question or have a follow up, please press star 1 on your telephone keypad. We'll take our next question from Jim Giannakouros with Oppenheimer & Company.

Jim Giannakouros: Thanks. Good morning, Pat, and Christian.

Pat McHale: Good morning.

Jim Giannakouros: Industrial Americas versus contractor segment, if I understood you correctly, the bifurcation as you saw it bigger versus smaller ticket items. Can you give some color on what you are seeing if you just cut it a little differently just by residential versus commercial markets and the cycles there?

Pat McHale: Yes, it's really tough. Our view is that both markets are pretty decent right now, but when you sell paint sprayer or texture machine into a channel partner, and then they sell it to a contractor, there is no way for us to really know exactly what they are using that product for.

Generally the larger products are used on larger jobs and small products are used on smaller jobs, but to be able to really figure out from a Graco perspective, whether it's gone residential or commercial, that becomes pretty tricky. So we generally don't try to guess on that. But both markets look like they are pretty decent right now, I would say.

Jim Giannakouros: Okay, thanks. And one follow-up if I may, I'm just trying to gauge how incremental margins are trending. Can you speak to just internal initiatives on just plant efficiencies.

I mean, historically it's been a nice offset in that price cost equation understanding the market pressures that you have now and the continued investment for what you're doing internally in the facility that you're running, the blocking and tackling et cetera. How much of an offset, or is this a year where that's not a major contributor?

Pat McHale: So, in the factories that are struggling for volume it's going to be difficult. We're doing all the same things that we always do. We've got cost reduction project, quality improvement projects, capital equipment going in, but where we have volume challenges it's just difficult for that to work.

So, on factories like the contractor equipment where we are still seeing volume, there is still opportunities there for that group to do some offsetting, and we look for strong second half hopefully out of the team up there, but in some of the other factories they are really slow.

Rates go up, because you get rid of your temporary laborers and you have your full time laborers. It's hard to get justification on new equipment, because you are trying to justify it on lower volumes. So, it definitely is putting a strain on us and you are seeing that reflected in our gross margins here in the first half.

So, you know, unless we see a change by probably at least a couple of three points in our overall growth rate going into the second half, the factories are definitely going to be challenged this year.

Jim Giannakouros: Understood, that's all I had. Thanks, Pat.

Pat McHale: Yes.

Operator: We'll take our next question from Marc Heilweil, Gratus Capital.

Marc Heilweil: Thank you. Hi, wonder - I need a little education on the process side of the business. So first could you - what is the average selling price for process equipment as opposed to industrial?

Pat McHale: Sure. So that's a pretty broad question.

Marc Heilweil: Yes, sure.

Pat McHale: We have got three different Graco divisions in there. Generally, the unit selling price in process is less than the unit selling price in industrial, but that's a pretty difficult comparison to make, given that the applications are so different.

So, for example, our direct oil and gas business is heavily focused on valves. And certainly the selling price of a single valve versus a piece of complex equipment that's going to do painting inside of a factory, there is not really a lot of comparison there.

Marc Heilweil: Sure.

Pat McHale: Other parts of our process business include our double diaphragm pumps, which again don't have a particularly high initial investment cost and then a lubrication equipment again, which is thoroughly low from a per unit standpoint.

Regardless of the fact that they are a low on a per unit selling basis, a lot of that activity across those business units is driven by projects. So, you may have to think about it a little bit differently. It could be a $300,000 project made up of you know, a bunch of lower priced Graco product and all sorts of other company's product put into a system.

And that customer's decision isn't necessarily have to do with what they pay per unit for a piece of Graco equipment, but it's whether this entire project that they want to do that would include quantities of our equipment is actually going to get done, if that makes any sense to you?

Marc Heilweil: It makes a lot of sense, thanks. And then on the process side, how would - yes, twofold question, what is the pace of innovation possible on the process side as compared to some of your others, because of course that's always been the Graco's strength. Is there a slower rate of acceptance and introduction of new products?

And secondly, you kind of - I think you may have dodged a question a little bit that was asked earlier, can you give us a broad view of the competitive landscape in the process side? Has it gotten a little tougher, or are these just, you know, macro issues that you are dealing with there?

Pat McHale: Yes, you are right, I didn’t answer that question, but I didn’t because I forgot not because I was trying to dodge. So thanks for reminding me. My view on process business for Graco is that currently and going forward we’re going to be a share taker not a share loser. We’ve decided to build a business around process that was small, or didn’t exist for Graco before.

So as we grow that segment, we are going to be taking business from others. So I don’t view that as a situation where we’ve got market share problems. I think people are going to need to watch out for us over the course of the next five or 10 years in that space. So hopefully that answered that. And I don’t see any changes in any of our business units there that had me concerned from a market share standpoint.

In terms of your question on the pace of innovation, we’re trying to build capability and capacity within the business units that we have in our new process segment to drive innovation. We are definitely not where we can be at from that standpoint. You know, the oil and gas team is only about three years old.

The process group that we’ve got within there is a new group as well and then we’ve got some acquisitions. So I think there’s a nice opportunity. Again, if you are taking a longer term view of what we can do at hat business I think there’s some nice opportunity for us to improve the pace of innovation in those markets.

I think generally customers will accept it. There are some markets where it’s probably going to take more time to get products see it, because of testing requirements. For example, some oil and gas applications where products need to be well-tested and specified, but I think the general model works in that space and it's one of the reasons that we've targeted that for growth.

We think that's a strength of ours, and we can leverage it into process in the future.

Marc Heilweil: Terrific, thanks very much for your sound management and your hard work.

Operator: We'll take our next question from Charley Brady with SunTrust Robinson Humphrey.

Charley Brady: It's just a follow-up on contractor. I want to make sure I'm clear on your comment. In the second quarter, did I hear you correctly that half of that 16 million incremental dollars, revenue dollars was the load in your product?

Pat McHale: Yes, approximately.

Charley Brady: So that's kind of a one in load and there's not an additional load in going into the second half or am I incorrect on that?

Pat McHale: Probably we'll get sell through.

Charley Brady: Right, okay. I just wanted to clarify that thanks.

Pat McHale: Yes.

Operator: We'll take our next question from Jeffrey Matthews with Ram Partners.

Jeffrey Matthews: Hi, thanks very much for taking my question. Two follow-ups, one is Pat said you're cautious on China, and I wonder why. And then sort of related question, you talk about a lack of confidence in CAPEX company sort of holding back.

I guess it - maybe industrial production is stronger that it could be, but what else is it they're looking for to pull the trigger on CAPEX? When you talk to other customers what are they waiting for to see?

Pat McHale: Okay. So the first question, cautious on China; actually China was pretty strong for us here in the second quarter. My caution is more Asia-Pacific in general, and it's for Graco results quarter-to-quarter, because we still have significant exposure to projects in our Asia-Pacific number. And so, from one quarter to another, we can go up and down.

It's not really reflective of a trend, so that's really what I was trying to communicate. There wasn't any particular fear there, but just that we can have a good quarter, we can have not so good quarter depending upon the timing of projects in an environment where we're not blowing out double-digits every quarter.

In terms of CAPEX spending, what are customers looking for? I mean, the customers that are doing okay themselves generally if you can show a solid cost reduction or quality improvement or if they're launching a new product and they need to make a process change, you can get them to open up their wallet and it's certainly not like everybody quit spending, because their sales are about the same that they were last year, which is a lot of sales, but it's just - it's on the margins.

And the difference between getting to mid-single-digit growth and being flat is not a large number of orders. And certainly as I mentioned before, from a capacity expansion standpoint companies don't have the pressure that they would where we'd be in a robust economic situation.

So that's part A, and then part B is that as people are struggling to maintain results in an environment where they are not getting much top line growth, they are being very mindful of how they are spending their dollars, and CFOs and other folks in the financial groups are getting involved.

And I think slowing the process down a little bit. So that's really what I see but again that's commentary, if there is not any market research behind that.

Jeffrey Matthews: It's better than market research, believe me. Thanks very much.

Operator: That concludes today's question and answer session. I will now turn the conference over to Pat McHale.

Pat McHale: All right. Well, thank you every one. Obviously not a great quarter, we're not particularly pleased. Hope, in addition to I guess our reality check for what we think may happen in the second half you also take away that there are plenty of good things that we continue to work on.

We're excited about what we think what we can do at the company going forward. And this is just not a great time, but we'll get through it, we're going to come up at the other end stronger. So, carry on and we'll talk to you again in three 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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