REFINITIV STREETEVENTS

EDITED TRANSCRIPT

GGG.N - Q3 2022 Graco Inc Earnings Call

EVENT DATE/TIME: OCTOBER 27, 2022 / 3:00PM GMT

OVERVIEW:

GGG reported 3Q22 sales of $546m, reported net earnings of $116m and reported diluted EPS of $0.67. Co. expects 2022 revenue to grow low-double-digit on organic constant-currency basis.

CORPORATE PARTICIPANTS

David M. Lowe *Graco Inc. - CFO & Treasurer*

Kathryn L. Schoenrock *Graco Inc. - Executive VP, Corporate Controller & Information Systems*

Mark W. Sheahan *Graco Inc. - President, CEO & Director*

CONFERENCE CALL PARTICIPANTS

Andrew Edouard Buscaglia *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

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

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

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

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

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

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

Thomas Claes Johnson *Morgan Stanley, Research Division - Research Associate*

PRESENTATION

Operator

Good morning, and welcome to the third 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. Graco has additional information available in a PowerPoint slide presentation, which is available as part of the webcast player. (Operator Instructions)

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 2021 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 Kathy Schoenrock, Executive Vice President, Corporate Controller and Information Systems.

Kathryn L. Schoenrock - *Graco Inc. - Executive VP, Corporate Controller & Information Systems*

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

Yesterday, we reported record third quarter sales of $546 million, an increase of 12% from the third quarter of last year. The effect of currency translation rates was a significant headwind in the quarter. On a constant currency basis, sales increased 17% with growth in every segment and region.

Reported net earnings were $116 million for the quarter. And despite a $0.05 headwind from foreign currency, reported EPS was $0.67 per diluted share, an increase of 14%. We expect translation rates to continue to be a challenge for the remainder of the year. At current exchange rates, the full year unfavorable effect of currency translation would decrease sales by 4% and earnings by 8% with a similar impact in the fourth quarter as we experienced this quarter.

The gross margin rate decreased 320 basis points in the quarter. While our pricing actions offset increased costs on a dollar basis, the margin rate declined 190 basis points. In addition, foreign currency translation rates decreased our gross margin rate by approximately 130 basis points.

With regards to cost, we did see some commodity prices beginning to ease during the quarter. However, they were not enough to offset broad-based inflationary cost increases. Interim price increases were implemented throughout the third quarter, and we will begin to see the full benefits in the fourth quarter and into next year. Our 2022 pricing actions have and will continue to offset the input cost pressures on a dollar basis.

Operating expenses decreased $6 million or 5% in the quarter. Reductions from currency translation rates in sales- and earnings-based expenses were partially offset by volume- and rate-related increases.

The adjusted tax rate for the quarter was 19% due to the unfavorable effects of foreign earnings taxed at higher rates than the U.S. rate. We anticipate this trend will likely continue and expect our estimated annual tax rate will be 19% to 20%.

Cash flows from operations were $272 million for the year. This is a decrease of $86 million from last year. Contributing factors include increased annual incentive payments and investments in working capital. We have elevated inventory levels, which are reflective of the high backlog and higher accounts receivable balances due to the overall business growth.

Through the end of the quarter, we have repurchased 2.5 million shares for $155 million. We continued to repurchase shares in the first weeks of October and as of market close yesterday, we have repurchased 3.5 million shares for $233 million year-to-date.

We also prepaid $75 million of our private placement debt, made capital expenditures of $147 million with $75 million related to facility expansion projects and made dividend payments of $107 million.

Finally, our full year estimate for unallocated corporate expense and capital expenditures can be found in the conference call slide deck on Page 10. I'll turn the call over to Mark now for further discussion.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Thank you, Kathy, and good morning, everyone. All of my comments this morning will be on an organic constant currency basis. Sales in the quarter were up mid-teens with growth in all reportable regions and segments. This resulted in record third quarter results in both sales and operating earnings. These gains were generally broad-based with most major product lines experiencing good order tempo throughout the quarter. Some of the increases were likely due to pricing actions taken in the third quarter, which were fully implemented by the end of September.

Our consolidated backlog was $440 million at the end of the quarter, which is $65 million higher than at the end of last year and $180 million higher than Q3 of 2021. I was pleased with the overall business tempo and profitability during the quarter despite continued cost pressures and currency headwinds.

We saw some relief in commodity prices. However, they were not enough to offset a broad-based inflationary environment. We anticipate that the pricing actions we have taken throughout the year will offset inflation on a dollar-for-dollar basis.

Now turning to some commentary on our segments. Contractor segment sales were up mid-teens for the quarter driven by outperformance in North America. Out-the-door sales in our pro paint channel are robust, and demand for our protective coatings and spray foam product lines remain strong. Painting contractors are still in demand, and they have healthy pipelines of work.

Graco's Contractor backlog decreased slightly during the third quarter to $90 million but is still 66% higher than a year ago. Availability of certain components remains challenging and is the primary cause for our high backlogs.

Going forward, we are keeping an eye on indicators such as housing starts, new and existing home sales, commercial construction, remodeling expenditures and interest rates. While some of these readings are less favorable than they were 3 months ago, we have not seen any adverse impact to our business at this time.

The Industrial segment grew 8% in the quarter with positive results in all reportable regions and achieved third quarter records for both sales and operating earnings. Profitability continues to be strong with incremental margin growth of 69% for the quarter and 64% year-to-date.

Demand remains solid in all major geographies and key product categories such as liquid finishing, powder coating and sealant and adhesive equipment. Backlog is up $25 million compared to the end of last year and $65 million compared to the same time a year ago.

The Process segment grew 30% for the quarter, again resulting in records for both revenue and operating earnings. This is the sixth consecutive quarter with revenue growth greater than 20%. Demand remains strong in all regions with continued broad-based growth in lubrication equipment, process pumps, environmental and semiconductor products. Profitability improved throughout the quarter, resulting in 34% incremental margins despite cost pressures on key components.

Moving to our outlook. Demand during the quarter was strong in all segments and regions. We're optimistic that these incoming order rates will continue for the remainder of the year. However, macroeconomic trends affecting many of our product lines and regions remain uncertain.

We are committed to our core strategies of launching new products, investing in our manufacturing capabilities, expanding our global channel and pursuing profitable growth opportunities in attractive niche markets either organically or through acquisitions.

Our backlog is still near record levels plus the effects of our pricing actions. We remain positioned to have a record year in 2022. We're raising our 2022 revenue guidance to low double-digit growth on an organic constant currency basis with growth expected in every reportable segment.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Deane Dray with RBC Capital Markets.

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

It sounds though all segments, all regions doing well, but maybe you can just take us on a tour geographically and with some focus on most recent, like last 4 weeks or so into October, kind of the puts and takes, where you're seeing strength and what might be slowing, if at all.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I would say North America remains really strong, and the Americas in general, have been good for us all year. I think it's the leading region in terms of revenue growth.

Europe has been surprisingly resilient given all the negative headlines. And of course, we got a big headwind with Russia and losing, I think it's somewhere around $30 million of revenue on a 12-month basis in Russian sales. But despite that, the absolute level of activity there has been probably better than what we expected. We're all holding our breath a little bit for what's going to happen this winter with energy and all those other things, the stuff everyone reads in the paper. But at least as far as now, in terms of what we're seeing, business seems to be on fairly good footing.

And then, of course, Asia is also doing well really across multiple product categories. And we've had a little bit of stop and start with China throughout the year, but we haven't really seen anything other than maybe a little bit of a speed bump there.

So I would characterize overall, a pretty healthy environment. With respect to the last few weeks, we really aren't going to comment about that. 3 weeks is pretty dangerous. 4 weeks is dangerous, too.

Of course, I did reference in my comments upfront that we did do pricing actions here in Q3, and I'm sure that there was some activity in terms of order rates in and around our pricing actions. And experience says that after you do something like that, you really got to wait a while before you can draw any firm conclusions. So we're going to do that. I still think the business is in good shape, pretty healthy and very happy with the quarter.

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

Great. And then just on the topic of price increases, and we had previously discussed that you all made the decision to implement a price increase apart from your annual January. Just to clarify, has that been one price increase? Because I know I heard it plural, price increases, but maybe that's just collectively across the individual businesses. But if you can just clarify that and how -- the extent to which there's been price realization.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. So I mean, we did 2 this year. That's probably why we said increases. So we did the one earlier this year and then we did the one midyear, and we did it really across all business units and all geographies. So that's a plural on that part of the question.

In terms of realization, it's very strong. I think we've said before that about roughly 2/3 of our growth in revenue this year can be tied to realized pricing. I think that still holds to be true. And our teams are doing a good job making sure that -- you go through the pain of pushing through a price increase, you want to make sure that you actually get it. And everyone is super focused on it, particularly in this kind of an environment where costs are still challenging.

David M. Lowe - *Graco Inc. - CFO & Treasurer*

I would just add -- this is David. I guess in terms of the recent price increase, I sometimes use the plural as well because -- due to different notice periods around the world, customers, the actual announcement and implementation date varied. In North America, there was a fair amount that was communicated in August, some in September. And then regionally, because of notice requirements, as Mark touched on, beginning in end of September. So we're really just now in the period where all of the interim price adjustments have been communicated and are effective on future orders.

Operator

Our next question comes from the line of Michael Halloran with Robert W. Baird.

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

So a couple of questions here. First, on the inventory side, both your internal inventory and then channel inventory. It seems like it's a little thin on the Contractor side from a channel perspective because of some of the availability challenges, but I want to confirm that. And any thoughts on the other segment on the inventory side? And then within the organization, where does the inventory stand now or at least -- because I know you said in the prepared remarks, it's a little elevated. But when do you think that starts normalizing out for you guys and you start seeing kind of an incremental or increased benefit on the cash flow side there?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I mean they're higher than what we want them to be. And I think you can really tie it to the backlog. I mean we've got $400-plus million of backlog. I think normal business, given the company and the dynamics, is probably half of that with our large powder business and things like that.

So in a perfect world where you're able to book and ship the way we did historically, I think you could probably expect that backlogs would come down and inventory levels would normalize.

This is really, again, tied to components. We've got a lot in work in Process inventory where we've built up equipment and it's ready to go, but we're waiting for an electronic component or something to come in before we can ship it out.

So -- with regard to the channel, I think that in CED, which is really the area where I think most people ask us questions. The feedback that we're getting from our channel partners is on the pro side, hey, give us everything you got. We want it. You're still on back order. Most of our back orders in CED are on the pro side, not so much on the home center side.

And on the home center side, I think they feel pretty good about where inventory levels are right now, given the level of business that they've had. So there hasn't been any mandates or any kind of communication from them that, hey, we need more or we need less inventory at this point. So I think things are pretty stable there.

On the Industrial side, they generally don't carry a lot to begin with. So there -- they rely on Graco really to supply them and to be their inventory for a lot of the stuff. So I would characterize them as wanting as much as we can deliver on that side of the business. And same thing on Process, too.

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

Great. Helpful on that side. And then more on -- one other Contractor question, I suppose. Any differences on the channel side? And then also, any differences when you think about the mix of the product category from some of the more simple products you saw on the Contractor side versus the stuff really designed for the contractor out there. Any notable trends on either of those 2 pieces?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

I'd say long term, no. But short term, I would say that our pro business has been stronger than our home center business, which I guess you would expect given the huge ramp-up that we had there through the pandemic and throughout most of last year.

So margin rates are higher on that stuff. There are more professional units, as I said in the comments, that I think that the contractors feel like they're busy. They're still hard to find. Pipelines are pretty good. So that's sort of the short-term thing that's going on right now.

But longer term, I would say -- I would characterize a little bit differently that both product categories are super important to us. We really do believe that by having the low end, the tradesmen product line, it really causes a nice dynamic with respect to people that are thinking about getting into the painting business. They start low and then they move up the chain to a professional unit when they grow up and become pro contractors. So both categories are really important to the company.

David M. Lowe - *Graco Inc. - CFO & Treasurer*

Yes. And I would just add to that, that on the -- we'll call it on the big Contractor activity in the protective coatings and the spray foam insulator, that business has been consistently strong throughout the whole year.

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

And then the mix of product, is that skewing a little higher towards the higher end because of the mix towards the pro channel then as a result?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I think at least in the short term here, we've seen some of that.

Operator

Our next question comes from the line of Saree Boroditsky with Jefferies.

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

Kind of building on Contractor, obviously, sales are at all-time highs, but margin performance is still well below levels seen in 2020. Could you talk through what you need to see to get margins back to the almost 29% level?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I think that group, in particular, has been hit pretty hard on the cost increases, probably disproportionate to some of the other businesses. They have a lot of electronic components that really go into all of their products. And when you step back and you run the map on our -- what we call, purchase price variance, which is the difference between what we thought costs would be versus what they actually are, in our factories, the vast majority of it goes into that business outsized compared to what their revenue is.

The pricing actions that we took here in the third quarter were really designed to offset costs. And all of our pricing actions have sort of been of that nature. And of course, if you're just offsetting costs and you get higher sales, you don't get incremental margin on the sales that you're generating. It really just translates into a lower margin rate.

Going forward, I do think that if cost pressures come down and we continue to push our pricing the way we have historically, that there is margin expansion there. Really efficient operation up there in Rogers, they do a great job. And to the extent that they have input costs that are lower than what they've been experiencing here in the last year or so, we would expect margins to expand.

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

And then it looks like you're pretty positive on the demand outlook. Maybe there's some margin upside, price/cost coming into 2023. So how are you thinking about the optimal balance sheet here? I think you bought back some shares that you remain in a cash position. So any update on how you're thinking about capital deployment and what the balance sheet should look like?

David M. Lowe - *Graco Inc. - CFO & Treasurer*

Well, I think that the use of cash is one of Graco's long-stated strategies. And I think you continue to see really aggressive and consistent investment in product development quarter in and quarter out. The teams are working on a lot of new technologies now for the next -- for launches over the next couple of years.

The product -- the CapEx investments, both, we'll call it plant as well as maintenance equipment, the schedules are aggressive, and we continue to make strides in terms of we broken ground on our second building on our Dayton complex, which will be our new state-of-the-art distribution center opening in '24, along with investments we're making to support the powder equipment business.

ROIs on existing operations, capacity investments and efficiency improvements are still very evident on projects that come to our internal finance committee, and we are being as aggressive as we've ever been in investments in that area.

And then that leaves us to balancing out what we want to do on the M&A side where our M&A team is engaged. They're active. They're diving into the markets and have a very good understanding of the Graco model and what's been successful. And we're hopeful with some of the, shall we call it, turbulence of recent months in the market, there could be some opportunities on that side and more agreeable pricing perhaps than we've seen in the past.

And that leaves us on the share side. And I think that we have been consistent in stating that we believe that it's wise to remain opportunistic. We believe that while Graco has got great investment and cash flow characteristics because we serve markets that are cyclical in nature. The Street, rightly or wrongly, views us as a cyclical. And when you're cyclical in the market, there are opportunities to buy. And when we see those, we like to think, in the past, over several years, we've been aggressive, and that will continue to be our position.

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

And if I could just squeeze one more. You mentioned product development costs, but I believe those are running slightly below last year's levels, potentially on an elevated cost base. So could you just talk about how you're thinking about spending? And any initiatives there?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. We're putting as much back in as we can. I think maybe some of that is due to the fact that we did some restructuring last year that I think we talked about, where we put a couple of the groups together, and I think we're just getting better leverage out of those teams, particularly on the Contractor side and also on the Industrial side.

But we're not holding anything back there, we continue to make investments. We know that products are the lifeblood of the company, and you shouldn't expect any changes.

Operator

Our next question comes from Bryan Blair with Oppenheimer.

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

Very impressive growth in Process. Mark, I think you called out sixth consecutive quarter above 20%. I was wondering in which end markets or application your team is clearly taking share there. And also, if there's anything to call out in terms of order timing or lumpiness. I'm assuming that isn't the case given the consistency of growth, and I don't believe you have a GEMA-like dynamic with any of the Process assets. But I figured I would ask.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I don't -- it's hard for us to know exactly whether we're taking share or not. Some of the companies are public, some aren't. So our data is really pretty bad.

But what I will say is that we've been really pleased with multiple product categories there. If you start with our diaphragm pump business, we're up there with a couple of 2 other competitors that are substantial, and we've launched some new technology into that market, which has really helped that group, I think, maybe gain some incremental revenue that they wouldn't have otherwise had.

Our lubrication businesses are very good, and in particular, our industrial lubrication businesses where we sell injectors and things into the machine tool industry. And I think our product availability and our availability to serve customers is maybe a little bit better than some of the big competitors there. And I think that's one area where we have gained new accounts. And once you have them, they're pretty sticky. So we're excited about that from a going-forward perspective.

Our semiconductor business has been extremely good. There's a lot of investment dollars going into there. So that's helping with the growth rates as well. And even our environmental business, the landfill business, we're seeing some growth there. So the team is really hitting well on all cylinders, and things are going well, and we're happy with the results.

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

Good to hear. I appreciate the color. And if we do see fears come to fruition and contractors paint business is pressured over the near term, how much of an offset might HPCF and pavement be? I realize pavement is the smallest of the product categories there, but I suspect you'll have pretty nice tailwinds there for at least a while.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. It's really a fairly broad product line that we have in Contractor, although they all are tied in with construction. We have line striping. We have texture. We have architectural coatings, which can be used on commercial and residential and remodeling projects. We have spray foam, which is a lot of people do it for remodeling to upgrade and get better insulation in their homes than the protective coatings, which is really materials that are put on things that sit outside and are exposed to the elements like bridges and with the infrastructure bill, there might be some stuff there. And also pipelines, with oil being higher than it was a year or so ago, that helps investment there, too.

So I think that the area that is probably one that is worth keeping an eye on is more of the residential, single-family construction, where we would expect things to slow down just given the spike in interest rates. But again, like we said before, long term, that's still a pretty good market because we are way underbuilt here in North America. I think it's something like 4.5 million units, which is like 3 years of demand just based on demographics.

So you can go through periods where maybe there's some softness. But long term, these are still really, really good markets for us.

Operator

Our next question comes from the line of Matt Summerville with D.A. Davidson Company.

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

Mark, you sort of indicated that the timing of the interim price increase may have driven a little bit of order ahead, a little bit of buy ahead, whatever you want to call it. Outside of Contractor, that doesn't seem all that rational in the other businesses, at least as I've come to think about them. So should I assume that if you saw any of that related activity, it probably would have been just relegated to Contractor? Could you expand a little more on that?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I think it's human nature, right? If you know a price increase is coming and you got some capital laying around, you're probably going to try to deploy it sooner rather than later. So it may not happen quite as prevalent on the Process side or on the Industrial side, but I can't tell you that it doesn't happen. And of course, the big channel partners that we have also were very well aware of what we are doing on the pricing side.

The good news of all of the actions that we took or have taken this year is that nobody has really been surprised by them. We haven't really had any pushback even from some of the larger partners that we have. So everyone understands it.

We do try to manage it a little bit. So like if we see an industrial distributor that's all of a sudden ordering a bunch of products and we can't tie it to a project, we may ask them about it. And I know that our teams do push back on occasion. But my comments on the upfront are more that we would expect in a normal situation when we're raising prices that there is a little bit of buy ahead.

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

And then how should we be thinking about -- obviously, it's early, but based on what your inbound cost profile looks like for raw materials, transportation, et cetera, et cetera, how should we be thinking about the type of magnitude of price increase that we would be looking at for early '23? And does the fact that you did this interim action change your view on implementing another price increase here in a couple of months?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. It's a good question. As we sit here today, when we run the math, we think we've really done a good job of offsetting the cost pressures that we have today that we're experiencing really over the next 12 months, but we don't have a great crystal ball on whether input costs are going to go up or down. They're just sort of based on where things are today.

We are still planning to raise prices early next year. I think it will be more on a case-by-case basis where some businesses may go, some may not go. Some of the regions may go, some may not go.

But one of the things that I think we've learned as a company here in this environment is that we have the ability to be a little bit more flexible on our pricing. In this environment, I think it's smart for us to stay flexible and not really commit to any specific dates or any specific percentages at this time. And so that's the approach that we're taking.

Operator

Our next question comes from the line of Jeffrey Hammond with KeyBanc Capital Markets.

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

Yes. Just wanted to go back to M&A. I think you highlight in the front of the slides kind of 3% to 4% growth. You guys have been -- certainly been running well below that for a few years. Just maybe speak to what you think maybe changes to get you more in that 3% to 4% zip code.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I would say the current environment is still a little bit elevated, but we are starting to see pricing become a little bit more reasonable compared to maybe what we had seen over the last couple of years.

We're really on a journey here of trying to create more of a competency at the company when it comes to acquisitions. We've built up a corporate team that's doing a fantastic job. They're working with our business units. All of the business units now talk about their M&A pipeline and the companies that they're targeting. And it's going to take us some time really to kind of get our pipelines up and be more active than what we've been in the past.

Our story to companies, when we talk with them is that we've got a lot to offer when we acquire a business. We have world-class manufacturing. We understand customer requirements very well. We have an enviable global footprint, and those are really the things that we're trying to leverage in the conversation.

So when we talk about M&A contribution and those percentages, we're really talking about more on a long-term basis through a cycle. Those are the targets that we're trying to achieve. And I think that we're getting ourselves in a better position by putting some resources on it here in the last year than where we have been historically as a company.

David M. Lowe - *Graco Inc. - CFO & Treasurer*

And I would just add on that point. Building out a team that's focused on this, that's working with the business units, they can do some of the missionary work in the market that really has been lacking over the last several years. I mean I know this firsthand, I was in a couple of different businesses. And we did work on M&A, but it was a lot more reactive when the [blue books] arrived. And having a proactive effort, cultivation of potential candidates in the market, first of all, could help us perhaps turn over some rocks and expose some -- expose something good that we wouldn't ordinarily get if we were relying on the process. And of course, to the extent that we can do that, we may avoid the auction process, which is a tremendous process, as I like to say, for sellers.

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

Okay. That's great. And then just back on Europe, a lot of people concerned there. It seems like maybe you saw some slowing in Industrial versus the other ones that seem quite resilient. Is there anything kind of different about Industrial where you're seeing more slowness or why these other ones are kind of proving more resilient there?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Nothing in particular. Of course, it's a quarter, so numbers can move around a lot. Just to remind you, too, that our European Industrial number includes powder. And powder can be lumpy with project activity. And in this particular quarter, we had some of that. So the legacy Graco businesses were very strong and pretty solid through the quarter.

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

Okay. And then just last one. You gave us kind of the updated end market mix. Construction is a big bucket, but I don't know if over time, you kind of have a better sense of what that res/nonres mix might be within there.

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. We really don't. It's hard to tell because when you buy a paint sprayer at a Sherwin-Williams store, you don't really know where that thing is going to go. It could be on a commercial job one day or a residential the next day.

I would say that it's a good mix. We have broad exposure to a lot of different customers and end markets, but getting granular in terms of details is pretty tough.

David M. Lowe - *Graco Inc. - CFO & Treasurer*

Yes. I would say relying on some of the external forecasts that we see, especially here in North America for different kinds of commercial construction, notwithstanding the challenges in areas like office, the forecast for some of the large categories look pretty positive for '23 and '24.

Operator

(Operator Instructions) Our next question comes from Thomas Johnson with Morgan Stanley Investment Research.

Thomas Claes Johnson - *Morgan Stanley, Research Division - Research Associate*

If we can just kind of go back to some of the regional dynamics here. You mentioned that Europe was surprisingly persistent this quarter. And obviously, you called out EMEA last quarter as an area where there was some weakening economic conditions to keep in mind through year-end. Just given the strong quarter here, could you kind of update us on how your outlook has evolved in that region and maybe where you've seen the biggest surprises from a customer standpoint there?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I think that all in all, we're pretty happy with what the team is doing over there. The demand levels, given the headwinds that they've had with losing a fair amount of revenue to Russia and then also struggling a bit with our ability to get them various product lines has slowed things down for them. We did see a little bit better flow out of our factories over to Europe in the quarter, so I think that helped them out.

But when you read about all the doom and gloom and things of that nature, I'm really proud of what our team has been able to accomplish in what's been a fairly challenging year.

David M. Lowe - *Graco Inc. - CFO & Treasurer*

Yes. And I think that time will tell because there is a lot of gloom and doom, as Mark touched on. But an environment of increased costs, labor costs, energy costs, et cetera, does lay the groundwork for Graco product lines with even better ROIs. So notwithstanding the fact that we will continue to follow events in Europe economically and politically with a lot of interest, a world of inflation, which I hate, can help demand for products that make operations more efficient.

Thomas Claes Johnson - *Morgan Stanley, Research Division - Research Associate*

Great. And then just kind of looking at the United States. Last 2 quarters have been very strong from a revenue standpoint there. Have you been surprised by the strength of kind of your domestic business? Is there anything maybe transitory that's impacting this such as increased component availability in the near term sort of releasing some pent-up demand?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I wouldn't say we're surprised. I mean it's been a continuation. We've sort of had this happening now for several quarters where demand has been good. It's been across multiple product categories and multiple end markets. So nothing too surprising there from our window on the world.

Operator

Our next question comes from the line of Andrew Buscaglia with Berenberg Capital Markets.

Andrew Edouard Buscaglia - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

So in your Industrial and Process segments, you often talk about factory upgrades is really the big driver and technology upgrades. Wondering, how much of what's going on right now is influenced really by that? And maybe like some of this is with -- while there is a lot of doom and gloom out there, there are interesting things perking up like energy markets and just broader industrial indicators are strong. So I'm wondering, what is the real driver right now that we're seeing? Is it confidence amongst your customer base that we're going to have the same demand and they're willing to upgrade those factories now?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Yes. I mean it's hard to say when you've got a product line that's like a mile wide and an inch deep as they say. A lot of onesie-twosies here and there.

But for sure, the vast majority of the stuff that we sell in Industrial and Process winds up in a factory. And I do believe that with some of the things that are going on and people looking for ways to take labor out of the equation because labor is tight or looking for ways to reduce material consumption because material costs have gone through the roof, it really does open some doors for us with our products where you can go in and you can demonstrate a relatively quick payback by putting in a new product and upgrading customers.

So I think that it's a good question. Companies are investing. Look at us, I mean, we've invested a lot in our facilities over the last 3 years and a lot in the factories in terms of machine tools equipment because demand is up and the paybacks are good. So as long as that dynamic is in place, it sets us up for continued strength.

David M. Lowe - *Graco Inc. - CFO & Treasurer*

Yes. And I would add on the -- helping the Industrial business -- take a key market, automotive. There's a lot of activity going on the automotive right now because they're -- obviously not -- on the EV side, of course, but just more broadly around the world.

And they make decisions now for their product families over the next 3 to 5 years. And those decisions, unless we are in an extreme recessionary situation, are ones where their commitment to their product plans means sort of -- in good times and bad, they'll need to make certain investments in their plant and equipment to have what they need for the new product platforms. And at least speaking of that industry, big product platforms, new ones is what drives demand for our kind of equipment.

Andrew Edouard Buscaglia - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Yes. Okay. Makes sense. And maybe along those lines, similar kind of bigger picture question, we haven't talked much about sort of your R&D strategy in a while. And I'm wondering where you're at with implementing things like sensors and technology into new products. Or is that more going to be coming from your M&A strategy?

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

I think most of our products are smart products or have the capability to the extent that the customer wants them. And having data and providing feedback to customers is -- has been a major focus of us so -- for us. So I think that we're very well along the way there.

Operator

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

Mark W. Sheahan - *Graco Inc. - President, CEO & Director*

Okay. Thank you for participating in today's call. In closing, I would like to acknowledge our employees around the world for their excellent efforts this year. It's been a challenging environment across multiple disciplines, but especially in operations, where our manufacturing and purchasing teams have endured many unanticipated hurdles. Our people are what makes this company great, and it's been rewarding to watch the teams come together. That concludes the call. Thank you, and goodbye.

Operator

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