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GGG - Q1 2020 Graco Inc Earnings Call

EVENT DATE/TIME: APRIL 23, 2020 / 3:00PM GMT

OVERVIEW:

Co. reported 1Q20 sales of $374m and net earnings of $73m or $0.42 per diluted share.

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PRESENTATION

Operator

Good morning, and welcome to the first quarter conference call for Graco Inc. If you wish to access the replay for the call, you may do so by dialing 1 (888) 203-1112 within the United States or Canada. The dial-in for international callers is (719) 457-0820. The conference ID is 6655137. The replay will be available through 1:00 p.m. Eastern Time, Monday, April 27, 2020.

Graco has additional information available in the 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 2019 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, Executive Vice President, Corporate Controller and Information Systems. Please go ahead, ma'am.

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

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 may be helpful.

Sales totaled $374 million this quarter, a decrease of 8% from the first quarter last year. While acquisitions added 1 percentage point of revenue growth this quarter, changes in currency translation rates decreased sales by approximately 1 percentage point.

Net earnings totaled $73 million for the quarter or $0.42 per diluted share. After adjusting for the impact of excess tax benefits from stock option exercises, net earnings totaled $65 million or $0.38 per diluted share. Our gross margin rate was 53.2% in the first quarter, approximately the same as last year. Favorable realized pricing nearly offset the adverse effects of lower factory volume, unfavorable product and channel mix and changes in currency translation rates. Operating expenses decreased by $3 million from the first quarter last year as reductions in volume and earnings-based expenses more than offset higher product development and occupancy costs.

Reported income tax rate was 11% for the quarter, approximately 3 percentage points lower than last year, primarily due to an increase in excess tax benefits related to stock option exercises. After adjusting for this effect and other nonrecurring tax benefits, our tax rate for the quarter was 20.8%, similar to last year.

We drew $250 million on our $500 million credit facility during the first quarter to increase our cash position and preserve financial flexibility. The proceeds from the advance are available to be used for working capital, general corporate or other purposes. This will add approximately $1 million to quarterly interest expense.

Cash flows from operations totaled $54 million in the first quarter as compared to $51 million last year, slightly above the first quarter last year.

Capital expenditures totaled $19 million in the first quarter. We also paid cash dividends of $29 million. For the full year 2020, capital expenditures are expected to be approximately $70 million, including approximately $50 million for facility expansion projects.

During the first quarter, we made share repurchases of approximately $90 million, including $8 million, which had not yet settled at the end of the quarter.

Cash used for repurchases was partially offset by issuances of $37 million. The purchase of approximately 2.1 million shares in the first quarter will largely eliminate dilution in 2020. We may make further opportunistic share repurchases going forward.

Due to economic uncertainty, we have withdrawn our revenue guidance for the remainder of 2020. However, I will take a moment to talk about the effect of lower sales and unabsorbed factory costs in hypothetical terms. As an example, the sales declined by 20% and factory volumes declined by an equivalent amount, while also maintaining our infrastructure, then the unfavorable effect of unabsorbed cost on gross margin rate is expected to be about 2 to 2.5 percentage points. If the sales declined by 30% and factory volumes declined by the same amount, while maintaining our infrastructure, the unfavorable effect is expected to be about 3.5 or 4 percentage points on gross margin rate. Although, factory volumes are challenging, we expect that favorable realized pricing, lower commodity cost in our normal practice of implementing productivity improvement projects will also continue and will favorably contribute to gross margin rate.

With a revenue decline of 8% in the first quarter, we saw a decline in operating earnings of 14% or decremental margins of 47%. If revenues declined similarly in the next quarter, we would expect a similar decline in profitability. At a 30% decline in revenue, similar to current booking trends, while maintaining our expense base, decremental margins are expected to be around 55%. Although, our decremental operating margins can be steep during periods of revenue decline, as shown in our historical trends, we are able to remain profitable with our current cost structure even with a substantial reduction in sales.

A few final comments, looking forward to the rest of the year. Based on current exchange rates and the same volume and mix of products and sales by currency in the prior year, the effective exchange is currently expected to be a headwind of approximately 1% on sales and 3% on earnings in 2020. Unallocated corporate expenses are expected to be approximately $30 million for the full year 2020 and can vary by quarter.

The effective tax rate is expected to be approximately 20% to 21% for the full year, excluding any FX from excess tax benefits related to stock option exercises or other onetime items.

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

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

Thank you, Caroline. Good morning, everyone. Rather than rehash the reported numbers, I'll try to shed some light on what we saw as Q1 progressed.

Coming into 2020, we had anticipated a difficult start to the year in our Asia Pacific business. With declining order rates in the second half of 2019 and continued weakness in core automotive and industrial markets, we anticipated a tough Q1 for Asia Pacific when we issued our annual revenue outlook. What we hadn't fully anticipated in our outlook, of course, was the global impact of the virus. The broad-based shutdown of businesses in China compounded an already difficult Q1 for us in the region. Our Industrial segment is about 60% of our revenue in AP and suffered the worst.

From an operations and supplier standpoint, we were able to work through the shutdowns in China without impacting our global ability to build and ship orders. Our business in the Americas and EMEA was generally in line with our outlook early in the quarter with particular strength in our Contractor segment. As the virus hit EMEA and then the U.S., we saw our incoming order rate plummet, and while it's bounced around week-to-week, we've been running about 30% below prior years since mid-March. While there are a few end markets that remain positive, such as semiconductor and sanitary, those exposures for Graco are small. Nearly all of our major end markets across regions and segments have experienced double-digit declines in recent weeks.

Specific to Contractor Americas, the pro paint channel outperformed the home centers in Q1, with both channels showing positive out-the-door sales. From incoming order rate perspective, in recent weeks, the pattern has reversed and home centers have been outperforming the pro paint channel.

Globally, Graco sales activity has been significantly hindered as access to industrial end users is difficult with stay-at-home orders in place, contractor selling events and other trade shows have been canceled and capital spending is being curtailed across industries. With the exception of the short China shutdown I already referenced, all our major production and distribution facilities have remained open and fully operational. When it became clear that the virus is going to be a global problem, we established a goal for every Graco production facility worldwide. The goal has 2 elements: 1) no Graco employee or person living in their immediate household ends up in the ICU or dead; and 2) we keep our operations running.

To this end, we've implemented a number of practices to try to protect those employees with the highest risk of having serious complications from the virus, up to and including sending some high-risk employees home with full pay until we feel comfortable they can return. For the rest of our employees, we have people working from home, if they can be productive or practicing social distancing, sanitation and good hygiene if they need to be at work. We've had a few people test positive, and I've been very proud of the reaction of other employees. They stayed calm and cool and carried on. None of our high-risk employees have tested positive. It seems quite clear to me based upon what we know about the virus and consistent with Graco culture that we can manage safety without shutting down.

Despite a significant drop in our bookings, my plan is to keep our payroll intact for the time being. In addition, we will continue to make investments in our growth strategies, including our 2021 new product plans, ROI based capital investments, new market initiatives and acquisitions. This will pressure our P&L in Q2, and you can expect high decremental margins, as Caroline has outlined for you. Our balance sheet is solid, we have a strong team, and for now I prefer not to manage the short term to be less worse, but instead prepared to leap forward when conditions improve.

We took a measured approach during the 2008/2009 crisis, and I believe our investors were amply rewarded over the following decade. If business conditions do not improve, we will, of course, take appropriate actions.

Our balance sheet and cash flow remains strong. We borrowed $250 million under our revolving credit facility in order to increase our cash position and preserve our financial flexibility. We will use the proceeds from borrowings to fund our strategic initiatives, including acquisitions and share buybacks, if good buying opportunities present themselves. Due to economic uncertainty, we're withdrawing our 2020 revenue guidance for the remainder of the year.

In conclusion, we expect the short term to be difficult with continuing declines in revenue and profitability. However, we will execute our growth plans and weather the storm. Our factories are running and employee morale remains high. Our long-term focus and global distribution channel will position us well to capitalize when our end markets rebound.

Operator, we're ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll go first to Deane Dray with RBC Capital Markets.

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

Great to hear everyone's voices and hope everyone is staying healthy and safe. Maybe we can start with the sensitivity on the decrementals that Caroline stepped through. That was really helpful. And no surprise that you're not taking any headcount out. And that's so typical for Graco looking for the longer term. So maybe just take us through the expectations of where else, if it's not headcount reductions, but you are cutting back on some spending? So take us through that and also your decision making on the CapEx. Which CapEx projects are you deferring? Which ones it looks like you've actually added to? So if we could start there, please?

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

Yes, I'll talk to you a little bit about spending, and then I'll let Mark talk to you about the CapEx piece. On the spending front, you shouldn't expect any significant expense reductions. We don't have any major facilities that we should be closing. We don't intend to back off on our strategic investments. We obviously will trim discretionary expenses around the edges where we can, and we've got some expenses that will reset themselves at lower levels. For example, we're looking in bad spots for things like incentives, and so the accruals for those obviously will come down from where they were at last year.

But other than that, I think you ought to consider most of our expenses fairly fixed as we move through the second quarter here.

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

Dean, on the CapEx side, we've got a target this year of $70 million, inclusive of $50 million of facility expansion, brick-and-mortar, some land, things like that. At this point, we haven't decided to stop or slow down any of those initiatives. They're long-term strategic kind of fit into the category of making investments for Graco for the long haul. So the CapEx on the facility and land investments, some is in North America, some is over in Switzerland with our Gema operation. And again, not really expecting any changes there. We do have about $20 million in other CapEx in the number. And I guess, depending upon how long this slowdown occurs, we may see that number tweak back a little bit because capital projects might be a little bit more difficult for our factories to justify, although, we're anticipating that they're still going to come forward with good projects like they always do.

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

That's real helpful. And then just as a follow-up, Pat, maybe you can just take us through the portfolio in terms of visibility and resilience. Just what are the businesses that typically either through after market or visibility give you that sense of -- as you look out the next couple of quarters?

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

I would say the vast majority of our business is book and ship. Obviously, we do have project business in our Industrial and automotive segments that tend to have a bit longer lead times. And when you take a look at our regional split, certainly, our Industrial, automotive business is larger in Asia Pacific. So I would expect maybe a little bit less visibility there and a little bit more lumpiness. I would anticipate that business that we've got in North America and EMEA will probably respond pretty much like you'll see the general economy respond. If we have a V-shaped recovery, I would anticipate that you would see that fairly quickly in the majority of our sales. If it's U-shaped or L-shaped, then I think that, that would be typically what you would expect to see in Graco's overall business.

Operator

Our next question will come from Matt Summerville with D.A. Davidson.

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

In terms of the orders declining 30% since mid-March, can you give a little bit more granularity in terms of what you see in the parts, aftermarket, accessory side of the business versus the new equipment side around that 30% number?

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

Yes. So I don't have that data for you this close to the end of the quarter. We'll get that coming up, but there hasn't been enough time post the end of the quarter for me to have seen that. But through the end of the quarter, our parts and accessories business was almost exactly right where it always is at. So I think that most likely, what we're seeing is a combination of the challenge of people making investments in CapEx, plus the fact that the shutdowns lowered volumes in many of our end markets that would have also lowered our parts and accessories sales. So they seem to have moved at least through the first quarter pretty much in lockstep. Whether that will diverge in the second quarter as more factories start coming back online, I'm not sure.

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

And then maybe just talk about -- you sounded like things really started to tail off towards the end of the quarter organically in the business. Can you maybe, Pat, talk about the organic cadence in the business overall in January, February and March?

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

Yes. We typically don't break down our organic growth by month. Once we get into that, that's a slippery slope of no man's land that we tend to shy away from. But our business, we had given an outlook for the year. And through the end of February, I still felt fairly comfortable that our outlook for the year was going to be okay. And then, of course, the wheels fall off the wagon in March. So it's not like the year got off to a terrible start, and I thought that it was going to be some sort of a disaster really when we had the shutdowns put in place in Europe and in North America that really kind of changes the whole game for us.

Operator

Our next question will come from Saree Boroditsky with Jefferies.

Saree Emily Boroditsky - *Jefferies LLC, Research Division - Equity Analyst*

Could you guys talk about what you saw in China Industrial in the quarter? And if you've seen any improvement in recent order activity over there in the last month? And is there anything about how activity progress that we can apply when thinking about the impact of coronavirus on Americas or EMEA?

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

Yes, it's a little bit tricky because our business mix in China looks a lot different than our business mix looks like in North America. I will say that incoming order rate in China has been bouncing around from pretty negative to pretty positive over the course of the last few weeks. So I think that if you want to look at it optimistically, there can be some signs that the fact that they're sort of through their shutdown and back up and running as generating some additional business opportunities for us. But I'd hate to make a long-term outlook based upon just the past few weeks. But I would say that there is some maybe green shoots for Asia Pacific.

Saree Emily Boroditsky - *Jefferies LLC, Research Division - Equity Analyst*

Great. And then in Contractor Americas, it was steady in the quarter, but you also had a little bit of easy comparables from a new product perspective. How do you expect demand there to progress for the second quarter? And are you seeing any differences in demand from areas in the U.S. that have less restrictive shutdowns?

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

Yes, there are areas in the U.S. that have shut down construction sites. And obviously, that is more negative for us than areas that they haven't. I think there are some other impacts that are probably worse for us right now. One of the things is, in many of the paint stores are not accepting customers to come in the door, so people are ordering their products and stopping and picking up, and of course, the new product opportunity for us to push with the contractor business. We really need to get in front of contractors and have them see our products to be able to do that. In addition, many of the shows, the local selling shows that are big for us in the first quarter have all been canceled, and there is no real face-to-face opportunity. So the shutdown certainly is not positive in terms of the states that have shut down construction sites versus those that haven't, but just access to customers and access to products has also been a big negative for us. And when we take a look at our order rates the last few weeks, all the segments have been bad. Contractor looks bad just like Industrial looks bad.

Saree Emily Boroditsky - *Jefferies LLC, Research Division - Equity Analyst*

Just following up on that. Lastly, I mean, with the order rates across the segments, can you provide any more detail on that 30% down? What you saw by segment or region? And I'll leave it there.

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

Yes. By segment, they all are pretty much in that range, plus or minus. And by region, with the exception of Asia Pacific, which has been bouncing around a little bit and had a couple -- a little bit better weeks since the middle of March, pretty much everywhere else has been bad.

Operator

Next we'll go to Joe Ritchie with Goldman Sachs.

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

Maybe just one point of clarification, Pat, the 30%, that's through April to date type number? Or is that like through the end of the quarter?

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

Through the end of last week.

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

Okay. All right. Got it. And then interesting, in taking a look at the Industrial segment, there was a real bifurcation on the growth rate between the U.S. and EMEA. Maybe you can provide just a little bit of clarification of why EMEA downturned a little bit harder than the Americas did?

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

Yes. For sure, they got hit a little bit earlier. If you remember, they probably get hit, I don't know, 10 days earlier. And also the shutdowns that happened in France and Italy and Spain, those were real lockdowns. Those are much more severe than the lockdowns that we've had here and included more of what we would consider essential businesses here. So I'm expecting a lot of pain coming out of EMEA, at least, over the next few weeks.

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

Got it. And so -- I mean is it fair to say just based on what you know in your manufacturing capacity today as well, like in the lock down that the Americas could hold up potentially a little bit better than EMEA in this downturn? Or how are you guys thinking about that directionally?

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

Well, EMEA is a big region, right? It's not just the countries that I mentioned, but you've got what's going on in the East and then we include Africa and the Middle East and Russia and all that. And of course, there is some other dynamics there with oil prices and currencies that kind of mess up that whole analysis. So I think it's a bit of a stretch. But certainly, wherever, in aggregate, the lockdown is tighter, I think, it's going to have a more of a short-term negative impact on the business. But you'd have to sit on and try to calculate out by country, by GDP, how you thought that was all going to play out and I haven't done that.

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

Okay. No, fair enough. One last one quick one, just Asia Pac. So it sounds like with things kind of bouncing back and forth a little bit. Is it fair to say that at least in that region we're probably through the worst of it? Or is that just too early to know at this point?

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

Well, the question is that what happens to the region if EMEA and North America dry up. And I think this is a big science experiment with what's going to happen with the overall economy here. And so it's hard for me to say that yes, okay, they're back open for business, and therefore, we've seen the worst of it when I'm not really sure what is going to happen with the global economy. And obviously, they're a supplier to North America and to Europe. I'd like to think that, that's the case and that maybe we've seen the worst of it there, but I don't think anybody has any clue as to what's going to happen here over the next 2 months.

Operator

Our next question will come from Bryan Blair with Oppenheimer.

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

I just wanted to quickly follow up on the equipment versus parts and accessories commentary. Is there any real significance in the delta by segment there? I know, Pat, you said that parts and accessories have held in pretty consistently so far. Is there any major difference by segment?

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

No, through the first quarter it looks pretty consistent. One comment that I will make, back in 2008/2009 when everything fell apart, I think starting in about October, we expected or I had expected -- I'd only been in the seat for 1 year, 1.5 years, and I had expected that during the course of that downturn, we were going to see a significant change in kind of the mix between parts and accessories and never really saw it. I would have assumed that parts and accessories business would have done better and then CapEx would have done worse, but they kind of both did bad through that downturn. And we did some digging at that time, and one of the things that was pretty obvious was that when the distribution channel was under pressure, which I think that they're going to be under some pressure now, they have the ability to not reorder parts and accessories from us when they sell some. So parts and accessories are the things that they'll typically stock. And if they stock 10, and there is a downturn instead of reordering when they sell 3, they can wait till they reorder -- they can wait until they hit a different kind of an order point. So if there's some other dynamics between Graco and the end user that I think buffer what happens from a parts and accessories standpoint. And so I'm not so sure that if you look out here in the next couple of months that we're going to see some real weird data coming in on that front.

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

Okay. It's very helpful color. And you touched on a couple of areas of relative resilience and then some broad based pain, which is understandable. From what you're hearing from customers and perhaps, you could speak to this by segment, is there -- anywhere there is greater confidence in -- on the back end of this once the shutdown is over, at least, in the U.S.that there is going to be a true snapback in activity? I'm particularly interested in what you're hearing from the channel and Contractor.

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

So from the different people that we hear from, I think the view tends to be a personal view. So there are those of us that view the virus one way and the shutdown one way, and there are those that view it another way. And I think a lot of the personal views are being skewed as being their view on the overall economy. And so I'm myself -- I'm basically discounting all the talking heads, and I'm discounting most people that have an opinion because I think we're all guessing. And so if it makes you feel better to hear 5 customers that are guessing things are going to be good, then you can feel better. And if you want to hear 5 customers that are guessing that things are going to be bad, you can feel negative. And to me, it's the anecdotal feedback that we're getting is not meaningful, and it's not yet impacting any decision that I'm making.

Operator

We'll go on to Mike Halloran with Baird.

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

So just some thoughts on how you're thinking about the health of your distribution channel today from their perspective? And then also how you think about inventory levels as you look through your channels?

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

Sure. I'll let Mark talk to you a little bit about the channel. We're connected with our channel, and we're doing some things to assist. And Mark is kind of leading that.

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

Mike, yes, basically, we're in good shape, I would say, in an overall basis when it comes to what we're seeing from the accounts receivables side and what we're seeing on the cash collection side. It's not to say that our channel partners aren't feeling the same strain that you're hearing from everyone else. I think that they are. But we haven't really seen any kind of meaningful deterioration so far with regard to that. Our view has been that Graco as an organization has a balance sheet. We're prepared to utilize that, and we're prepared to help our channel partners to the extent that they need help. And we've proactively communicated that really in all of the regions to let our major partners know that we're going to stand by them and help them through this difficulty. So I think that, that message has been delivered. So I would expect that maybe over the short term here that you may see us having our DSO creep up a bit, but we'll make smart credit decisions and use our balance sheet to support the business.

On the inventory side, it's been pretty flat year-over-year. I think you saw that in the filing here. And we'll be watching that, obviously, the business continues to supply. One of the challenges our factory managers are going to have is to make sure that they adjust what they're doing in the factory to reflect the incoming order rate. So right now, there is no issues on the inventory side that I'm aware of, but it's something we're going to keep an eye on.

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

And then a follow up to that, maybe even 2 follow-ups. The first is, when you then think about the support that you're potentially going to be given to your channel partners, could you put that in the context of how you're thinking philosophically about the balance sheet here, willingness to do share buyback in the short to medium term? And then also, how much dry powder you want to keep in, in case the pandemic creates a little bit more fallout and opportunity for you on the M&A side?

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

Yes. We're solid with our balance sheet, and I'm not overly concerned about really funding any of our initiatives here in the short term. And we have -- we will have no hesitancy to do share repurchases if we deem that the price is good. There are some talk out there that they're not looked on favorably. I think that we treat our employees right at Graco. We don't have a handout asking for government assistance, and if we decide we want to buy shares back, then we're going to buy shares back.

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

Yes. And then the second follow-up would be just -- if you think about what we do to differentiate yourself at the bottom of the cycle to help differentiate yourself as you come out of the cycle, part of it these systems are giving to the channel partners. Maybe anything else you would talk to from a differentiation perspective that helps you win over time here?

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

Yes. I think we do a pretty good job of making sure that our footprint is consolidated the way that we wanted, and that we've got people on the payroll that are productive and are delivering value. And so just running around and finding $50 million worth of savings when times go bad, I always smile when I see companies do that. I wonder why they didn't do that before. So I believe one of the differentiators that we have is that we're going to keep a really good organization intact. We're going to keep our 2021 product intact. We did that during 2008, 2009. And when we do that, and we come out of it, we're not running around trying to hire people and trying to re-fire up projects and spend a bunch of time spinning our wheels on things because we kept grinding forward during the rough period. So I think that worked well for us last time, and I'm anticipating that there is going to be a lot of our competition that's going to be out there looking for cost reduction and headcount reduction and deferring projects, and we're going to move forward, and I'm going to like where we are when we're done better than I'm going to like where they are.

Operator

Our next question will come from Walter Liptak with Seaport.

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

Just to kind of continue the conversation along the lines of the last one. It's pretty clear you're expecting business to make a comeback with hanging on to the organization as it is. I wonder if we could kind of think a little bit more about Asia, and your Asia business is one where it started going down in the first half of 2019. And so you're on some easier comps. And so like in your estimation, is Asia beginning to get better? Maybe some of the things that weakened early in 2019, picking back up. And I know it's only a couple of weeks that you mentioned that Asia is getting better, but do you think at some point, we're going to get a snapback as we get the government shutdowns behind us?

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

Walt, it's Mark. I would just say that the Asia business is still declining. So we haven't seen the point yet where it's gotten to 0 and get any kind of growth. I definitely agree with you that the comps are a little bit easier as we make our way through the year. In particular, Q3 and Q4 comps, where we saw really significant declines in AP last year, those should be theoretically easier for us. But given the uncertainty and not really knowing how long the thing will play out, it's difficult for us to gauge what's going to be happening there on a full year basis.

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

Okay. Are there some products that were weak in the first half of last year that are starting to come back now, or some different sectors of that Asia such as the China economy?

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

Well, again, it's still declining. So I wouldn't say anything is really coming back.

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

Okay. Okay, fair enough. Yes. The declines are getting smaller, though. You were down...

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

As I mentioned in the last few weeks has been bouncing around for some bad weeks and some good weeks. So it's -- again, is that a sign that we're bouncing along the bottom? I don't know. I guess, again, we're back to that thing. You want to be optimistic or do you want to be pessimistic. So it's not a bad sign. I guess that we've had a couple of good weeks and make time with our bad weeks. We're just going to have to let it play out a little bit longer before we know.

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

Okay. Fair enough. On the selling and marketing expenses, that's coming down presumably because of some of the variable selling costs. I was wondering what percentage of that $57 million is variable?

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

Well, you'll remember that we had already lightened our load on expense last year in 2019. So we don't have as much to take out this year compared to '19 as comparison to some of the years which were where we already did better.

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

So we think basically all the Graco's incentive plans are paid off of an improvement over prior year. That's just how we look at the world. We got to be better than we were the year before. And unfortunately now, going into this, we didn't have a very strong year last year. So we didn't have high incentive payouts last year. If we would have had high incentive payouts last year, there would have been a more substantial number to come out when we had lousy year this year. But given the fact that last year was soft, there is not as much to come out. So it's -- again, I think you should look at our expense base as we run through the rest of the year as being more fixed than variable.

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

We already started to true it up in the first quarter based on what we saw.

Operator

We'll go next to Brett Kearney with GAMCO Funds.

Brett Kearney - *Morgan Group Holding Co. - Research Analyst*

I'm just wondering with strong balance sheet you have, wondering on the acquisition opportunity front, if you've seen private market valuations come in at all at this point or whether it's too early. And anything that -- any areas that might be higher on the list than others on that front?

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

So our Process group has been the most active, and I would anticipate that, that's likely to be the case as we go forward. I'll tell you from our experience back in the '08, '09 crisis, the kinds of companies that we're interested in and the kind of markets that we're in, those companies generally survive, and they generally aren't rushing to sell their business during a downturn. So while you can theorize that this downturn is going to create some opportunities for us, in reality, not much happened in 2008, 2009 on that front. And when I take a look at the types of technologies and the types of differentiated customers that we'd be interested in adding to our portfolio, my guess is, they're also not going to be going broke or running to sell their business when times are tough. So I would say that most likely, our acquisition effort is going to continue on sort of as it has, where we focused on some of the growth segments within process and trying to build relationships with companies, so that when the time is right, we get a chance to get a deal done. But it's probably wishful thinking to think that you're going to see some sort of step change function in our success on acquisitions during the downturn.

Operator

(Operator Instructions) There are no other questions at this time. I'd like to turn the call back to Pat McHale for any additional or closing remarks.

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

All right. Thanks, everybody, for your time this morning. Obviously, one of the more interesting periods of time that we're all going to have to live through, and hopefully, we'll come off the other end in good shape. We're going to go back to work and see what we can do. Thanks.

Operator

And that does conclude our conference for today. Thank you all for your participation. You may now disconnect.