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GGG - Q2 2018 Graco Inc Earnings Call

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PRESENTATION

Operator

Good morning, and welcome to the Second Quarter 2018 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 4411660. The replay will be available through July 30, 2018.

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 question 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 2017 annual report on Form 10-K and 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 Caroline Chambers, Executive Vice President, Corporate Controller and Information Systems. Please go ahead.

Caroline M. Chambers - *Graco Inc. - Executive VP of Information Systems, Corporate Controller & Principal Accounting Officer*

Good morning, everyone. I'm here this morning with Pat McHale and Mark Sheahan. Our conference call slides have been posted on our website and provide additional information that you may find helpful.

A few of the key slides in our slide deck include Page 4, which is an overall summary of our results; Page 5, which shows the components of our net sales change, including the effects of currency and an overview of our sales by currency; and Page 6, which provides a reconciliation of the change in operating earnings from the prior year. Individual segment pages are later in the deck.

We saw strong sales in all segments with an increase of 6% from the prior year at constant exchange rates and without acquisitions. Growth in the Industrial segment was modest this quarter, primarily due to the expected lower project-based revenues this quarter as well as slightly lower order rates in EMEA.

Sales from acquired operations totaled $11 million in the second quarter, contributing 3 percentage points of growth. The effective currency translation also added 3 percentage points of growth to the top line this quarter. At current exchange rates, we will face currency headwinds during the second half of this year, largely offsetting the favorable currency impact that we experienced in the first half of 2018.

The strengthening of the U.S. dollar, especially against the Chinese RMB during the latter part of June, also result in exchange losses on net assets of foreign operations of approximately $3 million this quarter.

Reported net earnings totaled $89 million in the second quarter or $0.51 per diluted share. After adjusting for the impact of excess tax benefits from stock option exercises, net earnings totaled $83 million or $0.48 per diluted share.

Gross margin rates remain strong, up slightly from the second quarter last year. The favorable effects of currency, translation in pricing were nearly offset by the unfavorable effect of lower gross margins from acquired operations, including a charge of $1 million related to purchase accounting inventory valuation and unfavorable product and channel mix.

Factory performance continued to be strong during the second quarter as volume and cost improvement projects offset rising commodity and other costs. As our supplier contracts reset to the higher commodity prices, we expect to see increases in our cost. And while we expect to largely offset these cost increases during the second half of the year with efficiency and cost-reduction projects, assuming current volumes and excluding the effect of tariffs, commodity and other cost increases are beginning to put more pressure on our factories. We're beginning to see and analyze the effect of increased tariff rates on raw materials and component source from foreign suppliers. The timing of the practical effects of the higher tariff rates for foreign source materials and components will be slightly slowed by inventory and the supply chain. There are a lot of moving pieces, such as the effect of higher tariff rates on materials within purchased items and the expense and timing of changes in supplier pricing to us.

We also look at other outsourcing options as well as other possible future changes to the categories of materials and components affected by the tariffs.

Given these factors, it's difficult to make complete estimates for the remainder of this year or for next year. Based on the tariffs in place right now, our current estimate for the second half is that higher tariff rate, could affect gross margins overall by approximately 1.5 percentage point. The effect could possibly double for 2019.

The effect tariff increases will vary by product category. Operating expense increased by $12 million compared to the second quarter last year, including $2 million related to currency translation, $2 million from acquired operations, $4 million of increases in sales and earnings-based costs and $1 million of market-driven share-based compensation.

I'll take a moment to walk through our tax rate this quarter. Our as-reported tax rate was 15%, down 1 percentage point from the second quarter last year. Adjusted to exclude the impact of excess tax benefits related to stock option exercises, the effective income tax rate was approximately 21.5% in the second quarter, 9 percentage points lower than last year due to the net effects of the U.S. federal income tax reform legislation passed at the end of 2017.

Cash flow from operations totaled $171 million year-to-date in 2018 compared to $136 million year-to-date last year.

Share repurchases and net of shares issued totaled $152 million year-to-date 2018, and we may continue to make share repurchases on an opportunistic basis going forward.

Capital expenditures totaled $27 million year-to-date in 2018. We expect usual capital expenditures for machinery and equipments of approximately $40 million for the full year. And our current estimate for building projects to increase capacity for production and distribution is expected to be approximately $40 million this year. An additional $80 million to $100 million is expected to be invested in building projects in 2019 and 2020.

Subsequent to the end of the quarter, we made a $40 million voluntary contribution to a U.S. qualified pension plan. We expect unallocated corporate expense to be approximately $28 million for the full year in 2018, unchanged from earlier full year estimates.

Our expected tax rate for the third quarter and the full year 2018 is expected to be approximately 21% to 22%, excluding any effect from excess tax benefits related to stock option exercises or other onetime items, such as the tax effect of the third quarter pension contribution.

I'll turn the call over to Pat now for further segment and region discussion.

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

Thank you, Caroline. Good morning, everyone. All of my comments this morning are on organic constant-currency basis. Caroline has covered the details on our second quarter and first half earnings adjustments, so any references to profitability will be on an as adjusted basis. It was a solid quarter, and we delivered growth in every segment and every region with the exception of EMEA, which was down low single digits. In EMEA, we experienced general demand softness across a number of product categories as well as weak project shipments. Looking ahead, we expect project activity to help us in the second half and anticipate EMEA second half sales will support our outlook of mid-single digit growth for EMEA for the full year.

Moving onto the segments. Industrial, as expected, delivered low single-digit growth in the quarter, primarily due to the timing of finishing systems sales and other project activity. Industry was up against a difficult comp from the second quarter of last year where we had double-digit growth, so we view this quarter as a favorable result against that backdrop. Our Process and Contractor segments delivered solid double-digit growth in the quarter and the first half. Underlying demand in our Process segment end markets remains positive. We continue to see increased activity in the areas of infrastructure investment, mining, semiconductor and onshore oil and gas.

In our Contractor segment, we continue to see positive double-digit out-the-door sales across both the paint store and home center channels.

Turning now to our regions. I won't comment on EMEA as I covered that region earlier. In Asia Pacific, we delivered high single-digit growth with growth in every segment. Year-to-date growth in Asia is solid double digit and end markets appear to be holding up well at the moment. The Americas had double-digit growth in the quarter and year-to-date, led by our Process and Contractor segments. Demand in South and Central America remains soft.

Moving on to profitability. Our incremental margins in the second quarter of 2017 were extremely strong. So profitability in the second quarter of 2018 was up against a difficult comp. Excluding foreign currency and acquisitions, incremental margins for the quarter and the first half were approximately 30% and 36%, respectively, in line with our expectations for the full year.

Contractor incremental margins remain light for the second quarter in the lower 20s. Good expense leverage in the segment was offset by unfavorable channel mix and higher sales incentive commission of rebate costs as a result of the volume -- higher volumes. As Caroline mentioned, volume growth continues to help our factories offset material cost increases.

Moving onto our outlook. Incoming order rates continue to meet our expectations as we head into the next quarter. We are expecting growth from every reportable segment. Other than the South just mentioned in EMEA, demand levels appear to be holding steady. Based on our performance in the first half, we're holding our full year 2018 outlook of mid- to high single-digit growth. Although we anticipate second half pressures from tariffs, material cost and currency, we are encouraged by the strong levels of demand in many of our key end markets and feel confident that with the help of our employees and channel partners around the world, we'll have another strong year in both sales and earnings.

Operator, we're ready for questions.

QUESTIONS AND ANSWERS

Operator

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

Saree Emily Boroditsky - *Deutsche Bank AG, Research Division - Research Analyst*

I wanted to dig into your outlook for APAC for this year because your guidance implies a slowdown in the second half, but your end-market outlook for APAC process is more positive. So could you just help us understand the puts and takes behind your guidance?

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

Yes. I would say, our general outlook for Asia Pacific is that it should remain pretty solid through the back half of the year. We don't have any real specific concerns at this point. Business activity across the board seems pretty well, little weak in Japan, but pretty decent everywhere else.

Saree Emily Boroditsky - *Deutsche Bank AG, Research Division - Research Analyst*

Does that imply there could be some conservative baked into the guidance?

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

I don't know. We don't get that fine with our guidance.

Saree Emily Boroditsky - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. And then just given the likelihood that you're going to end the year close to a net cash position, could you provide an update on how you're thinking about capital allocation and then any additional color about how we should think about buybacks?

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

Yes. So we really haven't changed our philosophy and our direction on capital allocation. We continue to invest in our factories. We've got some brick-and-mortar projects going on. Certainly, we continue to pay a nice dividend and we evaluate that at the end of every year. And then in terms of the share buybacks at current prices, we have decided that we're going to be opportunistic, which is really consistent with what we've done lately.

Operator

Our next question comes from Joe Ritchie with Goldman Sachs.

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

Can you maybe touch on the finishing systems sales and timing there? Was any of that like from an end-market perspective, auto related? And how do you see that playing out in the second half of the year?

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

Yes, there's a little auto in there, but I think primarily it's on the Industrial side, and it just tends to be lumpy. And we bought power systems business back few years ago and that's added additional finishing systems to our portfolio and systems just tend to be big and they come when they come. So overall, order rates and demands for systems over the last couple of years have been good, but they have created some noise quarter-to-quarter, and I think everybody is just going to have to get used to that.

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

It's fair enough, Pat. Maybe following up with Caroline on the 50 basis points of gross-margin degradation that you guys expect or at least impact that you expect in the second half of the year from the tariffs. Can you just give us a little bit color like what went into that number? What are you guys baking in at this point? Any additional color would be helpful.

Caroline M. Chambers - *Graco Inc. - Executive VP of Information Systems, Corporate Controller & Principal Accounting Officer*

Yes, we took a look based on tariff codes that have been announced so far and took a look at how our purchases fall into those codes and made some estimates of what inventory might be in the supply chain and when we might start to see some of those tariffs codes. Of course, there's a lot of moving pieces. It seems as though that can change every day. And we don't know, for sure, when any suppliers might start to pass those tariffs on to us if it's not something that we directly import. So it's an estimate, but it's a pretty high-level estimate at this point.

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

Okay. Fair enough. And if I could maybe sneak one more in. Pat, it sounds like things are going really well at this point with Contractor. Starting to see some signs of housing slowing down a little bit. Maybe you can comment on that and whether you're seeing any of that as we've already started the third quarter?

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

Yes, I'm sure we look at the same data points. So we're seeing and reading what you're reading. The business unit is not really concerned at this point. They are still seeing good demand for our products out there. Pricing of homes still seems to be going up. So there's some question in our mind how much of this is related to demand versus -- or supply and demand versus people actually pulling their horns back. So I think we need to give it a couple more quarters and see, but again at this point, we still feel pretty good about demand for our equipment.

Operator

We'll go next to Jeff Hammond with KeyBanc Capital Markets.

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

So just on -- I guess, to frame the 50 basis point headwind, should we look at you guys as having kind of your normal incrementals and then haircut the 50 basis points from there or do you expect some other offsets like additional price actions, et cetera?

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

So, the 50 points is on the gross margin. So you'll have to just do the math on that. And again, that's an estimated number at this point. Certainly, we'll do the things we can do within our factories to try to minimize the damage, and there's also another dynamic going on, I'm sure you're aware of, with the devaluation of the RMB and so how that's going to play into the whole equation is in question. I would assume that the Chinese manufacturers want to try to keep their business. And if they can devalue their currency, there may be some opportunities there for us to negate some of the overall impact on the tariff. So it's pretty squishy at this point. We just think that 50 basis points on the gross margin would be to mark for you to put in your model and we'll see how it plays out.

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

Okay. And then any kind of additional price actions you're -- you've announced or you're considering to kind of directly combat those?

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

No, we do an annual price increase at the first of the year and we review all of our product categories. We don't go with the blanking -- blanket price increase. We review all of our product categories and look at a number of variables, the differentiation we may or may not bring in our product category, what the competitive environment it is, what's happening with the material costs and tariffs. So we'll look at it all and we'll implement in beginning of the year what we think the market will bear.

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

Okay. And then, can you just -- you did formally kind of raise your CapEx assumptions around some building products. Can you just talk more specifically what you're doing and what that adds from a capacity standpoint?

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

Yes, so we've got a number of facilities that have really been maxed out in terms of space with our growth over the course of the last couple of years, and we've seen this coming and I think we've communicated it pretty well, but the actions around getting the actual construction projects underway are starting, and you'll see those over the course of the next 2 or 3 years, and it's sort of a step function thing usually when we expand a facility, then we're good for a few years and if we keep growing, then we've got to come back and hit it again. So where we build will give ourselves some extra room, but we do have some things that we need to do.

Operator

We'll go next to Deane Dray with RBC Capital Markets.

Deane Michael Dray - *RBC Capital Markets, LLC, Research Division - Analyst*

Just to go back to the price question, because it is interesting out of all the companies this earnings season that are talking about the tariff pressures, the price cost equation comes up the whole time. And so you put a price increase in January and that was before we started seeing the brunt of the tariff pressures. Can you remind us what that price component was? How much did you realize? And what's the trade-off here of not being more proactive in trying to get -- go after more price, given the circumstances? Because this is certainly outside of any kind of seasonal pressures that you might see.

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

Yes, so our realized pricing generally is in that 1.5 kind of range, and I don't think there was anything dramatically different about our price increases that we put forth in January. Some of those take a while to work through, so that's still early in the year. I'm not overly concerned to be honest with you. We've got great factories and good cost reduction projects. Our high gross margins just mathematically put less pressure on us in terms of the material component of a revenue dollar than it does on probably folks that are in other sorts of businesses or industries. So we have a fighting chance even given the environment to continue to perform well. And I really like the consistency of the pricing programs that we have today. You throw a midyear in because things are going the right way and then things go the other way and then what do you do, put in a midyear reduction or you skip a year. So we've got sort of a cadence. Our distribution channel has to actually go through a lot of work when we implement a price increase. We got thousands of part numbers. They've got to go into their systems and update them all. We've got to do the same thing. It's a lot of screwing around to save a few bucks over the course of a few months. And I think that our program has worked really well over the years and we stuck to it and we plan to do that.

Deane Michael Dray - *RBC Capital Markets, LLC, Research Division - Analyst*

Good. And look it, I will tell you that one of the companies yesterday [Pentair] had the exact same discussion of why they were sticking to their annual increase and not disrupt their dealer networks and not disrupt customers. So we certainly have heard that position. And maybe just this is a related question, is, Graco is unique among the industrials that we follow certainly in terms of your concentration of manufacturing in the U S. Now that has certain advantages, but it also has disadvantages in this environment with tariffs. Is this cause you to rethink at all and maybe this is a rhetorical question but just the idea that you were particularly more exposed than the companies that had natural hedges where you have manufacturing in these regions that they sell into?

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

Yes, we've always been pretty focused on total cost, where we put our facilities and logistics and transportation and communication and speed to market and quality and everything else. So it's a pretty thorough analysis that we do when we decide where we want to produce product. Of course, any political things or tariff things are going to factor into that, but they're only going to be only one element in the overall model. In terms of advantage, disadvantage during this time, we've got half or more of our sales are here in the U.S. and having the factories here, I think, is not necessarily a negative in this environment. Certainly, we'll be sourcing some components and raw materials from overseas, but we may have choices going forward in terms of what we want to do there. And if we were manufacturing all overseas and bringing completed products in, depending upon which tariff codes they were in, we could be getting hit a lot harder on our U.S. revenue than we're going to be because our factories are here. So I think there's some puts and takes to it. And again, I think overall our model works and we're very focused on total cost and we'll continue to be.

Deane Michael Dray - *RBC Capital Markets, LLC, Research Division - Analyst*

That's a real helpful explanation. Just last question. It's a follow-up to Joe's question. Your answer was really interesting about trying to reconcile the double-digit Contractor growth with what we're seeing in housing, the builders, the building products, all those -- the stocks are getting rocked and I think that's what's you were mentioning about pulling horns in or derisking, but just the incremental demand, are you not seeing any change on the Contractor side?

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

Second quarter, out-the-door sales in both paint store and home center channel were double digits. So -- and we just had our operating review with the division and we're feeling pretty good about the back half of the year. Recognizing in a lot of areas of the country labor is getting pretty tight. And so as these folks want to get jobs done, they need to be productive. We can't quantify that, but we hear that and believe that, that is probably a dynamic that is also in our favor.

Operator

We'll go next to Michael Halloran with Robert W. Baird.

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

Just one quick one for me here. Looking at Europe and the EMEA region in general, stripping out the project activity, the finishing variability that makes a lot of sense, how would you characterize the environment underneath that, the more steady state stuff? Was that a little weaker in the quarter? Any thoughts moving forward on that side?

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

Yes. For us, it was definitely just underlying demand was a little bit weaker in the quarter weaker than we would have expected, and I'm not really sure why. We tend not to get too jumpy quarter-to-quarter because things can move around, but it's something definitely going into the second half here that we are tuned into and we'll be watching. Again, we think that the project activity that we will have in the second half is going to allow us to do just fine in EMEA over the course of the second half and meet our projections there, but, yes, it's a little bit concerning to see the softness that we saw just generally across the board in the second quarter and we're going to be watching that.

Operator

We'll go next to Charley Brady with SunTrust Robinson Humphrey.

Charles Damien Brady - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Just a quick one on the commentary on the mix. I guess, on Contractor, is that more a function of the usual pro paint versus home center or is it more granular in terms of within that, the mix of the sort of low, medium, high, which, I guess, also plays into that larger mix? I'm just trying to get a little more granular on kind of where you see the mix on the Contractor side now and has it changed much in the past 6 months or so?

Caroline M. Chambers - *Graco Inc. - Executive VP of Information Systems, Corporate Controller & Principal Accounting Officer*

I don't think it's changed much as it continues to be more the mix between home center and pro paint.

Operator

We'll go next to Brett Kearney with Gabelli & Company.

Brett Kearney - *G. Research, LLC - Research Analyst*

I just want to ask whether you're seeing anything interesting in your M&A bundle at this point. Obviously, you guys have great internal product development opportunities, but just want to get a sense for whether there's any areas of focus inorganically for you here?

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

Yes, we've got a team that's working on that. I'll tell you one thing we're seeing is, we're seeing people paying a lot of money for deals. So that's a concern. We don't want to go crazy out there and we're trying to be disciplined when it comes to our model, and we're going to continue to do that. While it would be nice to get some bigger things done, I think in this high multiple environment, that becomes less likely for us and the deals that we do get done, I would anticipate over the course of the next year or so tend to be towards the smaller side, deals that we can source, maybe we build some relationships with and we have some particular synergies that will allow us to be successful in an environment where people seem to be paying teens multiples to get deals done.

Operator

(Operator Instructions) We'll go next to Matt Summerville with D.A. Davidson.

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

Just a couple of additional ones. On the tariffs side of things, the estimate 50 bps in the back half of the year, maybe upwards of 119, understanding that, that's a rough cut. Should that type of number be applied evenly across all 3 businesses or would you say one reportable segment may be more exposed than the others?

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

Yes, that's a good question. We probably haven't sliced it enough still to give you the answer to that. Certainly, I do know some product categories within business units will get hit harder than others, but I haven't rolled up by product category, by segment what that's going to look like. So I think we're now probably just peanut butter spread it and as things just play out here over the back half of the year, we'll try to bring some more clarity to that.

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

In the second quarter, Pat, was the book-to-bill in your Industrial business positive and if you're willing to disclose it, would you let us know what that is?

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

We generally don't share a lot of book-to-bill information. It just leads us down a rabbit hole, right? Then we do it for one business and then we got to do it for the rest, and then we do it this quarter, we got to do it next quarter. So, well, I would say is the underlying demand environment across our business units, we think, is pretty decent. We think the end markets are pretty good, and we feel comfortable with our outlook for the full year. So I think that gives you what you need.

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

And then just lastly, have you seen customers' views towards capital spending plans change in light of this tariff environment? Are customers talking about trying to get things done faster, maybe pausing on things or any discussions like that happening at this point?

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

I haven't seen or heard a whole lot of that. It's interesting. Even in the categories that are going to get hit hard, there's not capacity to bring all the manufacturing back here tomorrow, right? So this is a long game, and I think companies are going to wait to see how it plays out before they run out and build a factory because their overseas competitor got a tariff slapped on them. You start to build a big factory to build something here to increase the U.S. capacity because somebody else got a tariff and then a month later something changes and you got a big project underway and you got nothing to fill the building up. So I'm going to guess that there's a lot of wait and see going on. I don't know, Mark's been out and about a bit. I'll let Mark chime in if he's got any comments.

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

I agree with that. I think that from what I see and what I have been seeing and hearing the only thing is that there are some issues with regard to putting up new buildings and are they going to have enough deal capacity and get things on the ground and up and running, it hasn't been, hey, "I am going to delay now because of these tariff impacts." So I think it's pretty muted at this point.

Operator

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

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

So I just want to understand a little bit more about your view on the tariffs, and it sounds like it's more of a price cost issue than any sort of a demand issue from your customers or any sort of a supply chain issue for you because you manufacture in U.S. Is that fair? And I wonder if you think that there -- if it is just price cost, are you seeing any changes in Europe or in Asia related to tariffs or even just discussions of tariffs?

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

So, I think it is price cost right now. The big question mark is what happens and to what extent and then how does that affect the global economy. And there definitely will be impacts plus and minus in different parts of the world and different product categories, maybe even to global GDP. But I think it's impossible for anybody to quantify right now. Everybody is going to have to make their best guess on how this is all going to play out. But I think there's a lot of chess moves left. And so my standpoint is, really it's a price cost issue and we need to have a little bit of patience here.

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

Okay. Great. And then going back to the capital spending question. We were out visiting the facility this quarter. We were really impressed by some of the automation and robotics that you guys are putting in, and I wondered what kind of returns are you expecting on some of those projects? What's been your experience with automation?

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

So the brick-and-mortar projects, of course, are squirrely to try to give you an ROI, but on most of our machinery and equipment, whether it's CNC machines or our robotic automation, we rarely approve anything that doesn't have 15% cash on cash return and typically we're probably up in the low 20s.

Operator

We'll go next to Liam Burke with B. Riley, FBR.

Liam Dalton Burke - *B. Riley FBR, Inc., Research Division - Analyst*

Pat, how is the flow of new product introduction has been going? And are you still providing a strong ROI proposition as they enter the channel?

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

We feel pretty good about the new product flow. Our Contractor launch this year was a little bit light. To make up for that, we launched early. We got our whole sales team all set in December and we hit the streets hard in -- on January 1 where sometimes our Contractor launch will spill into the -- later into the first and early into the second quarter. So the products were a little bit light this year just because of the timing, but we're doing real well with those. I think the other divisions are more consistent year-to-year and don't have as many of the ups and downs based upon the size of the project we take on. But the pipeline looks good. Contractors got a nice lineup coming for 2019 and in general, I feel pretty good about both the returns and the velocity of our new product program here.

Operator

And we have no further questions at this time. I'll turn the conference back to Pat McHale.

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

All right. I guess, that's it. We'll keep doing our job and we'll catch you in 3 months. Thank you.

Operator

That does conclude today's conference. Thank you all for your participation. You may now disconnect.
