GRACO INC

Moderator: Caroline Chambers
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10:00 am CT

Operator: Please stand by. Good morning and welcome to the Second Quarter 2015 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 is 7932377. The replay will be available through July 27, 2015. 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 are - these remarks constitute forward-looking statements for the purpose of the Safe Harbor provisions of the Private Securities Litigation Reform Act.

Actual results may differ materially from the results indicated, as the result of various risk factors, including those identified in Items 1A of the company's 2014 Annual Report Form 10K, and in Item 1A of the company's most recent Quarterly Report from Form 10Q. These reports are available on the company's Web site, at www.graco.com, and the SEC's Web site at www.sec.gov.

Forward-looking statements reflect management's current views and speak only as of the time they are made. The company undertakes no obligation to update these statements in light of new information or future events. As a reminder, today's conference is being recorded. I will now turn the conference over to Caroline Chambers, Vice President, Corporate Controller & Information Systems.

Caroline Chambers: Good morning everyone. I'm here this morning with Pat McHale, Jim Graner and Christian Rothe. I will provide a brief overview of our quarterly results before turning the call over to Pat for additional discussion. Our conference call slides and our Second Quarter Form 10Q are on our Web site and provide additional information on our quarter.

Last evening, Graco reported second quarter gap sales of 335 million, net earnings of 173 million, and diluted earnings per share of $2.90. There is some noise in the second quarter numbers so I will take a moment to identify the individual items that impacted our reported figures, so we can get to our organic numbers on a constant-currency basis. Starting with foreign exchange -- as expected -- FX continues to be a significant headwind. In the second quarter, FX was a $17 million drag on sales and reduced net income by $6 million -- or 10 cents -- per diluted share.

As identified in earlier quarters, we believe the full-year effect of current currency translation rates -- as compared to last year -- will be a headwind on sales of approximately 5% and 11% on net earnings. Acquisitions completed in the last 12 months increased sales in the second quarter by about 19 million, and contributed 2 million to pre-tax operating earnings or 2 cents per diluted share.

The effect of inventory step-up was minimal in the quarter. The two cents per share is after approximately $2 million of intangible amortization expense. The cash earnings per share for acquisitions were four cents in the quarter. Pat will further discuss acquisition performance during his comments. In April, we completed the sale of the liquid finishing businesses that were held separate. The conclusion of that transaction resulted in final dividend income -- which is post-tax -- of $12 million. With the conclusion of the sale, we will no longer receive hold-separate dividends.

In addition -- after transaction fees, post-closing adjustments and other costs -- the $590 million sale generated a taxable gain of $147 million. After taxes, the total impact of the transaction in the second quarter was $110 million, or $1.85 per diluted share. Post-transaction adjustments with the buyer should conclude during the third quarter. We don't expect these activities will have a significant impact to what has been reported through the second quarter.

We also had two non-recurring items benefitting the tax rate in the second quarter. First, a tax-planning project was completed, resulting in a non-recurring benefit of $2 million; second, the company has asserted that it will indefinitely reinvest earnings of foreign subsidiaries to support the expansion of our international business. This assertion is being made with respect to the current and prior period earnings that have not yet been returned to the US. This resulted in a non-recurring benefit of approximately $7 million.

With the two non-recurring items, we had a favorable tax-expense impact of $9 million in the second quarter, or 15 cents per diluted share. The indefinite reinvestment reassertion -- under our current foreign-earnings composition -- will have a benefit going forward of approximately one percentage point on our effective tax rate. We will be able to fund our domestic operation -- and have uses for foreign cash to grow our international businesses -- through investments in our legacy operation and new acquisitions.

In addition, we will also experience a somewhat higher level of variability in our tax rate from quarter to quarter -- depending on foreign-earning sources -- which is why our second-half guidance on our tax rate is a two-point range of 31% to 33%. The midpoint of that range -- 32% -- reflects the one-percentage-point improvement on our effective tax rate. A few other items to note before I turn the call over to Pat for his comments - cash provided by operating activities is $97 million year-to-date.

The increases in inventory and accounts receivable reflect organic growth, as well as the effect of acquired operations. Net debt was $270 million at the end of the second quarter, significantly below the balance of $790 million at the end of Q1. The primary driver of the decrease was -- of course -- the sale of held-separate businesses. We continued with share purchases during the second quarter, including a small, accelerated repurchase program of $60 million with a term not to exceed three months. The term wrapped up earlier in July with about 840,000 shares repurchased.

Pat will discuss further capital allocation priorities in his comments. Incremental spending in regional and product-growth initiatives was $1 million in the second quarter, and $3 million year-to-date. Capital expenditures -- year-to-date -- have been $20 million, and our current forecast is for approximately $4 million in CAPEX for the full year.

Unallocated corporate expenses are $3 million above last year -- through the first half -- and for the full year we expect unallocated corporate expenses to be approximately $6 million to $8 million above last year, primarily due to increased pensions, stock compensation and incremental costs related to the new central warehouse. Starting in the first quarter of this year, we created a new reporting segment that includes our process, oil and natural gas, and lubrication divisions. The new segment reflects our increased focus on growth in the process area, as well as recent acquisitions.

Further information about our segments is included on Page 19 of the conference call slides, and historical financial information for the segments is also posted on our Web site. I'll turn the call over to Pat now, for further segment and regional discussion.

Pat McHale: Thanks Caroline. Good morning everyone. My topline comments this morning will be at constant currency and without acquisitions. As noted in the press release, we achieved 3% organic sales growth and grew in every reportable segment and region in the second quarter.

While somewhat below in our own expectations for the quarter, we feel we're still on track for our expectation of mid-single-digit growth for the full year. Our contractor segment ended a five-quarter streak of double-digit growth in the Americas, growing mid-single-digits in the quarter.

This was a difficult top to last year, where we had strong home center sales, particularly related to entry-level equipment. The home-center side of our business was flat in the second quarter -- against this difficult (comp) -- while the paint store channel in the Americas grew at the higher end of the mid-single-digit range. Out-the-door sales -- in both the home center and paint store -- were good during the quarter.

In contractor (Amiya) we achieved double-digit year-over-year growth in Western Europe in Q2. The emerging markets of (Amiya) were down double digits -- particularly Russia -- and resulted in the mid-single-digit regional number for contractor.

We continue to experience difficulties in Asia Pacific in the contractor business, with the region down high single digits in Q2. This is driven by ongoing underperformance in China. We recently made some leadership changes in the region to try to get back on track. We believe that the remainder of 2015 will continue to be challenging. With regard to our industrial and process segments, growth rates by region were relatively unchanged in the second quarter compared to the first quarter. The exception is our industrial segment in Asia Pacific, which grew at a double-digit pace.

At this point, we don't feel this is resurgence, but -- rather -- a reversion to the mean. Industrial Asia Pacific outperformed in Q2 but had underperformed in Q1. Growth and production levels throughout the region remain relatively disappointing. We are seeing some decent project activity, but it's based on general industrial automation and efficiency gains rather than macro-driven growth. Looking at the overall (Amiya) regions -- similar to last quarter -- sales in the developed markets of (Amiya) were strong, with low double-digit growth.

We also achieved growth in Central Eastern Europe and Africa this quarter. However, sales in Russia were half of what they were a year ago and the Middle East was down high single digits, offsetting much of the strong performance in the West. Before moving on to our outlook for the second half, I want to discuss profitability for the second quarter and update you on our oil and natural gas initiatives.

On the operating-earnings line, foreign currency was a $9 million drag this quarter. And we had incremental spending on regional and product-growth initiatives of $1 million, but we benefited from $2 million in operating earnings from acquired operations. The end result is an adjusted improvement in operating earnings on an organic, constant-currency basis of $6 million. Off a very low organic growth rate, we were able to achieve better than 50% incremental margins. This is in contrast to our experience in the first quarter, where we had incremental margins well below our historic rate.

The key difference was that the first quarter had a significant portion of its growth from the contractor segment - much of that was from growth in the home center channel where we have lower gross margins. We were also missing growth in the regions outside of the US, where we get higher margins. In the second quarter, home center sales were flat and we saw a higher level of growth out of Asia Pacific. These two items drove our improved incremental margins in the second quarter.

To underscore the earnings per share on an apples-to-apples basis for Q2, I want to repeat a couple of numbers that Caroline shared with you a few minutes ago. We reported adjusted earnings per share in the quarter of $1.05, which can be found in a table on the fourth page of our press release and Slide 5 of the deck. It removes the impact of the liquid finishing business. In addition to that, you need to remove 15 cents that we received as a benefit from the one-time tax items, and 2 cents from acquisitions.

Going the other direction, unfavorable currency was a ten-cent drag on the quarter, and we had one cent of incremental expense for regional and product-growth initiatives. If you net those items, earnings would have been 99 cents per diluted share. This compares with adjusted earnings per share of 89 cents for the same period of 2014.

Moving on to oil and natural gas - less than 5% of our sales worldwide come directly from the oil and natural gas end market, and a majority of those sales are by the acquisition of Alco and high-pressure equipment late last year and early this year. These businesses are feeling the impact of the cyclical downturn. When comparing performance of the businesses against their first half of 2014 -- before we owned them -- shipments are off in the high-single digit to low-double-digit range.

On the topline, this performance is macro-driven and -- we believe -- not a long-term trend. We bought these businesses for three primary reasons -- all of which are for the long term -- the products, end market and opportunities to improve profitability. The thesis is intact and we're believers that oil and natural gas will be strong over the next couple of decades. We're in a cycle and the market will move up again.

Regarding profitability, we continue to be very positive about the long-term improvement potential. Both Alco and high-pressure are strong businesses that were run in a constrained capital environment. Outsourcing was common and their manufacturing technologies at least a couple of generations behind. We have approved a number of new technology investments for these businesses -- and we will begin to bring these online late this year and into next year -- helping cost, quality and delivery.

Further, we're looking to consolidate the Alco footprint into a single location, which we hope to accomplish in 2016. In short, we continue to find synergies and are optimistic that we're in a position to obtain the ROI on our shareholders' capital. We're pushing forward with the spending on our improvement plans -- despite the weak topline -- to be positioned to capture more profitability by the time the market turns.

Our organic oil and natural gas initiative is also moving ahead with our first internally-developed product line -- chemical injection pumps -- being released for sale this summer. We believe that our new product is differentiated and is in a good position to gain acceptance. Like any organic-growth initiative, it will take time to get a foothold. We've already invested in a commercial team, which is in place and ready to start selling.

Moving on the outlook, our thesis for the year remains intact - mid single-digit organic sales growth on a constant-currency basis for the full year 2015, with growth from all reportable segments and regions. Our contractor business should achieve double-digit growth for the year. The process and industrial Americas' businesses are looking at mid-single-digit growth. The industrial business in the US is running slightly behind that pace today, so there is some downside risk.

In the contractor business -- while there's enough buffer in the year-to-date numbers that we're confident in the full-year double-digit outlook -- the team is optimistic that they can also achieve double-digit growth within the second half. Reported financial results -- and outlook of some of our big paint store partners last week -- would indicate that there's some risk to the second-half view though. Paint volumes appear to be growing at a low-to-mid-single-digit pace.

Our team believes contractor can outgrow the market -- as they have for several years -- but partner performance does indicate that the risk profile has grown in recent months. Our (Amiya) region is flat year-to-date, with strong growth in the West being wiped out by significant declines in Russia and modest declines in the Middle East. As we look at the comps in Russia through the rest of the year -- as well as recent bookings trends -- the third quarter appears to be another quarter where Russia sales will be down nearly half.

Comps begin to moderate as we exit the year, although we expect a double-digit sales decline in Russia in the fourth quarter as well. As such, we're keeping our outlook for low single-digit growth in the region for 2015. In Asia Pacific, demand continues to be spotty and heavily reliant on project activity. While the second quarter was a strong mid-single-digit performance, our year-to-date sales are still down slightly. We expect to end the third quarter in positive territory, and end showing full-year low-single-digit growth for the region.

In summary, the underlying business fundamentals remain sound. Pricing is holding and our factories are performing. We're staying the course with our strategies and investments. A couple of final comments - first -- regarding capital allocation -- Caroline noted that during the first quarter we entered into a short-dated accelerated share-repurchase program. Don't view this as a significant change in our capital allocation strategy.

We're still focused on growing by acquisition and continue to work our pipeline. A couple of small deals closed in the corner - in the quarter, but we continue to look for larger transaction opportunities. As has been noted by most peers in our space, multiples are high. We're maintaining our discipline and will pull the trigger on the right opportunities at the right valuation. Regarding share repurchases, we anticipate continuing to reduce our share count. Our priority, though, is to continue to drive the top-and-bottom line by organic growth and acquisitions.

We have deployed nearly 190 million year-to-date, and 370 million in the last 18 months on acquisitions. During that same period, we repurchased about 270 million in Graco shares net of shares issued. Before turning it over for questions, I can't let this call end today without recognizing the man sitting across the table from me -- our CFO -- Jim Graner. I've been the beneficiary of his counsel every day during the eight years that I've been CEO. Jim is an outstanding businessperson -- and with a quick mind -- and his leadership skills are outstanding.

Jim always puts the shareholders' interest first, and has been a tireless champion of ROI and fact-based decision making. Everyone in the Graco organization has a deep respect for the value Jim has brought to the company. While not so young in years, Jim remains young in mind and body. And on behalf of the shareholders, board of directors, and all the employees at Graco, I thank Jim for his service and wish him well in his -- what I know will be -- a very active and robust retirement. With that -- Operator -- we're ready for questions.

Operator: Thank you. The question-and-answer session will begin at this time. If you would like to ask a question, please signal by pressing star 1 on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star 1 to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions. Your question will be taken in the order that it was received. Please stand by for your first question.

And our first question comes from Joe Ritchie with Goldman Sachs & Company.

Joe Ritchie: Thank you. Good morning everyone.

Pat McHale: Morning.

Jim Graner: Hey Joe.

Joe Ritchie: Jim - congratulations. It's been a pleasure. And I also want to say congratulations to Christian.

Christian Rothe: Thank you.

Jim Graner: Thank you.

Joe Ritchie: The - just - I guess my first quick question may be going back to some of your comments - Pat. You talked about paint volume growing, you know - the trends decelerating a little bit here and growing at the low-to-mid single digit - at least the market rate growing at that pace. Can you talk us through a little bit what's happening there? Is the end market just starting to slow down a little bit? Is there any excess inventory in the channel? What can you tell us about that dynamic?

Pat McHale: So, from an actual paint dynamic, you're probably better off listening to the commentary from the people that are selling paint. They did make some comments about projects being behind due to some weather and some other things, but -- you know, from our viewpoint -- we've got a good product line out. We've got good programs for the second half. The housing market -- in our view -- is still in the middle of a nice recovery.

Some of the data points you're seeing out there on home sales and pricing is very positive, and hopefully they'll work hard to get jobs finished in the second half of the year, and they'll need equipment to do that. But our team thinks that we're going to continue to perform well and is optimistic that we can have a second half that has double-digit growth in contractor North America.

Jim Graner: Our channel partner is -- (and by the) sale information that we've got -- continue to show robust out-the-door sales - double-digit kind of category and there are no concerns over inventory levels in the channel.

Joe Ritchie: Okay. That's good to know. And I saw - it was interesting to hear -- Pat -- you mentioned that Western Europe was up double-digits. I would imagine it's been awhile since that's occurred, but I'm curious to hear some thoughts there and what you're seeing in that end market specifically.

Pat McHale: You know, it's interesting. If you take a look across our business units, Western Europe has been performing really well - and certainly going to give some credit to the team and I'm sure there's some impact on some of the new products that we've launched, but it's been surprisingly strong. Unfortunately, it's just been wiped out by what's happening in Russia and the Middle East.

You know, I don't have any particular color for you there, other than the Western European market seems to be performing better than what you would expect looking at GDP and construction growth rates, and I don't really know why.

Joe Ritchie: Okay. All right. That's fair enough. Maybe one last question. I guess - going back to incremental margins, and -- you know, we know going into the year -- we expected something significantly less, just given the incremental investments that you were making in oil and gas and other areas. I guess - as we think through the second half of the year, is it still your expectation that there's going to be, you know, incremental investment of roughly -- I think -- $7 million for all of 2015? And how do you think about the incremental margins -- across the business -- in the second half?

Christian Rothe: Joe - this is Christian. We're taking another look at that incremental investment and, you know, we -- you're right -- we did say seven million in the last quarter. It looks like it's going to be five to six right now, for the full year. So, it is pulling back just a touch. It's, you know -- frankly -- you know, a rounding error when we're talking about that magnitude of money. So, it's not a reflection of us pulling back at all on the spending side.

On the incremental portion of it, as, you know, as you know, there's a big headwind on the FX side. Pat talked about the fact that there was a favorable mix in the second quarter compared to what we had in the first quarter. I think we're probably going to see that moderate as we get into the second half, so the incrementals -- certainly -- are probably going to pull back somewhat from where we are - where we were in the second quarter.

Joe Ritchie: Okay. That's helpful guys. Congratulations again, and I'll get back in cue.

Pat McHale: All right. Thanks.

Operator: And our next question comes from Matthew McConnell with RBC Capital Markets.

Matthew McConnell: Thank you. Good morning and congrats on a good quarter.

Pat McHale: Thanks.

Matthew McConnell: Congrats also -- I want to echo the comments -- Jim and Christian. Congrats to both you guys.

Jim Graner: Thanks Matt.

Matthew McConnell: So, just to follow up real quick on the incremental -- very strong, organic incremental this quarter -- and I think you mentioned mixed was going maybe normalize a bit in the back half. Does that mean APAC slows down? Or - what else would be affecting the organic incrementals in the back half of the year?

Pat McHale: Yes, so - you know, we take a look at it, and our expectation is for contractor to be better in the back half of the year. And contractor's got slightly less margins that our industrial business. So, you know, that's likely to be part of the story.

Matthew McConnell: Okay. Great. Thanks. And I know you've gotten a bunch of questions -- especially last quarter -- about price. And it seems like everything's on track there. But are you still getting, you know, your usual point or two of price? Or is currency having any impact on your ability to get price realization?

Pat McHale: Yes - no - pricing has been fine. It's held up well -- really -- around the world, and across product lines. Again, you know, some of the movement that you see -- on terms of flow through margin from quarter to quarter -- really is mix-dependent. But the underlying fundamentals of the business -- from both price and even our factory performance -- have been, you know, really sound I'd say here - this year.

Matthew McConnell: Okay. Great.

Jim Graner: When we measure price, we measure it in the currency of sale.

Matthew McConnell: Yes.

Jim Graner: But we are getting prices in the euro and British pound and those other currencies that are under some relative pressure versus the US dollar.

Matthew McConnell: Okay. Great. And maybe one last one on cash conversion. I know it's been a bit slow -- and there's some seasonality to that -- but anything you're seeing on inventory or receivable levels - why those might be up a little bit?

Caroline Chambers: Basically, we think that reflects just normal seasonal growth, as well as some improvements in service levels.

Matthew McConnell: Okay. Thanks very much.

Operator: And our next question comes from Joseph Radigan with Keybanc Capital Markets.

(Shane Rorke): Good morning. This is (Shane Rorke) on for Joe. Thanks for taking the call. I was wondering if you could give some color on the order trends you saw in the quarter - how the tempo went -- sort of exiting June -- and maybe what you're seeing so far in July?

Jim Graner: Yes, so -- this is Jim -- relative to, you know, looking at the short term for the third quarter -- we did end the quarter with about $23 million in more backlog than we had at the equivalent period in 2014. About half of that is from our acquired businesses - the other half is from our industrial, a segment which we feel good about. Those orders should ship, mostly in the third quarter. Also, looking at our order rate in the first three weeks of July, the percentage increase versus 14 is the same as it was for the second quarter of the year. So we - again, we feel good about the near-term revenue outlook.

Joseph Radigan: Okay. That's helpful. And maybe just one more - in the contractor segment, I think you mentioned the sales of the new home center product is about flat. Is there any commentary you can add on sell-through and, sort of, what you're seeing in demand kind of in that channel?

Pat McHale: Yes - sale-through on the home center during the quarter was - the sell out-the-door at the home center was fine. It was our total sales into the home center that were flat, but -- again -- reflective of some - pretty big numbers in the second quarter of last year, as we had launched some of our new entry-level products. So, we don't think there's anything to miss there, and should expect to see some growth as we move forward to the second half again.

Joseph Radigan: Okay. Thanks a lot.

Operator: Our next question comes from Kevin MacZka, with BB&T Capital Markets.

Kevin MacZka: Thanks. Good morning.

Pat McHale: Morning.

Jim Graner: Hey Kevin.

Kevin MacZka: Can I just ask a margin question on industrial? I don't know if sequential is the right way to look at this or not, but you added about 10 million of sales there and about 8 million of ((inaudible)). Can you just talk about that? Was there some unique mix that was unfavorable in Q1 and more favorable in Q2? Or what drove that strong sequential incremental?

Christian Rothe: Yes - so, you know, it is a mixed shift that's happening. You know, as we talked about, we weren't getting a lot of regional growth in Q1. We got better growth out of Asia Pacific in Q2. We called out in Q1 the fact that that regional mix was having an impact on the business and that -- going back a little bit more towards what we would consider a normalized-type number -- we saw a bounce-back in Q2.

Kevin MacZka: Okay. Shifting gears, if you look at the regional commentary, it seems like there's a few that Asia's getting -- or excuse me -- (Amiya) maybe is getting a little bit better - Asia maybe softening a bit. It looks like your process business kind of jived with that, with (Amiya) up, Asia down, but industrial was the opposite. Can you just talk a little bit about what are some of the drivers there, that would drive (Amiya) down in industrial but up in process, and up in Asia and down in process?

Pat McHale: So, my view is - is that - so, first of all, cutting it that fine gets difficult. You know all the different end markets our industrial and process businesses are in. You know, that'd be a pretty complicated analysis to try to figure that out. My view is that Asia and Europe are both pretty much performing -- in aggregate -- as we expected. You know, we really haven't changed our outlook on either of those regions as we've moved through the year here, and we're not choosing to move it going into the second half.

So, you know, you can see things going up and down, but -- again, I think from an end-market perspective between processed and industrial -- trying to make any real observations out of that difference in rate, I think, is probably not meaningful at this point.

Jim Graner: Kevin - I think if you take a look at our order rates, they are more consistent than our billings. We had some shipments deferred -- I will say -- in Asia Pacific from the first quarter into the second quarter, due to the dock strike and our creation of our warehouse over there. So, Pat's comments earlier about second quarter Asia Pacific - getting us to a more normalized year-to-date number.

Kevin MacZka: Yes. Okay. Got it. And then just finally - Pat. You've kept that same topline outlook all year. I think you made mention of maybe some areas of risk to that forecast. And - wondering if you could just quickly revisit that? I think you mentioned contractor perhaps not double-digit in the second half would be one area of potential - what were the others?

Pat McHale: Yes - the other was that, you know, our industrial business is running slight -- in the Americas -- is running slightly behind our - the mid-single digits that we expected to achieve, so there could be a little bit of risk there. But, you know, it generally - we feel pretty good about where our outlook's at and didn't feel the need to do anything with it.

Kevin MacZka: Well, your outlook -- for mid-single digits -- certainly seems better than most industrials right now. So, that's good to know. Okay. That's all I had. Thank you.

Operator: Our next question comes from Liam Burke with Wunderlich Securities.

Liam Burke: Thank you. Pat - you mentioned in your comments that you'd developed in-house in your own oil and gas product. In terms of new product development, is there any area that you're concentrating on this year, or is it your standard across-the-board?

Pat McHale: Yes - no - it's our standard across-the-board. You know, the way we're organized by business unit, each one of our business units -- not the reporting segments, but even the business units within them -- have their own engineering teams. And so, we're launching -- and we have five-year product plans in each one of those business units -- and we're launching products on a regular basis.

So, the oil and gas is a - was a new investment for us, and we started adding engineers and ramping up that team here -- year and a half ago - or whatever it was -- but beyond that our tempo should be pretty consistent in the rest of the businesses.

Liam Burke: Okay. Thank you. And Christian -- I know this is semantics -- but in Caroline's prepared comments, she mentioned $270 million in net debt. Is that net debt or is that a gross number?

Christian Rothe: That's the net number. So there's cash of ((inaudible)) and there was long-term debt of 310.

Liam Burke: 310. Thank you.

Operator: As a reminder, that is star 1 to ask a question. And we'll take our next question from Walter Liptak with Global Hunter Securities.

Walter Liptak: Hi. Thanks. Good morning guys and congratulations Jim and Christian. Wanted to ask kind of a follow-on to, you know, the, you know, the way that you phrased it with at-risk to the - with the low single-digit in industrial. You know, I think your comments were, you know, kind of at risk because of - that China - that maybe that's not macro driven and in the USA.

And, you know, I wonder -- you know, in both of those regions -- you know, what the trends were during the quarter, you know, and, you know, are you seeing any projects -- especially in the US -- getting pushed out to the right just because of, you know, I guess this general slowing or slowing in oil and gas markets?

Pat McHale: So let's go back to my - let's go back to my risk commentary. Maybe I didn't do a good job communicating. I really only pointed out two things. I pointed out that our industrial business in the US is running slightly below the pace that we need to hit what we think our expectation is. So, just the fact that it's running a little bit behind of where we think it's going to end up - we thought we'd point out that there's a little bit of risk there.

And then, on the contractor side it was just some commentary from the American paint store partners regarding the paint. And then, what our team thinks they're going to do in the second half. Other than that -- in terms of the regions and industrial and Europe and Asia and everywhere else -- we're sticking with the same outlook that we've given since the beginning of the year, and we feel pretty good that we're going to achieve it.

Walter Liptak: Okay. Fair enough. It sounds, though, like the industrial -- which was strong in China -- that that, you know, in the third quarter you wouldn't expect that growth rate sustainable - that it might have been one project or couple of projects. Is that right?

Pat McHale: No - really what we're saying is, you know, the first quarter was weaker than we thought it should have been, and the second quarter was maybe stronger -- Jim referred to some shipment issues -- and, you know, for the year they're more around that flat kind of a number. We do expect to end up by the end of the year, but it's going to be noisy.

You know, if you're looking for real consistency coming out of Asia Pacific -- quarter to quarter -- I don't think you're going to see that. I think you're going to see some jumping around. But again, it's - we don't have a negative outlook for the second half. I'd say we're slightly positive compared to the first half.

Walter Liptak: Okay. Fair enough. And then - wanted to ask about the management change in China contractor. You know, what was behind that? You know, obvious - you know, I think we've talked on conference calls before about your China strategy, and that, you know, you want to grow despite the macro trends. But was there a change now to strategy along with management - or maybe a little color on this?

Pat McHale: So, it's a big market, and we think that there's a lot more opportunity than we're capturing over there. And of course, the - one of the key strategies for Graco is to build out channel and to drive end-user conversion. And we really need a team in China that can do that. So, last year we changed out China -- the leader for our contractor business in the country of China -- and now more recently, we just added the director from Asia Pacific who will be the boss of that person, plus lead the other areas of contractor in Asia.

And of course -- I think - I believe -- he just started a week or so ago. And so, he's going to have to have some time to get his feet on the ground and decide -- from a strategic perspective -- what changes we want to make. So, we indicated that probably would remain challenging through the end of the year. I expect to give him some time to figure out what he wants to do, and then -- going into next year -- we'll probably be able to provide some clarity. But ultimately, we need to drive channel and we need to drive end-user conversion, and that's what we intend to do.

Walter Liptak: Okay. Yes. Understanding that - any comments on the macro trends there?

Pat McHale: Well, you know, they're not great. But when you go over there and you look, there's stuff being built everywhere. So, if you just sit back and you wait for orders to come in, it's going to be tough right now. But we look at it as all the untapped potentials - if people were painting with equipment -- even in a down market -- there's lots of pieces of equipment that can be sold. So again, that's our challenge.

We don't focus so much on what's happening with the construction market in CED and the emerging markets. We really have to focus on our own execution and what we can do to drive people to use equipment.

Walter Liptak: Okay. Understood. All right. Thank you.

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

Pat McHale: All right. Looks like I have a surprise comment here from Mr. Jim Graner across the table. Jim - go ahead.

Jim Graner: Well, I'd just like to thank Pat for the positive comments. It's been a great ride for me - hopefully a great ride for the shareholders. And I'd like to be invited back the next time the EPS is 2.90 per quarter.

Pat McHale: All right. Very good. Well, thank you all for joining us and have a good day.

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

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