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EDITED TRANSCRIPT

GGG.N - Q4 2021 Graco Inc Earnings Call

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OVERVIEW:

Co. reported 4Q21 sales of $540m, reported net earnings of $120m and reported diluted EPS of $0.69. Expects 2022 organic constant-currency revenue growth to be in high single-digits.

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PRESENTATION

Operator

Good morning, and welcome to the fourth 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. The dial-in number for international callers is (404) 537-3406. The conference ID number is 7385629. The replay will be available through 2 p.m. Eastern Time, Tuesday, February 8, 2022.

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 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 and Information Systems.

Kathryn L. Schoenrock - *Graco Inc. - Executive VP, Corporate Controller & Information Systems*

Good morning. I'm here today with Mark Sheahan and David Lowe. I will provide a brief overview of our quarterly results before turning the call over to Mark for further discussion. Our conference call slides have been posted on our website and provide additional information that you may find helpful.

Yesterday, Graco reported fourth quarter sales of $540 million, an increase of 15% from the fourth quarter of last year. As a reminder, the fourth quarter of 2021 included 14 weeks as compared to 13 weeks in 2020. The effects of currency translation rates and acquisitions did not have a meaningful impact on worldwide sales for the quarter. Reported net earnings were $120 million for the fourth quarter or $0.69 per diluted share.

After adjusting for the impact of the pension settlement loss, excess tax benefits from stock option exercises and certain nonrecurring tax benefits, net earnings were $116 million or $0.66 per diluted share. Gross margin rate was down 120 basis points from the fourth quarter of last year as the favorable effects of product and channel mix, realized pricing and increased factory volume were not enough to offset the impact of higher product costs.

These higher product costs, such as material, labor and freight decreased our gross profit by $16 million in the quarter and $40 million for the full year. For the Contractor segment, higher product costs were $11 million for the quarter and $29 million for the full year. The increase in cost ramps up as the year progressed, with the majority of the cost increases occurring in the second half. We expect to face similar cost headwinds in the first half of 2022.

Supply chain constraints such as logistics capacity and component availability continues to have an unfavorable impact on our factory's ability to deliver in the quarter and will persist into 2022. Operating expenses increased $17 million or 15% in the quarter, mainly due to the increased activity as pandemic-related restrictions eased compared to a year ago. Higher sales and earnings-based expenses also contributed $4 million in additional expense in the quarter. The adjusted tax rate for the quarter was 18%.

Cash flows from operations are $457 million for the year compared to $394 million last year. The increase is due to the improvement in earnings, partially offset by higher working capital that reflects growth in business activity. Significant uses of cash are capital expenditures of $134 million, including $71 million for facility expansion projects, dividend payments of $127 million and a voluntary contribution to our U.S. pension plan of $20 million.

During the fourth 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. In connection with the transfer, we recognized a noncash pretax pension settlement charge of approximately $12 million in other nonoperating expense in the quarter.

A few comments as we look forward to 2022. In January, we repaid $75 million of our private placement debt and a $3.5 million prepayment fee which will be recognized as interest expense in the first quarter of 2022. Based on current exchange rates and the same volume and mix of products and sales by currency, the effect of exchange would have an unfavorable impact of 1% on sales and 3% on earnings for the year. Unallocated corporate expenses are projected to be $28 million to $30 million and can vary by quarter.

The effective tax rate for 2022 is expected to be 18% to 19%. Capital expenditures are estimated to be $190 million, including $140 million for facility expansion projects at our Minnesota, Sioux Falls, Switzerland and Romania locations. We may make share repurchases in 2022 by opportunistic open market transactions or short-dated accelerated share repurchase program.

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

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.

We finished the year strong with record sales in all reportable regions and segments with the exception of the Contractor segment, which achieved its quarterly record earlier this year. We also exceeded our peak annual revenue by $334 million and peak annual operating earnings by $95 million, both previously set in 2018.

Consistent with much of 2021, incoming orders exceeded deliveries in the fourth quarter. Again, this was primarily driven by shortages in key materials and components. Some items worth mentioning include electronic components, castings, engines, motors and raw materials. We are also experiencing unprecedented backlogs at subcontractors who are flooded with demand from customers, including Graco.

At the end of the fourth quarter, our consolidated backlog was approximately $375 million, which is $95 million higher than what it was at the end of the third quarter and $220 million higher than at the end of last year. The full year growth in backlog alone represents more than 10% of our 2021 annual revenue. Our price increase for 2022 will be implemented in the first quarter. However, due to the size of our backlog, we may not begin to fully realize the impact of the increase until the second quarter. We anticipate that our pricing actions will be enough to offset current cost pressures from inflation.

Now turning to some commentary on our segments. We have completed the move of our high-performance coatings and foam products from the Industrial segment to Contractor. This transfer better aligns our Contractor-focused businesses and addresses any overlap we had in markets, products, end users and distributors. The teams are energized and looking forward to the benefits of the new organization.

The Contractor segment rebounded in the fourth quarter, growing at high single digits, and ended up the year up mid-teens off tough comparisons to the prior year. The global construction and home improvement markets remain strong with new housing starts, commercial spending and remodeling activity, all expected to grow this year.

Incoming order rates have reflected this strength, resulting in a backlog of $64 million which is up $18 million from the end of the third quarter and up $38 million from the same period last year. Out-the-door sales at our major distributors are robust, and we are optimistic that this pace of business will continue.

Strong Industrial segment performance continued with its fourth consecutive quarter of double-digit growth. The segment grew low teens for the quarter and achieved both quarterly and annual records for sales and operating earnings.

Consistent with our other businesses, the biggest challenge is overcoming supply chain constraints that have contributed to a spike in backlog of $92 million compared to the same time last year. Overall, our key end markets remain healthy with specific strength in automotive, electronics, alternative energy, battery and agriculture.

Process segment sales grew 35% for the quarter, resulting in both quarterly and annual records for revenue and operating earnings. This segment was slower to recover than our other segments. However, we are seeing strong demand worldwide in our Lubrication, Process Pump and Semiconductor businesses. We're expecting this recovery to continue into 2022.

Moving on to our outlook. Overall, the business is performing well. New product pipelines are robust and worldwide demand levels remain solid. As a result, we are initiating revenue guidance for the full year 2022 of high single digits on an organic constant currency basis, with growth expected in every region and reportable segment. This guidance is based on the assumption that approximately 2/3 of the growth will come from our pricing actions and the remainder a result of our core strategic initiatives.

While we expect to face headwinds in 2022, we believe the strength of our markets, product lines, operations and people, position us well to deliver another year of record sales and earnings. In closing, I want to say thank you again to all of our employees, our suppliers, distributor partners and end users for another great year.

Operator, we're ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Deane Dray from RBC Capital Markets.

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

Maybe we can start with the expected cadence of earnings for '22. We're hearing from lots of companies talking about all the product challenges, labor, inflation, et cetera, that are pressuring first quarter. Your -- the demand looks fine according to your 6-week update. But what are you expecting in terms of like seasonality, first half, second half? Any colors there would be a big help.

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

Yes. I think it will be fairly consistent with what we've done in the past, Deane. Obviously, our Contractor business is our most seasonal business that we have, and they tend to post big revenue in Q2 and Q3. In terms of the earnings cadence, I mean, really, it's the same story that we had in the back half of 2021 in terms of the pressures that we're expecting to see on the cost side at least through the first quarter until our pricing actions kick in, and then we should see an improvement, I would speculate, in Q2 and Q3 and then perhaps for the rest of the year.

Of course, all that has a big caveat tied to it. We're experiencing some moderation in the costs -- input costs that we're seeing right now. And the expectation is that things remain relatively stable as we go through the year here. And if that's the case, I think we should be in good shape.

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

That's good to hear and talk about the price actions you're taking now or have taken in January. I mean you all are unique in that you resist all the calls for intra-year price increases. That's just not your style, it's not your business model and we completely respect that. So take us through what's different this time in price actions? How much is inflation adjusted? How much are like new product launches and so forth? The dynamics this time feels a lot different.

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

Yes. So for sure, we like to play the long game when it comes to pricing. And of course, that approach has really paid off well for Graco, our customers, our distributors, and we have implemented pricing actions here in '22 that will hopefully offset all the cost pressures that we had.

They're higher than what we would normally experience in a normal pricing year, which I think everyone expected. The pricing increases that we did varied by division and by region. So it's hard to give a lot of color around specific numbers, but the feedback so far that we've gotten from our customers has been not surprised. Most of them are experiencing pressures in their business as well, and we haven't gotten any real major pushback on the pricing actions that we've taken.

In my opening comments, I talked a little bit about the fact that our top line revenue growth forecast for the year being high single digits. And when we step back from our pricing actions, we think that with luck, we'll be able to realize about 2/3 of that growth just through our pricing actions.

Of course, there's always puts and takes and projects and things that happen throughout the year. We're going to try to keep a close eye on our pricing. And hopefully, at the end of the year, we'll be able to realize decent pricing in 2022, which, of course, will be much higher than what we have done on a normal year basis.

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

That's great color. Just last one for me, if I could. Can you size what sort of revenues were missed in the quarter because of product availability and that all presumably went into backlog. So when -- how much was missed? And when would you recoup that for -- is it first quarter, second quarter? But that would be helpful.

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

Other than the increase in the backlog, which was pretty substantial in Q4. It's hard for us to actually know how much revenue was missed. The good news is we kept the orders, right? So we will be able to serve those customers. But having the backlog's up $375 million on a full year basis and growing in the fourth quarter gives us some confidence heading into the '22 that we've got a good chance of having another good year.

Operator

Our next question comes from the line of Mike Halloran from Baird.

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

So a couple of things here. One, maybe just an update on how you're thinking about the capital allocation, capital deployment side of things externally. Obviously, prioritizing growth internally, but I know you hired some of the focus a little bit more on M&A. And just want to understand how that's integrating with the -- at the division level and how the opportunity set looks from here.

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

This is David Lowe. I would say that our capital allocation process has -- is one that we're continuing from the long history of the company, as you touched on. As Kathy mentioned, we've got a very aggressive capital expenditure program over the next year, 1.5 years with major facility investments in several different locations. We continue to invest aggressively in product development. I think at $80 million, it was a record for 2021, and we're committed to that.

I think on the -- when we get beyond those things, and we get into some of the topics that you're referring to, Mike, our new colleague, Inge Grasdal joined us just a couple of weeks ago. So he's getting his feet wet in the organization. But the strategy Mark outlined to bring Inge in the organization is the one that we're pursuing.

We think having the focus of an experienced executive that has negotiated and completed a number of deals as well as the capabilities and, if you will, the technical knowledge from an engineering background to work closely with the business units should put us in a very good position as we assess opportunities, and we're quite excited. And as somebody that has an opinion on capital allocation, I'm looking forward to being in a position where when the opportunities are right, we can pursue transactions larger and smaller as we see appropriate.

And then I guess I have to touch on capital allocation for share repurchases. I would say that 2021 was a year where we didn't acquire stock. And it's a reflection in part of, I think, Graco's long history of being opportunistic successfully, I believe, in terms of buying shares. And relative to at least some years, we had a fairly narrow trading range in 2021. But we remain committed to being in the market, being active in the market and I'm hoping we'll see some opportunities to move forward in that space as well. I don't like share creep any better than anyone else.

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

And help me translate a couple of things here. Obviously, backlog is up across the board, bookings remain robust. Your volume expectations are more muted, which makes sense as comparisons track through the year. But how are you thinking about kind of that normalization curve as these things start tracking towards each other. So when do you think normalization can start materializing when you get backlogs back towards what historical levels might look like as a percentage of revenue or whatever metric you want to use, essentially how does that curve play out in your mind?

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

Yes. It's pretty tough to predict. I think at the beginning of the second quarter, a lot of people thought we'd be in better shape by the end of the year than where we actually wounded up being. So most of the information that we're seeing would indicate that maybe by Q3, things will get more normalized, but a lot of the pressure in our organization, and I'm sure others in terms of getting product out the door is really tied to some of the electronic components that go into a lot of the Graco product lines.

And there's a mad fight going on amongst a lot of different industrial companies to get their hands on those things. And eventually, it will shake out. In the meantime, our teams are doing their level best to stay on top of things and get as much product out the door as we can. But hopefully, by Q3 or so, things get more to a normal pace for us.

Operator

Our next question comes from the line of Joe Ritchie from Goldman Sachs.

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

Can we talk about the volume assumptions in a little bit more detail? It seems like you've got some pretty muted assumptions baked into your expectations for this year, just given the backlog trends you're seeing, some of the supply chain constraints hopefully easing in 2022. So maybe help kind of parse out how you're thinking about volumes across each of the 3 segments?

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

Yes, I'll take a crack at it. I mean obviously, it's February 1, right? So there's a lot of year left here as we work through 2022. And as we are sitting here today, there's enough uncertainty really around the supply chain and the constraints that we have in our production that give us some pause when it comes to setting our growth objective for the full year.

Of course, we're going to get a price increase. Of course, we've got a big backlog. But the wildcard really is, I think, the previous question on when things open up for us. And at this point, I think you can expect that sort of baked into our assumptions at this point, we're hopeful that things will open up by the third quarter of the year.

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

Got it. That makes sense. I guess it pays to be conservative to start the year. We'll see how things kind of progress. In Contractor, so it's interesting, right? Like last year, you didn't see what you and the rest of the market, we didn't really see much nonresidential activity. You had a lot of the leading indicators that are pointing to an uptick in that end market in 2022.

I'm just curious, as you kind of think about the movement towards something like the higher-end models within your Contractor segment. Like have you -- how far along are we in terms of getting traction with the market on the adoption of higher-end sprayers?

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

I think we're pretty far along here in North America. Most of the big contractors that do those jobs all have a fleet of equipment, and they replace that on a fairly regular basis. So to the extent that they've got a backlog of jobs and they're busy, then they're more likely to upgrade their fleet and go to newer technology and as opposed to just repairing what they got.

The market in that space does look favorable compared to a year ago. I think that the latest data I saw commercial construction was projected to be up about 4.5% in '22 after a decline in '21. And then you combine that with the other good favorable macro characteristics, housing starts are strong. [$1.6 million] in 2021 with a little growth in '22. New home sales are going to be up, remodeling activity is good.

So the mentality of the contractor is really important. And as long as they got jobs and they're busy and they have a backlog, they're more willing to buy our equipment, and I think that's what we've seen played out here in '21 and hopefully, continues in '22.

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

Yes, that makes sense. And then maybe my last one, just on Process. Like the trajectory of that business, particularly on the margin side has been pretty incredible. That now that's sitting at 23% type margins at the end of 2021. I guess how are you thinking about this business? And what's kind of like the right entitlement for this business over the next few years? I guess what I'm asking like where can margins go in this business?

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

Well, I think that the team there has done a great job. They've got a really good infrastructure in place and the name of the game now is leveraging and getting as much revenue through the top as possible because there isn't a whole lot of expense infrastructure to be added, except for maybe on the production side in a couple of places.

But -- our double diaphragm pump business looks really solid. We're getting involved in some things like lithium battery production where we're moving some of the highly caustic materials that are used in that. Our Semiconductor business is, as you would expect, very strong. So as we get more through the top line, I expect margins to go up. We don't really put targets out there, but I think it would be reasonable to expect that you'd see some improvement.

Operator

Our next question comes from the line of Bryan Blair from Oppenheimer.

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

I just wanted to clarify. Are you expecting that Contractor price cost will be neutral or maybe positive for the full year respecting the first versus second half dynamic that will be there? Does that shake out to neutral to positive given current visibility?

Kathryn L. Schoenrock - *Graco Inc. - Executive VP, Corporate Controller & Information Systems*

I think what we're looking at right now, we would expect that contractor price cost would be neutral. Of course, where the supply chain goes and where commodity prices go, could always impact that. But I think for what we're estimating right now, we would expect that their pricing actions would offset their costs in '22.

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

Understood. And following up on the capital deployment question, is it fair to assume, given the respective market structure and Graco's market share along with, I guess, the background of your new EVP, that any larger scale, more needle-moving M&A would be in your Process segment?

And related question, respecting that you have aggressive organic investment plans, and that's the norm for Graco. You do have a pristine balance sheet. I was curious if you could frame your realistic dry powder if we look forward 12 months or whatever a reasonable time frame would be?

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

Yes. So Bryan, I mean Inge is literally about a month into the job here. So we're going through a process where he's working with all of our teams to identify not only real close adjacencies, but other areas where we might be able to bring some Graco competencies to help them grow their businesses. And of course, we have a lot to offer to companies when we acquire them.

We have world-class manufacturing. We understand customer requirements better than most. We have an enviable global footprint. And it'd be interesting to see what comes out after he works with the team for a year or so. But my objective really is to get the organization to think about using M&A a little bit more as a revenue and earnings growth driver for Graco by putting corporate focus up at the top of the house.

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

Yes, I would just add as a former operating person that it really would be helpful to have -- it will be helpful to have somebody in that role working side by side with the business unit leaders. The business unit leaders have a lot of insights about what they're good at and where they see opportunities.

But they're running their businesses daily and having an expert in cultivation, negotiation, identification and research really should help the business units articulate in really maybe each one of the segments, credible and realistic development plans.

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

Understood. Appreciate the color.

Operator

Our next question comes from the line of Matt Summerville from D.A. Davidson.

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

A couple of questions. With how you're running the business now with foams now being under the Contractor umbrella, are there any changes to segment seasonality? Any changes to the segment's incremental margin profiles we should be thinking about as we model on a go-forward basis?

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

I don't think anything meaningful. I'm looking at Kathy here, but I ran that business for a while, and it is -- there's maybe a little bit of seasonality in North America in Q2 and early Q3, but it's a very global business on the protective coating side and that tends to be very stable. So I couldn't really fine-tune your numbers for you on that one.

Kathryn L. Schoenrock - *Graco Inc. - Executive VP, Corporate Controller & Information Systems*

No. And I think if you go to the spreadsheet on our website, you can look. And we have the history of the restated results out there, so you would be able to see what that looks like for the last couple of years.

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

And then to that end, how has the organic profile look in that business versus the Graco average? And from what I recollect, I think you acquired your way into the foam business maybe 15 years ago, something like that and it's been inside the Industrial business ever since. So why make this change now? And what type of synergies should we expect you guys to be able to extract from the change?

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

Yes. I think that we are not going to break out the historical revenue of that segment because it was part of Industrial, and we just don't feel like for competitive purposes, we should do that. But it really is a way to combine Graco's contractor-focused businesses and address some overlap that we had with regard to customers, product development, engineering resource, sales resource, marketing resource, et cetera. And so that the contractor team is really sorting through what those -- what their overlaps look like and then they'll decide how they want to address that on a P&L basis. But in the end, we should be more efficient, more targeted and more focused on those customers than maybe what we were when they were part of the Industrial business.

Operator

Our next question comes from the line of Jeff Hammond from KeyBanc Capital Markets.

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

Just on Contractor, I mean, I know there was a concern kind of second half comps, and it seems like the business did have some [decel], but now seems to be kicking back up. Just how are you thinking about kind of the demand momentum there and kind of that tough comp dynamic?

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

I think it looks pretty good to us. I mean we just went through some meetings with the team, and they're pretty optimistic about '22. When they talk to the customers, the retail channel partners that we have, they're still looking for more stock and inventory, both here domestically and regionally. The professional side of the business, the higher end sprayers looks really favorable.

As I said before, with all the construction activity that's going on, contractors are busy, and that's a good thing. And over and above that, I think our product pipeline for the next couple of years, what they've got teed up should also help their growth. So I think we're bullish on that business. And the team has done a great job, and it's all about execution here.

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

Okay. Great. And then the higher CapEx spend, I think the last couple of projects or years have been kind of focused on Contractor, where is kind of the incremental capacity being added as you look at this next slug?

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

In terms of the businesses, we've got several in the works. In the Minnesota area, we're building a new facility that will house the diaphragm pump and some of the related Process division manufacturing. The facility is also going to be shared with our HPCF business, which is -- which will be conveniently located about a mile away from our CED headquarters. The Gema businesses in Europe, we're investing in 2 facilities in Romania and in Switzerland. And we're doing an expansion in our Sioux Falls facility, which provides a number of products, primarily applicators and spray guns to a number of the Graco businesses.

Operator

Our next question comes from the line of Connor Lynagh from Morgan Stanley.

Connor Joseph Lynagh - *Morgan Stanley, Research Division - Equity Analyst*

I wanted to return to Process. Obviously, that's a very, very high growth business at the moment. I'm just curious if you could characterize. Do you see this as sort of onetime catch-up in demand versus where this was historically? Do you see some room for further growth as we move through the year and sort of lap these really high comps? How are you thinking about that through the year?

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

Yes. I think as I said in the earlier remarks that they were a little bit slower out of the gates than our Industrial business. So in terms of the comps, they probably had a little bit easier comp in Q4 than what the Industrial business had, let's say. But again, in that business, order intake is really good. Our orders continue to outpace our delivery. So we're heading into the year here with a decent backlog there. And it's coming from a lot of different areas, like the ones that I mentioned earlier. And if we can get more of that revenue through the top line, we should see some nice margin expansion.

Connor Joseph Lynagh - *Morgan Stanley, Research Division - Equity Analyst*

All right. Fair enough. Changing gears a little bit here, just returning to the repurchase conversation. How should we think about that given that you do have this focus on M&A, you do have the organic expansion initiatives. So I guess the question is, how much excess capital do you really need to see on your balance sheet to think that, that's something you want to do or more about the share price? Basically, just how does the sort of calculus work in your guys minds?

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

Well, it's a bit of an art as opposed to an absolute science. I mean Graco has a very strong, I'll call it, liquidity position, both in terms of the arrangements that we have in place as well as cash on hands. And as I said, we find opportunities throughout the year to do good ROI-driven decisions, most recently, adding to our pension plan as well as a favorable prepayment of debt.

The issue on stock, as I've said over the last decade, the company has been in the market very opportunistically and quite aggressive at time to time. And I think we've, on some occasions, talked about having a long-term return on investment of something like 15% IRR on our stock purchases. And we want to remain in a position when the opportunity is right that we can jump and jump aggressively and quickly.

And I think that we shall probably see the opportunity in stock markets from time to time, and we'll be positioned to move appropriately when the situation arises.

Connor Joseph Lynagh - *Morgan Stanley, Research Division - Equity Analyst*

Appreciate the context.

Operator

Our next question comes from the line of Andrew Buscaglia from Berenberg.

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

I want to touch on Industrial a little bit. It would be your biggest segment. And it's -- the 6-week bookings number somewhat surprised me that things perked up pretty quickly into the New Year already. And I'm wondering, what are -- what are the dynamics behind this in that? How much of that business is still like really far below pre-COVID levels? And is the growth, I know you're facing some tough comps, but what are some of the things you're looking at or conversations you're having with customers, the distributors that are saying that, that growth rate will be sustainable despite kind of all the headwinds we're seeing with supply chain challenges, et cetera?

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

Yes. I think the shorter the time period you look, the more dangerous it gets when it comes to absolute percentages and growth and things like that. But I'll just reiterate what we've said that we really do see across the board very solid demand with our customers. It doesn't really matter if we're talking about our liquid finishing equipment or our powder coatings equipment or sealant and adhesives equipment. They've all experienced demand from end users that are really being pulled through the distributors. And as we sit here today, that level of demand still is robust.

It makes sense to me from the standpoint that with all of the increase in demand in the economy and consumers and people buying stuff, it's really put pressure on manufacturers to take another look at the equipment that they have, and they're looking for ways to eliminate any waste, improve efficiencies and improve the quality of the products that they have. And that really squares up very well with everything that we do in that business. So we feel pretty good about what's going on there.

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

Okay. And similar to Contractor, you gave some kind of drivers or sort of economic data that you look at. Within Industrial, is it concerning you maybe that PMI and IP production is strong? But I think peaking here. Are you guys don't really feel that that's a good tracker for the Industrial segment?

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

Yes. We look at a lot of different things, but it's hard for us to really look at any 1 or 2 metrics and come away with any revelations. So we look at industrial production, GDP, PMIs and other stuff, but that's such a broad-based category for us that it's hard to tie it to any 1 or 2.

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

Yes. For example, when I was in finishing, I mean 1 number, and there's many, as Mark touched on, automotive production. I can look at that data going back to '17 and '18. We saw a surprising decline in '19, and obviously, '20 was very difficult. I can paint a picture with underinvestment in the automotive plants as well as demand for new products, the next couple of years there, to some degree, look a little bit like the picture we see for Contractor.

Operator

Our next question comes from the line of Walter Liptak from Seaport Research.

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

Kind of sticking with the macro trends. Asia Pacific, you've got all green lights going. I wonder if you could just maybe provide us with a little bit of color by countries. And specifically, there's been some question about China and the real estate markets and if there's a hard landing, soft landing. I don't know if you have any thoughts about that.

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

Yes, I'll take a stab at it. I mean for the year, we really saw nice growth in all the major geographies throughout the Asia Pacific region and really across all of our divisions. So the Automotive business in China was good. Australia was good with CED. We had some nice solar projects that were in China that also helped. The container and the shipping markets have been favorable in '21 versus what we saw in '20. We've got mining projects going on in Southeast Asia and again, in Australia and New Zealand. We've got good Lubrication business happening in China for wind energy and some other applications. And then like I said before, you've got a lot going on with EVs and batteries and lithium-ion applications in places like Korea. So really good activity across the board.

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

Okay. Fair enough. And on one of the earlier questions, I think somebody asked about what the M&A dry powder is. If you can give us, I don't know, a dollar amount or where you would take your debt-to-EBITDA levels up to?

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

Well, we've got a lot of cash. And we've always, I think, said that we'd be comfortable levering up for the right deal, that 2 to 3x EBITDA. So you guys can do the math on that. But we have a lot of firepower available on M&A if we find something that we like.

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

Okay. All right. And then last, just considering that you'll be at least price cost neutral for the year, do we -- should we assume or can we think about the operating profit flow-through going back to that kind of traditional 40% level?

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

Yes. I think that's reasonable. Of course, the first half of the year is going to be different than the second half of the year just in terms of realizing price, but there should be no reason that I can think of right now that would prevent us from being able to do that.

Operator

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

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

All right. Well, thank you very much for your participation, and thanks for being interested in Graco.

Operator

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