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GGG - Q2 2013 Graco Earnings Conference Call

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PRESENTATION

Operator

Good morning and welcome to the second quarter 2013 conference call for Graco Inc. If you wish to access the replay for this call you may do so by dialing 1-800-406-7325 within the United States or Canada. The dial in number for international callers is 303-590-3030. The conference ID number is 4627991. The replay will be available through July 28, 2013.

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 2012 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 Caroline Chambers, Vice President and Controller. Please go ahead.

Caroline Chambers - *Graco Inc. - VP, Corporate Controller*

Good morning everyone. I'm here this morning with Pat McHale, Jim Graner and Christian Rothe. I will provide some top level discussion on our overall financial results for the first quarter and then we'll turn the call over to Pat.

Slides are available to accompany our call and can be accessed on our website. The slides include information about our consolidated financial results for the second quarter in our usual format.

Sales this quarter totaled $286 million, an increase of 7% from the prior year with varying trends by division and region. Sales grew by 14% in the Americas with increases in both the industrial and contractor segments while sales were flat in the lubrication segment.

The growth in the Americas was particularly strong in the contractor segment which grew by 28% with strong sales in both the paint store and home center channels.

Sales in EMEA increased by 2% with growth in the contractor and lubrication segments. Sales declined by 6% in Asia Pacific with ongoing weakness in mining and general industrial applications, affecting sales in the industrial and lubrication segments.

Changes in currency translation rates from the prior year did not have a significant effect on sales or operating results for the quarter overall with $1 million of unfavorable currency translation from Asian currency partially offset by favorable currency translation from the euro. A table showing impact of volume, acquisitions and currency by segment and region is included on page five of the slides.

Net earnings totaled $58 million or $0.92 per diluted share for the quarter. Page eight of the slide deck provides a quarter over quarter overview of changes in operating earnings.

Gross profit margin as a percent of sales was 55.5% for the quarter, up from 52% for the quarter last year which included $7 million of non-recurring inventory charges related to the acquisition of Powder Finishing. Realized pricing and manufacturing cost improvements were partially offset by changes in mix. Operating earnings improved in every segment from last year.

The decrease of $7 million in acquisition divestiture related expense offset higher marketing and selling expenses and were driven primarily by launch activities in the contractor segment and other volume related increases.

Unallocated corporate expense can vary from quarter to quarter based on timing of certain items and excluding acquisition divestiture related expense, is expected to be in the $5 million to $7 million range per quarter going forward.

Other income includes $11 million for the quarter and $15 million year to date of dividends received from the liquid finishing business and is accounted for as a cost method investment.

Just a brief reminder on the background of this investment and the dividends -- the liquid finishing business was purchased in April 2012. It is reflected as a cost investment on our balance sheet and under terms of the hold separate order from the Federal Trade Commission, we cannot exercise direction or controlled operations of liquid finishing nor can we exert significant influence over the liquid finishing operations. Our investment in the liquid finishing business continues to be reflected as a cost method investment and the liquid finishing financial results are not consolidated. Income is recognized based on dividends received from current after tax earnings and is included in other income on Graco's income statement.

To reduce cash and undistributed earnings in the hold separate operations, a higher level of dividends, $11 million, was distributed this quarter as compared to the usual $4 million received in prior quarters. We expect dividends to be approximately $8 million in the third quarter though the timing of dividend distribution from certain foreign jurisdictions is dependent on regulatory approval.

We have not yet received the final order from the FTC requiring the divestiture of liquid finishing. Of course, when the final order is received and the sale of this investment is completed, there will be no further dividends or income stream from the liquid finishing investment.

The effective tax rate for the quarter was 29% as compared to 32% last year, reflecting the effect of the federal R&D tax credit that wasn't renewed until the first quarter 2013 and the effect of the after tax dividend income received from the liquid finishing businesses.

We have included our usual slides about segment results in the slide deck starting on page 12. Net cash provided by operating activities was $61 million for the quarter with changes in working capital in line with business volumes and consistent with prior quarterly trends.

Capital expenditures were $6 million and we paid dividends of $15 million. We also resumed modest share repurchases in the quarter. Our outstanding long term debt has declined by $91 million year to date to $466 million. We anticipate that the total future cost of a divestiture will be approximately $10 million. The timing of the expense and the final amount will be affected by the sale of liquid finishing and the regulatory review process.

The tax rate for the third quarter and the full year is expected to be approximately 29% to 30%. Capital expenditures for the year are expected to be in the range of $20 million. We also expect to continue a moderate rate of share repurchases in coming quarters.

With that, I'll turn the call over to Pat for more comments on our quarter.

Pat McHale - *Graco Inc. - President, CEO*

Thanks, Caroline. Good morning everyone. This morning I'll provide some commentary on the trends we saw in our business in the second quarter and our outlook for the second half of the year.

During the second quarter, the sales line played out generally in line with the outlook we gave in April with strong growth in the Americas and continued macro headwinds internationally. We are particularly pleased with the performance of our contractor business in the Americas which posted growth of 28% year over year and the overall financial performance of the Company was a record level for both quarterly sales and earnings.

Let's walk through each of the regions and segments and I'll briefly give you a few data points.

First, Asia Pacific -- overall, Asia Pacific was down 6% against a strong 2012 Q2 comparable and performed slightly worse than anticipated in the quarter. At the same time, the business performed slightly better than anticipated in the first quarter so our year to date performance of negative 3% is broadly in line with our original expectations for the first half. The macro environment is still weak so quarter to quarter fluctuations aren't entirely surprising.

In Asia Pacific, our industrial segment declined 7%. Our contractor segment posted low single digit growth while our lube business was down double digits. The decline in lube reflects ongoing weakness in certain key mining accounts which had a strong first half of 2012. Our comparables for the second half in the lubrication business will be easier and we're not expecting this same level of year over year decline to be a theme. That being said, the Australian market for lubrication started softening in the first half so we're keeping a close eye on that.

Demand continues to be highly variable from country to country and across product lines for our Asia Pacific region. We saw moderate growth in Korea, mostly for projects destined for China. We also saw growth in Southeast Asia and India with softness in China, Japan and Australia.

Moving on to EMEA, macro headwinds in EMEA continue to be challenging but we were able to grow the region 2% in the quarter. As with the first quarter, we posted nice growth in our lube business and we're pleased with mid-single digit growth in our contractor segment. Our industrial segment was down slightly with nice growth in our process products, offset by declines in certain other product lines.

Notably, our business in Western Europe eked out a small amount of growth in the second quarter while the emerging markets of Eastern Europe and Russia posted strong growth.

The Middle East was weak in the second quarter and we're watching that region closely for signs of further changes in the economic or political environment.

Moving on to the Americas, as expected, our contractor segment performed well with strong double digit growth during the quarter. Both the paint store and home center channel billings grew at a double digit pace in the second quarter. I should note that we had an expansion of the number of SKUs stocked at a major home center customer during the quarter which resulted in a sales increase of about $4 million on the initial stocking. As is typical with these store resets, there were some additional costs incurred by Graco. After taking those costs into account, the incremental profitability for the stocking order in the quarter was zero. Those costs are largely behind us now so we're expecting the follow on sales to be at our typical profitability level.

To put this in context, the drag in our operating margins for the worldwide contractor segment in the second quarter for the store set was about 100 basis points.

We remain positive about the dynamics in the North American housing market. Comments from the field are good and we're expecting double digit growth in the contractor Americas business in the second half. If you recall, we started to see a ramping recovery in the fourth quarter of 2012 so our comparables will get more difficult as we finish out the year.

Our industrial segment in the Americas returned to growth in the second quarter. The 7% growth in the business was broad based across product lines and end markets which is encouraging. That said, we believe the growth rate will likely drop back closer to the first half run rate as opposed to the higher growth rate that was experienced in Q2.

Last quarter I talked about seeing signs of caution with customers when it comes to capital spending and despite our performance in the second quarter, it's still an area of concern that we're keeping a close eye on.

Sequentially, our earnings as a percentage of sales in our worldwide industrial segment dropped from Q1 to Q2. Part of the decline was simply the decremental margins on the sequential revenue decline. It was also a mix shift within our businesses that make up the industrial segment which dampened operating margins and a quarter to quarter currency headwind. After analyzing the results I am satisfied that the business is performing and it's not an area of concern.

Our lubrication segment in the Americas grew slightly in the second quarter with high single digit growth in our legacy vehicle service business but offset by a double digit decline in our industrial lube business. Industrial lube was impacted by a lower demand in both on-road and off-road mobile applications.

Now for our outlook, our outlook for the year is relatively unchanged from a quarter ago. We expect full year growth in every region. In the Americas, the contractor segment should grow double digits for the second half while we continue to expect low to mid-single digit growth in industrial and lube.

As discussed for the last several quarters, we continue to expect EMEA will be a struggle throughout the year due to the lack of any real help from the macro environment in Western Europe. We haven't seen a catalyst to restart the growth and it looks like the market will be sideways for the next few quarters at least.

As our investors know, we are focused on penetrating emerging markets of EMEA further and are expecting that we can get growth from our overall EMEA region as a result. The current outlook is unchanged with a view for low single digit growth for the full year 2013.

The expectation in Asia Pacific is similar to EMEA with low single digit growth for the full year 2013. In Asia Pacific, the comparables do get easier in the second half of the year, more so in the fourth quarter.

As always, we're focused on driving new product sales, expanding our distribution coverage and working our end user conversion strategy in our contractor segment.

In summary, our overall outlook for the full year 2013 is unchanged. Our factories continue to perform well and our strategic growth initiatives provide opportunities on revenue that we work on each day. With these efforts along with the tailwind from the U.S. housing sector, I'm expecting that Graco will have a record sales and earnings for the year.

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A few comments on the liquid finishing divestiture process -- it's now been a year of including similar comments in our quarterly conference call. The final decision and order from the FTC has not been issued and the timing of the order is unknown to us. We had disclosed previously that there were two intellectual property matters that were holding up the process. Of those two issues, the larger and more important one was resolved during the second quarter. There was no cost to Graco to get this resolved and the resolution did not change the competitive position of the business. We're hopeful that the last remaining item will be resolved quickly. As stated before, Graco doesn't believe this matter is material to the overall operations of the business. That being said, the FTC is focused on the matter and is taking action that they deem to be appropriate.

Unfortunately, I'm not in a position to give much more detail. In the meantime though, the business continues to perform well. We saw $11 million in hold separate dividends flow through to Graco in the second quarter and we believe that the profitability of this business is sustainable.

This concludes my prepared remarks. Operator, we're ready for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. Ladies and gentlemen, we will now conduct the question and answer session. (Operator Instructions)

Your first question comes from Jim Giannakouros from Oppenheimer and Company. Please go ahead.

Jim Giannakouros - *Oppenheimer & Co. - Analyst*

The mix headwinds that you alluded to overall but I think more specifically in industrial, can you put some finer points as to the dynamics there affecting gross margin and outlook there for the second half?

Pat McHale - *Graco Inc. - President, CEO*

We have a lot of different product categories in industrial and sell into a lot of different regions and we don't break those out. Those are niche product lines that we don't break out sales trends by product line for obvious competitive reasons so those things can move around quarter to quarter and I really view that as more noise than anything else.

Jim Graner - *Graco Inc. - CFO*

Jim -- Jim Graner -- the sequential decline in operating margins mainly comes from the decremental revenue of $22 million and headwinds from lower currency rates in Q2 versus Q1. Only about one-third of the difference represents a mix issue.

Jim Giannakouros - *Oppenheimer & Co. - Analyst*

That's helpful and more specifically on the lube margin, that whips out quarter to quarter, nice lift there. How should we be thinking about exactly what lifted margin there and is that sustainable in the second half?

Jim Graner - *Graco Inc. - CFO*

We had some really nice performance in lubrication segment in the factory in the second quarter versus the first quarter and primarily all of the improvement in operating margin came from the factory. Taking a cautious look at that, we would say that you should look at the six month results as being typical of what you should expect for the second half of the year.

Operator

Your next question comes from the line of John Franzreb from Sidoti and Company. Please state your question.

John Franzreb - *Sidoti and Company - Analyst*

I want to talk a little bit about the $10 million in divestiture costs that you expect to come. Can you talk a little bit how that is going to play out? You had $1 million of costs in the quarter. Should we be thinking about $1 million in incremental costs each quarter going forward and the bulk of it when the final sale order comes in? Give us a little bit of color about that $10 million number.

Jim Graner - *Graco Inc. - CFO*

John, that is pretty appropriate. The majority of that cost will come with fees that relate to the sale, investment banker and other fees, legal fees, but the $1 million rate is probably appropriate until such time as we announce a transaction.

John Franzreb - *Sidoti and Company - Analyst*

And what is the rationale or the thought process behind the dividend number you're taking each quarter? You jumped it up and now next quarter, you're looking at $8 million -- a little bit about what goes into that discussion?

Jim Graner - *Graco Inc. - CFO*

We had started this process with thinking we would do a steady $4 million per quarter, trying to just offset our interest cost without giving a lot of volatility to future comparables. We found ourselves with a larger balance in cash in that business than we wanted so we attempted to take it all out in an additional $10 million or $11 million in the second quarter. We failed to get approval from one government jurisdiction. It looks like that approval came in July so the delta between the $11 million and the $15 million will be paid out in the third quarter, giving us $8 million for the quarter so we're still sticking with the thought process of $4 million a quarter as a standard rate.

John Franzreb - *Sidoti and Company - Analyst*

That's perfect, Jim. That makes sense. And one last question, did you say that the new product rolled out in contractor, the restocking, was a 100 basis point headwind to contractor margins? Did I hear that properly?

Jim Graner - *Graco Inc. - CFO*

Yes.

John Franzreb - *Sidoti and Company - Analyst*

And do we have any information on what the sell through of the new products is, how it is being received?

Jim Graner - *Graco Inc. - CFO*

Yes, I would say that both in the paint channel and the home center channel, our sell through is a little bit less than their purchases were from us in the quarter which is typical I would say of the stocking cycle on a seasonal basis. We're not concerned with the inventory level in either channel at this point.

John Franzreb - *Sidoti and Company - Analyst*

And is this the second generation of the handheld?

Jim Graner - *Graco Inc. - CFO*

That is part of it, yes, and also just some I'll say, the medium sized electric units.

John Franzreb - *Sidoti and Company - Analyst*

And I guess one last question, have we seen any change in mix with some of the larger paint supplies versus the smaller size?

Jim Graner - *Graco Inc. - CFO*

When we look at the segment in total, we don't just because of the large increase in the home center units. We just target the paint center channel. We are seeing sequential increase in the larger units, about six percentage points in this quarter coming between what we call our [gas] large electrics and our niche products.

Operator

Your next question comes from the line of Charles Brady from BMO Capital Markets. Please go ahead.

Andrew Dunham - *BMO Capital Markets - Analyst*

Andrew Dunham, on for Charlie Brady. Just had a question, just kind of want to confirm it -- you guys don't expect any continued stocking in the next coming quarters at all in the home center channel?

Jim Graner - *Graco Inc. - CFO*

That is basically behind us. There might be $500,000 to $1 million this quarter but the initial stocking order is there. We do expect of course, flow through and the sell through being replaced so it is an expansion of the market share for us.

Andrew Dunham - *BMO Capital Markets - Analyst*

Easier comps notwithstanding, do you see the Asia Pacific market environment getting better or worse?

Pat McHale - *Graco Inc. - President, CEO*

This is Pat. We're trying to figure that out. My view is that it is kind of in a sideways place right now and I don't see any signs of great improvement likely in China here in the next couple of quarters. They've got some challenges that they're working through and I think mining is going to continue to remain soft.

On the other hand, automotive production is still okay and we play in a lot of niche markets. We've got contractor business where we can still convert end users so from a Graco standpoint, we think we can eke out full year organic growth but the market over there in general I think is weak and it's likely to remain that way for a while in my view.

Andrew Dunham - *BMO Capital Markets - Analyst*

In terms of change in product mix in contractor to higher priced, higher margin equipment, have you guys been seeing that and how much of contractor today is the higher priced, high margin equipment and if you have any timeline on when it might return to more normalized levels?

Pat McHale - *Graco Inc. - President, CEO*

I think we're seeing that trend in the paint channel. As I mentioned, sequentially, the share of the gas units and electric units in what we call our niche product categories, grew by six points of the total so the share grew and that's again part of our underlying profit growth getting us I'll say to an adjusted 26% for the quarter so we see it coming back in small pieces and the trend continuing for at least another four to six quarters.

Operator

Your next question comes from the line of Matt Summerville from KeyBanc. Please go ahead.

Matt Summerville - *KeyBanc Capital Markets - Analyst*

A couple questions -- first, I just want to make sure I understand the stock in contractor. Did this happen as an extension of your existing shelf space at the expense of someone else's? Is this a new product category? How many stores were impacted here, sort of the price point? Can you just give a little more granularity as to what exactly transpired?

Jim Graner - *Graco Inc. - CFO*

Sure, it did happen at the expense of some competitors so we have an expanded product offering pretty much similar in 1,925 of this account's stores. They have started to sell the handheld units as well as the, I'll call them the medium sized electrics from, I'll say up to the 799, 899 price point so it's a nice change for us. It doesn't quite get us back to where we were in 2007 but it's a nice step in that direction.

Matt Summerville - *KeyBanc Capital Markets - Analyst*

What sort of prompted that decision on the part of the customer to, I guess, kind of come back to Graco or is this more Graco pushing to get back into the customer at those price points?

Jim Graner - *Graco Inc. - CFO*

I think we continue to win, Matt, due to better service and better products.

Matt Summerville - *KeyBanc Capital Markets - Analyst*

On China, how much was your business down in China in Q2 and year to date? Do you have that figure?

Jim Graner - *Graco Inc. - CFO*

I do. Hang on a second and I'll find it.

Matt Summerville - *KeyBanc Capital Markets - Analyst*

And I guess maybe while you're looking for that, Jim -- Pat, you mentioned mining. You mentioned auto. Can you maybe just give a little more of a high level overview on some of the end market trends you're observing across the world?

Pat McHale - *Graco Inc. - President, CEO*

The North America market is probably -- or I should say the Americas is probably the strongest across broad product categories right now although I wouldn't say it's smoking hot other than the contractor business. In terms of other end markets that are pretty good worldwide, the process business is pretty good worldwide. There are some exceptions but generally, our process pumping is performing pretty well in most regions.

We've seen some recent strength in our foam and polyurethane business over in Asia Pacific which has been good. Our sanitary business has been strong and then our, what we call our AFD business which is really our, I'll call it sealant and adhesive sort of business which includes the new hot melt product that we launched here earlier this year, that has performed pretty well on a global basis so it's not all doom and gloom. There are definitely some niches that are still performing pretty well globally but there are a lot of other fairly significant product categories where things are looking pretty weak.

Matt Summerville - *KeyBanc Capital Markets - Analyst*

Has customer uptake of that new hot melt product met your expectations so far?

Pat McHale - *Graco Inc. - President, CEO*

Yes, I think so far we're very pleased. Generally, what a customer will want to do is they'll want a test product before they make a commitment to change over their production capabilities and we've got really good reception to our efforts to get testing in place, particularly here in the Americas. Certainly more work to do in the regions but as of right now I'm still feeling very positive about our ability to hit our projections on that.

Jim Graner - *Graco Inc. - CFO*

Matt, back to your question on China, year to date China sales are down 3% and they were down 8% in the second quarter.

Operator

Your next question comes from the line of Mike Halloran from Robert W. Baird. Please go ahead.

Mike Halloran - *Robert W. Baird - Analyst*

Tacking on to the industrial side, did you see any change in demand trends as you worked through the quarter in any of the regions or was it continued choppiness or continued stability depending on which region you were in?

Jim Graner - *Graco Inc. - CFO*

I will share with you that our orders in June on a daily average basis were 5% higher than the average of April and May and I can't tell you the breakout by segment. I haven't got the calculation with me.

Mike Halloran - *Robert W. Baird - Analyst*

Was that comps driven or was that the fact that you were saying maybe a little bit of underlying improvement in some of the regions?

Jim Graner - *Graco Inc. - CFO*

This is sequential so April, I averaged April and May on a daily basis and compared it to the average order rate for June so sequentially, the orders in June were five points higher than the average for April and May.

Mike Halloran - *Robert W. Baird - Analyst*

Okay and do you happen to have a trailing 12 month EBITDA and revenue numbers for the ITW business that is held aside?

Christian Rothe - *Graco Inc. - VP, Treasurer*

Yes, this is Christian. The trailing 12 revenue number, and keep in mind that we report a certain number for the whole separate business but the liquid finishing business that we would be selling is just slightly different so on an adjusted basis, it's going to be in the ballpark of about $260 million on sales and the EBITDA is in kind of that mid-50s number. The other caveat I would give you is that if we get to a sales process at some point when a decision and order is issued that a potential buyer may look at that adjusted EBITDA number and it may look up or down depending on how they look at it.

Mike Halloran - *Robert W. Baird - Analyst*

Makes sense, and then on the acquisition side, how aggressively are you guys looking today and does this liquid finishing business preclude you from being a little bit more aggressive in the marketplace if you found the right transaction?

Pat McHale6 I think we're putting more effort into it than we ever have at Graco. We've got some pretty good resources in place across the organization. We've worked hard to identify market spaces where we think that we can bring our core competencies and add value. We're building relationships. We're knocking on a lot of doors. We're looking at a lot of things and I feel pretty good about the effort that we're putting in. Of course, valuations are a little bit high right now as I'm sure you guys know so we need to make sure that we're using Graco-like discipline as we take a look at opportunities and I'm sure we will. I do not feel at this point constrained by the fact that we haven't divested liquid finishing yet.

Operator

Your next question comes from the line of Joe Ritchie from Goldman Sachs. Please go ahead.

Joe Ritchie - *Goldman Sachs - Analyst*

As it relates to the contractor margins this quarter, can you give us any kind of color on how much of the improvement was related to just the volume leverage versus mix and then further, as we think about the trajectory into the back half of the year, it typically tends to be seasonally a little bit weaker and so how should we think about the trajectory in the second half?

Jim Graner - *Graco Inc. - CFO*

We tried to do some reconciliation for the operating margins on our slides so on slide 15 you can see the year to date in the volume leverage and you can see that the majority of this improvement is coming from the expense volume leverage so in other words, flattish expense with more volume. Margins, gross margins slightly higher just due to the mix things we talked about before and for sure Joe, you are correct that sequentially or on a seasonal basis, the second quarter tends to be our peak of operating profitability so the volumes, we're expecting to drop off in the third and fourth quarter as they have every year.

Joe Ritchie - *Goldman Sachs - Analyst*

Okay so if you do get the 100 basis point benefit, there is a drag this quarter from the -- I think you mentioned it was a 100 basis point drag earlier but you do expect seasonally for those margins to get worse. I guess as we think through on the industrial side, there were some mix issues in the quarter. The margins were still very good but the last quarter I think you had guided to 34% to 35% over the next couple quarters so again there with the mix issues behind you, how should we think about industrial margins as we look at 3Q?

Jim Graner - *Graco Inc. - CFO*

Again, the guidance had two caveats -- one, that the volume was the same and two, that the exchange rates stayed the same so the decremental volume of $4 million plus and the headwind from various Asian currencies, in particular the yen and the Aussie dollar caused two-thirds of that decline from the 34% to the 32% in round numbers. We still feel very good about that. The mix will fluctuate a little bit from quarter to quarter. I'll let you make the call on the volume and the exchange rates.

Joe Ritchie - *Goldman Sachs - Analyst*

Okay great, and I guess one last question. On the share repurchases, it looks like you did resume some modest repurchases this quarter. Again, how should we think about that on a go-forward basis?

Jim Graner - *Graco Inc. - CFO*

As we stated before, it's our intention to keep the share count flat so we're currently buying at a level that would do that over the next 12 months and again, we'll be opportunistic given other alternatives for acquisitions and other deployment of capital.

Operator

Your next question comes from Jim Krapfel from Morningstar. Please go ahead.

Jim Krapfel - *Morningstar - Analyst*

You talked about, you just spoke about your industrial margins for the next quarter. Longer term, do you see more upside there? Historically speaking, they're at very high levels.

Pat McHale - *Graco Inc. - President, CEO*

This is Pat. We get asked this question, I don't know, all the time at least for the six years I've had this job and probably for Jim's 30 years that he's been doing his work and our model is try to drive value into our product so that we can command price increases on an annual basis by giving the customer more and then to drive our factories to zero cost change and if we can do those two things we can give ourselves some opportunity to increase our gross margin and then we've got a pretty good structure the way we're set up driving our product through global distribution that we can take any increases that we get on volume and leverage those through the commercial channel pretty effectively. We don't sit around necessarily thinking about how are we going to increase our operating margin in industrial. We spend a lot of time thinking about how can we add value to our product, how can we improve the productivity of our factories, how can we improve the efficiency of our channel, and if we do well on those things, that seems to provide an ongoing opportunity for us to perform.

Jim Krapfel - *Morningstar - Analyst*

Okay, and then second question, you've spoken about industrial capital spending outlook still not being great. What are you seeing there now maybe versus, say, 90 days ago?

Pat McHale - *Graco Inc. - President, CEO*

I haven't seen much different to be honest with you. Things just feel kind of sluggish out there. There is a fair amount of concern and there is no region that is really on fire. We don't have China cooking now and making up for the fact that Western Europe is a little bit soft. We've got some concerns in China. We've got some concerns in Western Europe. I really feel like the performance that we're going to drive over the course of the next few quarters is going to be a lot up to us and the effectiveness of our new product launches and things that we can do to convert end users and drive growth. I'm just not seeing any sort of a global catalyst and I haven't seen much change from 90 days ago. If Jim wants to weigh in with his thoughts, we've been traveling different places, he's willing to do that as well.

Jim Graner - *Graco Inc. - CFO*

No, I share those same thoughts.

Operator

Your next question comes from Walt Liptak from Global Hunter. Please go ahead.

Walt Liptak - *Global Hunter - Analyst*

This is the first quarter where we've really seen the contractor business pick up and so I want to make sure that I'm understanding this.

Pat McHale - *Graco Inc. - President, CEO*

We're grown double digit for a number of years in contractor. It would pain me not to point that out.

Walt Liptak - *Global Hunter - Analyst*

Okay, well, it had a definite uptick and I wonder if it could be -- you called out that $4 million of inventory build with the restocking. Is there a way of looking at the product that went through the stores versus inventory build or have you already done that?

Pat McHale - *Graco Inc. - President, CEO*

Let me just take a shot at this and then Jim can jump in if I didn't understand the real part of your question.

On the home center side, that $4 million of inventory stocking is because we took shelf space from competitors and we expanded our product offerings so that's not a reaction by them to add more units of an existing product category in anticipation of improvement in the general business but that was really a specific sales win by the contractor equipment team at Graco and what that should do for us on a go forward basis with a broader product offering and more shelf space is give us more out the door sales.

In terms of what the overall out the door sales activity was versus sell-in, it's of course a little bit muddled this quarter because of the inventory stocking and the line expansion that we did so I'd prefer not to try to put too much granularity around those numbers. Did I get at the question?

Walt Liptak - *Global Hunter - Analyst*

Right, so if we back out that $4 million, you had roughly 15% growth in contractor and I think the guidance that you're talking about is kind of double digit so something like 10% to 15% in the back half.

Pat McHale - *Graco Inc. - President, CEO*

We saw growth in both the professional and the home center in terms of both their purchases and their sales.

Jim Graner - *Graco Inc. - CFO*

I'll try another way to answer the question. In North America, without the $4 million sales in the home center, both the sales in the paint channel and the home center channel grew in the low 20% kind of range. Your 15% is a global number, impacted by Asia and Pacific -- excuse me, Asia Pacific and EMEA lower growth rates. We're seeing some pretty good volumes in both our channels here in North America.

Walt Liptak - *Global Hunter - Analyst*

Okay, got it and along the same lines of another question that was asked on industrial, in the contractor business, is there an aspiration or a target margin that you think you can get to in contractor?

Pat McHale - *Graco Inc. - President, CEO*

No, really the model that we use across our divisions is fairly similar. Contractor invests a lot in new products to try to target new niches and to try to drive increasing value for our contractor end users and we work hard in our factories. It's really the same model and we don't have kind of an endgame that we're after. We like continuous improvement. That's our culture. That's how we run our incentive programs. That's how we run our internal metrics and so we just keep digging every year trying to get a little bit better.

Walt Liptak - *Global Hunter - Analyst*

Okay, is there anything structurally different about contractor versus industrial that says that you couldn't get to the low 30s margins?

Pat McHale - *Graco Inc. - President, CEO*

I think there is for sure. I mean, if you take a look at kind of product categories and the price points that we're in there, they're different and so I wouldn't necessarily try to equate the two. I think you're better off taking a look at historical contractor performance and then trying to figure out what the mix is going to be long term between our home center and pro paint business also has implications there. I think our -- Jim, you can chime in -- our long term peak operating margins in the contractor business were in the high 20s.

Jim Graner - *Graco Inc. - CFO*

Yes, 27%, 28%. So, that's our short term goal, short term being the next couple years, is to get back to our peak and that's -- a lot of the questions earlier about the mix of the bigger units, when that mix happens, there is nothing that should prevent us from getting back to those levels.

Walt Liptak - *Global Hunter - Analyst*

Okay, got it. Thanks, very helpful.

(Operator Instructions)

Operator

Your next question comes from Nicholas Prendergast from BB&T Capital Markets. Please go ahead.

Nicholas Prendergast - *BB&T Capital Markets - Analyst*

Most of my questions have been answered and I'm sure you guys answered this one so I hate to backtrack but my phone was breaking up. Earlier, you gave some numbers regarding the ITW liquid finish. I believe you gave trailing 12 revenue and EBITDA. Is that correct?

Jim Graner - *Graco Inc. - CFO*

We did, yes.

Nicholas Prendergast - *BB&T Capital Markets - Analyst*

I think I caught EBITDA was somewhere in the mid-50s. What did you say for revenue?

Jim Graner - *Graco Inc. - CFO*

About $260 million.

Nicholas Prendergast - *BB&T Capital Markets - Analyst*

Two-six-zero?

Jim Graner - *Graco Inc. - CFO*

Yes.

Nicholas Prendergast - *BB&T Capital Markets - Analyst*

Okay, that pretty much wraps it for me, thanks.

Operator

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

Pat McHale - *Graco Inc. - President, CEO*

Alright, thank you everybody for your time this morning and I will talk to you again next quarter if not before.

Operator

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