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GGG.N - Q2 2025 Graco Inc Earnings Call

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## OVERVIEW:

Company Summary

## CORPORATE PARTICIPANTS

**Christopher Knutson** *Graco Inc - Vice President, Controller, Chief Accounting Officer*

**Mark Sheahan** *Graco Inc - President, Chief Executive Officer, Director*

**David Lowe** *Graco Inc - Chief Financial Officer, Treasurer*

## CONFERENCE CALL PARTICIPANTS

**Deane Dray** *RBC Capital Markets Inc - Analyst*

**Saree Boroditsky** *Jefferies LLC - Analyst*

**Jeffrey Hammond** *KeyBanc Capital Markets Inc - Analyst*

**Brad Hewitt** *Wolfe Research LLC - Analyst*

**Matthew Summerville** *D.A. Davidson & Co - Analyst*

**Andrew Buscaglia** *BNP Paribas Securities Corp. North America - Analyst*

**Joe Ritchie** *Goldman Sachs Group Inc - Analyst*

**Walter Liptak** *Seaport Global Securities LLC - Analyst*

## PRESENTATION

### Operator

Good morning, and welcome to the second quarter conference call for Graco Inc. If you wish to access the replay for this call, you may do so by visiting the company website at [www.graco.com](http://www.graco.com). 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 2024 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](http://www.graco.com) and the SEC's website at [www.sec.gov](http://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 Chris Knutson, Vice President, Controller and Chief Accounting Officer.

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### Christopher Knutson - Graco Inc - Vice President, Controller, Chief Accounting Officer

Good morning, everyone, and thank you for joining our call. I'm here today with Mark Sheahan and David Lowe. I will provide a brief overview of our quarterly results before turning the call over to Mark for additional commentary.

Yesterday, Graco reported second quarter sales of \$572 million, an increase of 3% from the second quarter of last year. Excluding acquisitions, which contributed 6% growth, sales declined 3%. Currency translation had no effect in the quarter.

Reported net earnings decreased 4% to \$128 million or \$0.76 per diluted share. Excluding the impact of excess tax benefits from stock option exercises, adjusted non-GAAP net earnings were \$127 million or \$0.75 per diluted share, a decrease of 3%.

The gross margin rate decreased 200 basis points in the quarter. The impact of acquisitions accounted for nearly 80 basis points of the decline, which will continue for the remainder of the year. In addition, tariffs increased \$4 million in the quarter, resulting in an additional 80 basis point decline. Price realization was not enough to offset higher product costs resulting from lower factory volume, tariffs, and unfavorable channel and product mix in the quarter.

Operating expenses increased 2% in the quarter, driven by incremental expenses from acquisitions of \$9 million or 7%. Excluding expenses of acquired operations, operating expenses declined \$7 million or 5% on savings from the One Graco initiative, lower sales and earnings-based incentives, and timing of stock-based compensation expense.

Operating earnings decreased \$4 million or 2% during the quarter due to decreased factory volume and the effect of tariffs. Operating earnings as a percent of sales were 28% for the quarter or 1 percentage point lower than the same period last year.

Contractor segment operating margin rate for the quarter was 26% compared to 31% for the same quarter last year, a decline of 5 percentage points. The acquisition of COROB decreased the contractor operating margin rate by 2 percentage points, with the remaining decline due primarily to higher tariffs and lower factory volume.

Interest and other decreased \$3 million in the quarter. The volatility of the US dollar, especially against European currencies, resulted in exchange losses on net liabilities of certain foreign operations of approximately \$5 million for the quarter, which we don't expect to continue. The adjusted effective tax rate was 20%, which is consistent with our expected full year tax rate of approximately 19.5% to 20.5% on an as-adjusted basis.

Cash provided by operations totaled \$308 million for the year, an increase of \$50 million or 19%. Improved inventory management from consolidating operations under One Graco and lower sales and earnings-based incentive payments drove the increase.

Cash flow from operations less capital expenditures increased \$93 million or 51% for the year-to-date. Cash provided by operations as a percentage of adjusted net earnings was 144% for the quarter and 125% for the year-to-date.

Significant year-to-date uses of cash include share repurchases of 4.4 million shares totaling \$361 million, dividends of \$92 million, and capital expenditures of \$30 million. These cash uses were offset by share issuances of \$25 million.

A few comments as we look forward to the rest of the year. Based on current exchange rates, assuming the same volumes, mix of products, and mix of business by currency as in 2024, movement in foreign currencies would have a 1% favorable impact on net sales and no impact on net earnings for the full year. Unallocated corporate expenses are projected to be \$37 million to \$40 million for the full year. And finally, we expect capital expenditures to be approximately \$60 million to \$70 million in 2025.

I'll now turn the call over to Mark for further segment and regional commentary.

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**Mark Sheahan** - Graco Inc - President, Chief Executive Officer, Director

Thank you, Chris. Good morning, everyone. All my comments will be on an organic constant currency basis.

Overall sales were up 3% in the second quarter, including a 6% contribution from COROB, offsetting an organic revenue decline of 3%. Contractor accounted for more than 80% of the organic revenue decline in the quarter, with the Americas being especially weak when compared to last year's strong second quarter. EMEA and Asia Pacific grew in all segments, including the semiconductor market, and in China, which were depressed for most of last year.

The current trade environment is still uncertain, causing many end-users to delay project decisions and take a wait-and-see approach until trade negotiations and the tariff landscape is clear. During the quarter, incremental costs related to tariffs were about \$4 million, affecting EPS by \$0.02.

To offset the impact from tariffs, we have announced targeted price increases beginning in September. These pricing actions are focused on key markets and geographies most impacted by tariffs and are in addition to our normal beginning of the year price increases. We expect that these pricing adjustments along with our mitigation efforts of product redesign and secondary vendor sourcing will offset most of the full year impact from tariffs as they exist today.

Incoming order activity remained steady during the quarter compared to the full year and consistent with billing activity as backlogs are still at normal levels across all segments. The past six weeks, rates have also been consistent with the full year run rate.

The home center DIY channel has been our biggest challenge in the first half of the year, down low double digits. However, the current six-week run rate has stabilized and exceeds the run rate of the second half of last year.

Now turning to some commentary on our segments and regions. Contractor segment sales declined 5% in the quarter. North America was soft in core markets as contractors delayed new investments due to ongoing housing affordability issues and a smaller project pipeline. The home center channel struggled from reduced foot traffic and reduced DIY demand in the Americas versus last year's second quarter and year-to-date -- than year-end results -- year-to-date results. This quarter was the most challenging comparable for Contractor as the second quarter of 2024 had channel fill related to significant new product launches resulting from delays which we discussed last year. We are expecting a stronger second half with easier comparisons, the effect of our pricing actions, and our upcoming new product releases.

The Industrial segment declined 1%, with growth in EMEA and Asia Pacific not enough to offset a decline in the Americas. Powder finishing systems sales were strong with increased quoting activity and improved performance in the Americas and Asia Pacific regions. This increase was not enough to offset -- to fully offset declines in the other Industrial product categories in the Americas.

In several markets, end-users are cautious and waiting to see the result of ongoing trade negotiations. Quoting activity worldwide is still strong, but we expect end-user caution will continue until greater clarity exists in the global trade environment.

Last week, we announced the acquisition of Color Service, a global manufacturer of specialized automatic precision dosing systems for powders and liquids. Known for their expertise in gravimetric dosing technology, the company delivers precise weight-based material measurements that improve consistency and efficiency in production across various industries, including textiles, rubber, cosmetics, plastics, and food. Headquartered in Italy, Color Service employs approximately 140 people worldwide and an annual revenue of EUR34 million in 2024. We expect the transaction to close in the third quarter, and the business will be part of our Gema Powder Division, which is part of the Industrial segment.

Expansion Markets were down 3% for the second quarter as the positive momentum in the semiconductor market, which we started seeing at the end of last year, continued in the quarter. However, this was offset by a decline in the environmental business.

Moving on to our outlook. Despite headwinds from uncertain global trade environment and the soft North American construction market, which led to our organic revenue decline in the quarter, on a full year basis, our organic revenue was flat. Our consistent incoming order rates, combined with pricing actions and an easier comparable in the Contractor, gives us confidence as we enter the back half of the year. Accordingly, we are keeping our 2025 revenue guidance of low single-digit sales on an organic constant currency basis.

That concludes our prepared remarks. Shannon, we're ready for questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Deane Dray, RBC Capital Markets.

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**Deane Dray** - RBC Capital Markets Inc - Analyst

Can we start with the price increase announcement? And this is far from being as seismic as it was back in 2022 when you did the first time ever intra-year price increase, and this one seems certainly warranted given the tariff pressures. Can you just -- how is this price increase different? Can you size it? And anything about the implementation? And is this all price? Any surcharges? And any color there would be great.

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**Mark Sheahan** - Graco Inc - President, Chief Executive Officer, Director

Yes. Great. Thanks for the question. I think when we spoke last, we said we wanted to be patient when it came to what we wanted to do with respect to the tariffs. And as things played out, I think that patience was smart, because the overall impact got less and less as facts came out and things got clarified.

So nonetheless, we did start to see some of the impact hitting us, and we were also watching what was happening in the end-markets that we participate in and seeing what's happening with a number of the competitors who are also raising prices. So that gave us the opportunity and the confidence to know that we could also do the same thing.

We are not doing anything other than trying to offset the pressure that we've got in our P&L. I'd characterize the increases as targeted and targeted at the geographies and the areas where we're seeing the most input cost pain. And also, I'd characterize them as sort of low single-digit type increases in a few select areas within the business that will offset the tariff pressure that we see for the rest of the year, provided that the landscape stays the way that it is.

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**Deane Dray** - RBC Capital Markets Inc - Analyst

That's really helpful. And then for David, free cash flow was one of the bright spots in the quarter just in terms of conversion. Was there anything -- any one-timers in there at all? Or just what do you attribute the strength of the conversion this quarter?

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**David Lowe** - Graco Inc - Chief Financial Officer, Treasurer

Well, thank you. We called that out because we thought it was a pretty solid sign as to the cash generation capacity of the company. So thanks for asking the question.

I would say our attention to inventory continues to contribute to what you really started to see last year with a focus on improving turns, which are less than world-class in the industrial sphere, and it was another good quarter there. And of course, certain aspects of our One Graco initiative contributes a greater efficiency, a focus on expanding centers of excellence, which will make our manufacturing operation over time more efficient. Also in small steps are helping our cash conversion.

So I'd like to think that what we saw here is not one time. Of course, our business does have a seasonal component, the Contractor side of it. So we haven't done anything about that. But we feel very good about the future cash generation capacity of the company.

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**Deane Dray** - RBC Capital Markets Inc - Analyst

That's great. Just to clarify, when you say better progress in inventory, what's interesting this quarter, we've seen a number of companies actually adding inventory either through a prebuy or some buffer inventory to kind of smooth out with all the tariff noise. But you're actually making progress in reducing inventory?

**David Lowe** - Graco Inc - Chief Financial Officer, Treasurer

Yes. I mean, we took -- I mean, again, there are some things that we absolutely need to have, and we've been aggressive where we needed to be aggressive on the sourcing side. But overall, to some degree, we sort of significantly expanded the raw material that we were carrying from the whole sourcing escapade of a couple of years ago. And for the most part, we've been comfortable working that down to what would probably you would say is more normalized levels because we've got more confidence in our supply chain.

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**Operator**

Mike Halloran, Baird.

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**Unidentified Participant**

This is [Paz] on for Mike. I wanted to follow up on the Color Service acquisition. Could you maybe tell us a little bit about how the acquisition came about? You mentioned in the press release that it opened up new opportunities. Can you maybe discuss the opportunity and how you see it fitting into the portfolio with a little more color, please?

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**Mark Sheahan** - Graco Inc - President, Chief Executive Officer, Director

Yes, Paz. Thanks for the question. So actually, a few years ago when we started to think more about external growth in addition to our organic initiatives, we really challenged our teams to take a look not only at their existing portfolios, but other adjacent technologies that might be interesting to them.

And our Powder team, led by Claudio Merengo at the Gema group, they really did a nice job of looking at some opportunities that aren't necessarily powder paint but technologies that they understand. And they really surface this area as a potential target area for us. So that led to some discussions with the ownership and ultimately resulted in the acquisition.

What we like about it is the growth rates have been pretty good, this business, maybe slightly better than what we've seen in the legacy Graco businesses, at least over the last five years. It's technology that we understand. It's dosing, it's measuring. It's gravimetric measuring, which we understand and we know about.

The location is good for us because it's closely located to our SAT business in Italy. And the leadership team of SAT will actually be working very closely with Color Services' leadership team to make sure that we capitalize on any integration possibilities, opportunities to help them with operations, production, be more efficient. So it was really a combination of a lot of different things that caused us to get excited about this.

They have some big customers, too, which is nice. They're involved with all the tire manufacturers, they get involved in the textile industry, cosmetics. So it does broaden out our portfolio a little bit beyond what we have seen in the past.

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**Unidentified Participant**

Great. No, that's helpful. And then if we switch gears a little bit, if we look at your core kind of construction markets, what are you looking for to feel like your customers are gaining more confidence, particularly in the DIY and home center area where maybe US consumers have been a little bit stressed and housing market has been tight? At this point, what do you think is the green shoot that is necessary to get some of these projects moving?

**Mark Sheahan** - Graco Inc - President, Chief Executive Officer, Director

Well, it's got to be affordability, right? Obviously, a rate reduction would help quite a bit as long as the prices don't go up when the rates go down. Unfortunately, when the rates went up, the prices really didn't go down as you would have expected them. So affordability is still the biggest challenge I see in the new construction market that we have. And that impacts activity. Obviously, it also impacts our spray foam business to a certain extent because a lot of the new builds are using that technology in there.

So I think any major shift in affordability would be very much appreciative. I know it's on the radar. We've read a lot of different reports and we've been listening to some of the commentary coming out of Washington. So I think that they know that this is an issue. There are still a number of people that are locked in at low mortgage rates and they just can't move even though they would like to move. So if you look at the number of homes being sold this year and last year, it's extremely low compared to what you would expect in a normal economic environment in a country the size of the United States. So there's quite a bit of pent-up demand, I would say, that is yet to be unleashed, hopefully, once the affordability gets a little bit in better shape.

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**Operator**

Saree Boroditsky, Jefferies.

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**Saree Boroditsky** - Jefferies LLC - Analyst

Maybe just first, building on the price increase. I believe the last time you did a midyear price increase, you took less price in the following year. So would you think about something similar as you think about 2026? And then do you take any more pricing on the Industrial side versus Contractor given the more consumer focus?

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**Mark Sheahan** - Graco Inc - President, Chief Executive Officer, Director

Yes. I think that we would expect that we'll have a normal price increase at the beginning of next year, to answer the first question.

And in terms of where we targeted, how we targeted, both groups participated in the price increase at different levels both Contractor and Industrial, and Expansion Markets, I should add. This was something that we did across all of our business units.

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**Saree Boroditsky** - Jefferies LLC - Analyst

And then maybe going on about the uncertainty that you're seeing, but some of the other markets, could you provide some more detail on what you're seeing from customer spending by end-market in the Industrial segment? And do you expect any changes from some of the incentives with the One Big Beautiful Bill?

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**David Lowe** - Graco Inc - Chief Financial Officer, Treasurer

I think the latter question is, big picture, long-term clarity on tax rates, favorable treatment on investments and related things in manufacturing, will, over time, be a real positive for Graco. Reshoring, onshoring, relocation is good for our business.

I would say that if you're -- the first part of your question, we could talk at length, but just to give you a flavor that our teams -- I'll touch on a couple of specific markets. But pipelines are good, quotations active. Some end-users are more willing to pull the trigger when there is this cloud of uncertainty, that Mark talked about, than others.

If I had to generalize on a global basis, I mean, certainly markets that at the moment have some positive momentum and then some that are a little bit softer. The automotive OEM market is positive, especially the area around EV where battery activity has improved, at least recently. They tend to be large orders, so the business is lumpy.

Also, the automotive component supplier market is strong, especially in the Asia Pacific market. Our vehicle service business, the dealer lubrication business, has been strong. And Mark touched on the strength of powder equipment. That shows up in the architectural profile market, agricultural equipment and also other automotive components. So we see markets being active and people pulling the pin.

I would say the slower areas, reflecting what we know about the business, there are regional differences. But solar here in North America is quite soft. The transportation market, especially the truck OEMs really have been significantly slower than we have seen. Mining, which affects our lubrication product line, we've seen a slowdown with the large customers that sell equipment to the big mines. Aerospace has sort of entered a soft patch. And no surprise, in light of the Contractor discussion we had, markets like window and door and wood products are soft.

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**Mark Sheahan** - Graco Inc - President, Chief Executive Officer, Director

So I would just say that, with all that good color that David provided, you got some ups, you got some downs. But in net-net terms, it's a pretty flat environment, and there's still a lot of caution out there amongst our end-users that wanting a little bit more clarity around what the trade landscape is going to look like. And I think once that gets cleaned up, there is a potential that there's some projects that get released and there's some pent-up demand in the pipeline, is what our teams are telling us.

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**Operator**

Jeff Hammond, KeyBanc Capital Markets.

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**Jeffrey Hammond** - KeyBanc Capital Markets Inc - Analyst

Just on the guide, holding the low single-digit growth, you were kind of flat in the first half. I'm just wondering what informs kind of the better second half. Is it comps? Is it this next bite of the apple on price? Is it order trends getting better? Just what gives you confidence you see the uptick?

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**Mark Sheahan** - Graco Inc - President, Chief Executive Officer, Director

Yes, I think it's all those things. I think we probably said some of them, or at least I did in my script. But we do have the price that will kick in, in September, that will be helpful. When we look at the run rates, they've been fairly consistent for a short-cycle business. You always get some volatility that pops in and out. But generally speaking, we feel pretty good about the incoming order rates. And then comparing those to what we saw in the back half of last year, that's how we really got to the numbers that we are comfortable with.

Again, do I like a low single digit? No. I mean I'd like to see a lot more. But given the fact that we're flat and we've had some of this turbulence in the first half of the year, I think that we feel reasonably confident that we can get to the guide by the end of the year.

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**Jeffrey Hammond** - KeyBanc Capital Markets Inc - Analyst

Okay. And then along with the strong free cash flow, you guys have really stepped up buyback. Just a little more color on how you're thinking big picture about capital allocation and maybe taking a more aggressive approach both buybacks and deals here going forward.

**David Lowe** - Graco Inc - Chief Financial Officer, Treasurer

Okay. Well, I think -- okay, I'll take a shot at that. I think you make a good point that it's really, with the cash flow that we have from operations, our business model is an and, not an or. And our first choice continues to be investing in the business, investing in new technology, because that's how we think in these business-to-business niche markets that we participate in, that's how you win.

We've been -- we like our operations. We invest aggressively in state-of-the-art automation, machine tools and such. And we, in my 30 years here, that's not an aspect of our business model that we have ever stunted on.

As far as transactions, M&A goes, I think the last year has been instructive, that we started the process three years ago, a disciplined process, step-by-step, sometimes slow to get off the ground, but over the last nine months, we've committed to well over \$300 million to deals. And as you know, we have the dry powder to do more. And there continue to be transactions in the works that we are excited about.

And yes, we talk about our stock repurchase activity as being opportunistic. That's the approach that we've taken over the long, long cycle, and we think it's been successful, and we put over \$360 million to work.

I think that what will determine the future level of that activity is what we see in the market. We really do like buying when the market is less enchanted with the prospect of companies that serve cyclical markets. And from '08, '09 to 2015 to 2020 to 2022, we've stepped up when we've had that opportunity.

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**Operator**

Brad Hewitt, Wolfe Research.

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**Brad Hewitt** - Wolfe Research LLC - Analyst

So one of your significant customers and contractors pointed to an outlook for a low single-digit decline in paint stores volume in 2025. I know it's not entirely apples-to-apples, but curious how that compares to your contractor market volume expectations for the year. And how much visibility do you have to return to positive organic growth in Contractor in the second half of the year?

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**Mark Sheahan** - Graco Inc - President, Chief Executive Officer, Director

Yes, I'd have to probably peel the onion back a little bit to give you a good answer to the first question, not having all the details in front of me. But what we did with our business is we really tried to look at it globally and holistically, and we looked at the different product categories. And Pro Paint is one of them, but we also have a DIY base. We also have a spray foam product line. We have protective coatings equipment.

And these are global businesses. So looking at the order rates and looking at the activity in the end-users in the markets, we put our forecast together for the remainder of the year. Also knowing that the back half of our year last year wasn't robust, so we may have had an easier comparison than the company that you're referencing.

For us, targeting and projecting and predicting the future is always a big challenge given the short-cycle nature of our business. But the markets are -- they're not in bad shape. There's still activity out there. Painters are still buying equipment. Equipment breaks all the time. There's decent activity, it's just not robust activity.

And I think the earlier question that I got on what we're looking for in terms of a green shoot, it's really, once the affordability gets a little bit better, there will be more project activity, more people are going to be moving out of their homes into new homes, that creates a lot of remodeling activity. It's really trying to pinpoint exactly when that's going to happen. We're probably not the best at being able to do that. But all in all, I mean, we feel pretty confident in the guide that we're giving.

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**David Lowe** - Graco Inc - Chief Financial Officer, Treasurer

Yes. I would just add that I think that channel partner that you're talking about a couple of times described their business environment as choppy. And I think that's exactly how we would define it. They do a good job of splitting out key markets, including their consumer DIY space, which they cited as being particularly slow, also the auto refinish market and the wood products markets.

Where they talk about things being slow, we would tend to agree. Where they talk about seeing some pockets of strength, for example, in the protective coatings market, equipment market, in our particular space, we would also agree. It's one of the challenges when you serve as many markets as we do to try to roll it all up when, as you've seen for the first six months of the year, you're right at the water line.

But I would agree with everything that's been said about from the current order rate all the way through to the things that we are doing in the second half of the year. And let's hope for some increasingly -- increasing clarity on trade-related uncertainty, should help us achieve our projected outlook.

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**Brad Hewitt** - Wolfe Research LLC - Analyst

Okay. That's helpful. And then as it relates to the 1% to 2% revenue hedge for the year related to China, I noticed you guys took that out of the slides, but it's still in the 10-Q. Is it fair to think the base case expectation there is for closer to a 1% headwind or maybe even less given the year-to-date results and the rollback in the China tariffs?

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**Christopher Knutson** - Graco Inc - Vice President, Controller, Chief Accounting Officer

I would say that for us, the China market has come back. This is Chris, by the way. And we took out the hedge as part of our outlook. I think it's still in the 10-Q as part of one of our risk factors, to let everybody know that, hey, this is kind of our exposure that we have there. But we have seen activity within the China market pick up, particularly in the Powder coating space. And despite the tariffs, we are optimistic that, coming off of a pretty low year, that we're going to have growth there.

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**Operator**

Matt Summerville, D.A. Davidson.

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**Matthew Summerville** - D.A. Davidson & Co - Analyst

I want to just talk a little bit more about M&A. You're talking about your second deal in the last, call it, nine months or so for you guys. Is this -- Mark, do you feel like you've finally been able to establish Graco as a company that has an M&A pipeline and funnel and team in place that you can really become more of a compounder -- of an inorganic compounder of capital? And to that point, can you maybe speak to the actionability you see looking ahead, average deal size, things like that?

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**Mark Sheahan** - Graco Inc - President, Chief Executive Officer, Director

Yes. Thanks for the question, Matt. As I've been pretty transparent on this for quite a while, we really felt as a management team that we needed to create an infrastructure and an awareness that, while our organic growth is great, we have this -- we have a nice opportunity to add to that with good strategic acquisitions.

And we really had to build the pipeline up from scratch. I think I've said this, if I'm repeating myself to you, I apologize. But I could have asked any of our leaders for their M&A target list when I got this job, and they would have given me on list, but there was no detail behind it. So now we've

got really good pipelines with companies that we believe would be good strategic fits for Graco. We've talked to the owners. We understand why they fit. We have opportunities in terms of being able to make them better organizationally.

And I think that with respect to what's happening in the market right now, I think that the pricing has gotten a little bit better compared to what it would have been back in '21 when I became CEO.

So the other thing that's happened here is we've gained some really confident people within our organization that feel like we can drive value in these businesses beyond just operational synergy value. We think that there's customers that we share in common where we can get some leverage. We also believe that our footprint, our global footprint, gives us some opportunities to maybe make some of these businesses bigger and more profitable than what they are.

And I think we've built up some real competency within the Graco organization to be able to not only identify but to integrate these acquisitions fairly seamlessly. And the owners, I think, are pleased with what they've seen at least in the short term here.

So I like what I see. The pipeline looks great. There are activities happening even as we speak. You never know what's going to happen, but I feel like our chances to be able to add on inorganic growth to the organic growth machine that we have at Graco are really pretty good.

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**Matthew Summerville** - *D.A. Davidson & Co - Analyst*

And then just as a follow-up, in realizing with Expansion Markets, it doesn't take all that much in absolute revenue dollars to move the organic pendulum one way or the other. But I guess I'm a little bit surprised that I would have thought the environmental business would maybe be a bit more steady for Graco. So can you talk about what maybe drove the rollover there and if you're seeing any wavering on the semiconductor side of the business? It sounds like you're not, but I just want to put a finer point on that.

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**Mark Sheahan** - *Graco Inc - President, Chief Executive Officer, Director*

Yes. I mean when you're looking at 13 weeks, it's always a little bit dangerous. So we did hear that there may have been some federal money that got tied up after the first quarter with respect to some of the environmental policies that are being talked about in Washington compared to what may have been talked about previously.

I'm not that well-educated on that particular topic, but I think that could have been a factor there. And we really don't think that long term, anything is going to change in that category. It is a 13-week time period, so there's always a little bit of volatility that's going on there.

Semi, we feel pretty good about. I think they might have a tough comp in the fourth quarter. But other than that, activity is good. As you know, there's all kinds of fabs being talked about globally, whether you're in Europe or here in the US, and we think we've got a good chance of getting some of that business. So it feels much better than it did 18 months ago when we had big backlogs but not much orders. Now we've got reasonable backlogs and orders are coming in. So I feel good about that for the rest of the year.

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**Operator**

Andrew Buscaglia, BNP Paribas Exane.

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**Andrew Buscaglia** - *BNP Paribas Securities Corp. North America - Analyst*

I just want to get your thoughts on incremental margins this year, just given you had that reorganization realignment, you have pricing coming through. So I guess what's an incremental margin for you guys look like, even just like sounds like 1% to 2% volume growth is the bogey here into the back half?

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**Christopher Knutson** - Graco Inc - Vice President, Controller, Chief Accounting Officer

I think, Andrew, when we think about our incremental margins, if we can get growth across all of our groups, it always varies with the highest incrementals coming out of the industrial group. So if more growth comes out of there, we're going to get a little bit better. But I think probably in that mid- to low 30s is really where our -- where we typically average from an incremental margin.

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**Andrew Buscaglia** - BNP Paribas Securities Corp. North America - Analyst

Yes. Okay. And then I wanted to get a little bit more color on the comment you made in Contractor around home centers. Obviously, that probably affects your DIY area. But what -- how do you see that playing out? I would imagine that's something that wouldn't change overnight.

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**Mark Sheahan** - Graco Inc - President, Chief Executive Officer, Director

Yes, I don't think it's going to change overnight. The only data point that we wanted to share with you guys is that, yes, it's been tough year-to-date. But if we look at the last six weeks of incoming orders, they've actually stabilized and they're actually maybe a little bit better than what we saw during the same period last year in the second half. So maybe we've seen the worst of it.

It has been difficult, I would say, for the last couple of years. We referenced foot traffic just because I know that the large home centers have been talking about that for quite some time. And I think -- I believe that a lot of the DIY activity that goes through those channels on the paint side is tied to remodeling activity and new houses that are being acquired by people where they have to do some cleanup or fix up before they sell the house, the new owner comes in and they want to change the color of the paint or whatever they do.

So I really do believe, again, going back to the earlier comments, if we can get some traction on housing, affordability, turnover, sales and purchases of new homes, I think the DIY market is going to come back. There hasn't been any real changes competitively or anything like that that we're concerned about.

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**David Lowe** - Graco Inc - Chief Financial Officer, Treasurer

And what I would just add is when that business comes back as our most experienced, most focused merchandisers in terms of our channel lineup, they're not famous for carrying a lot of extra inventory. And so the uptick that Mark is talking about that will eventually come should flow through to us pretty quickly.

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**Andrew Buscaglia** - BNP Paribas Securities Corp. North America - Analyst

David, if I could ask one more. I know we're in a -- you guys are embarking on more acquisitive period, which is great. But how do you balance that with your very high return on invested capital? I think some investors may worry being more acquisitive could bring that number down. So what are your return hurdles you're focused on? And how do you think about that?

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**David Lowe** - Graco Inc - Chief Financial Officer, Treasurer

Well, our starting point is we look for businesses, even if they're in adjacent markets, that have the characteristics that we like in our businesses. And I mean even the most recent one that we announced a couple of weeks ago is a good example. This is a niche market. This is a niche market that serves some major industrial spaces. The business has a significant amount of recurring revenue like most of our businesses. The applications that our products are used for are pretty essential in the process of these different manufacturing environments.

All of that says that in a business-to-business world, if you're developing the right products with the right technology and getting them to the market, and they create value for your customers, it will translate well to the way we like to go to market and drive a value proposition that we can make money on. And I think that we keep those things in mind, that those are the characteristics that cover most of our markets and help us generate a pretty healthy return.

Mark also touched on valuations. That's the other thing to this whole process. The one thing the buyer can control is the price they're willing to pay. And when we see valuations for businesses that have slipped a little bit in the recent years, and we can do the kinds of things that we think we can do, invest in the business, expand their manufacturing capacity, help them expand their global footprint and so forth, the right price with the right niche market, we think can create value for the shareholders.

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**Operator**

Joe Ritchie, Goldman Sachs.

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**Joe Ritchie** - *Goldman Sachs Group Inc - Analyst*

So I want to go back to just the timing of the pricing announcement. I'm curious, are you -- did you decide to wait until September, to wait for the moratorium to potentially become permanent? And then just maybe just any color you can give on the initial discussions that you've had with your customers on being able to affect the pricing increase.

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**Mark Sheahan** - *Graco Inc - President, Chief Executive Officer, Director*

Yes. Well, obviously, I mean, I think we wanted to wait right out of the gates just to see what might happen in the first 30 to 60 days. I think that was a smart move. We didn't put a surcharge on. We did a price increase. And we think it's fair for our channel partners to get enough of a heads up to be able to communicate what that's going to be with their customers. And that's really why we gave them enough time and have this hitting in the September time frame versus doing something immediately and causing maybe some disruption in the market.

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**Joe Ritchie** - *Goldman Sachs Group Inc - Analyst*

Okay. So it sounds like the receptivity has been pretty good from your channel partners?

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**Mark Sheahan** - *Graco Inc - President, Chief Executive Officer, Director*

No surprises whatsoever.

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**Joe Ritchie** - *Goldman Sachs Group Inc - Analyst*

Okay. Great. And then specifically as it relates to Contractor, it's interesting like this is the area that you've gotten -- you've had the most impact from a product cost standpoint and maybe being offside on the pricing and the tariffs. So a 3-point impact this quarter, I mean, is it fair to assume that as we head into the fourth quarter, you're able to recoup a lot of that 3 points? I'm just trying to get a sense for where margins can go from here on the Contractor side.

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**Mark Sheahan** - *Graco Inc - President, Chief Executive Officer, Director*

Well, if you tell me what the volume is going to be, I'll tell you what the margins are going to be. I think that there's some potential for a bit of a rebound here. It really depends on how the business holds up. What we did say during the prepared remarks was that last year's Q2 was really

strong per contractor. And so when you look at the comparisons and what happened a year ago versus now in the declines, I mean, I think you need to factor that in. And then, of course, we have the COROB acquisition, which is also part of the equation as well.

All in all, I'm pretty happy with the performance from a profitability standpoint of the company overall and our business units. I think we all get it, we all understand, we all are operating an environment that is, I would call choppy or sluggish. And we're not doing anything to damage the business, but we're also being very careful with our spending as we go through the rest of the year here.

We spent time on cash flow. You can see in the end, a big believer that cash is king and you got to make sure you're generating it, and that's something that our teams are focused on as well. All in all, I think given the environment that we're playing in, this isn't a bad year for us.

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### Operator

(Operator Instructions) Walter Liptak, Seaport Research.

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### Walter Liptak - Seaport Global Securities LLC - Analyst

Just kind of a follow-on to the last one. As you guys are working on the One Graco, and it sounds like a theme is lowering expenses, I wonder if you could talk a little bit more about, on the cost side, I think you said costs were down \$7 million, which is down 5% compared to the organic sales decline of 3%. That looks pretty good to me. And so I wonder if you could help us understand, is that -- is there a mix going on here? Or are there some benefits happening from One Graco consolidation? Or are these more like continuous improvement benefits that might be more sustainable?

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### Mark Sheahan - Graco Inc - President, Chief Executive Officer, Director

Well, I'll start, and I'll let the guys chime in if I misspeak. But I think we had said that we're looking for about \$16 million of reduced expenses for the full year, and I think we're on track to hit that for the full year as well. And we're tracking half the year into it. So I think you can probably just assume that we're halfway through it.

I wanted just to clarify though that we didn't do One Graco to cut costs. We really did to improve efficiencies and to make our business easier to deal with, with our customers. And I spent quite a bit of time here in the first half of the year meeting with distributors, and the feedback has been extremely positive. They are very appreciative of the fact that we've knocked down some of the silos and the barriers that we created ourselves by having separate business units. They like the fact that we're opening up our product lines. They like the fact that we have coordinated our pricing efforts across business units that were not coordinated in the past. And they like having a single point of contact within our Industrial businesses that they really didn't have before.

So you combine that with what we're doing on the operations side where we're looking at the factories and we created some complexities there as well, we announced that we're closing our Minneapolis facility and we're going to be able to move all the production into existing facilities that we already have at Graco. That should create efficiencies that haven't shown up yet in the P&L, but once we start doing that, they will. And I think having the centralized operations team managing all aspects of production has led to the inventory reductions that we highlighted earlier and led to improved cash flow as well. So it's a multifaceted approach that we're taking with One Graco. It's early days. We feel really good about it, but the signs are positive.

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### Operator

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

**Mark Sheahan** - Graco Inc - President, Chief Executive Officer, Director

Okay. Well, I appreciate everyone's participation in the call. Thank you for your time today. Have a great rest of your day.

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**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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