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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good morning, and welcome to the fourth quarter conference call for Graco Inc. If you wish to access a replay for this call, you may do so by visiting the company's website at www.graco.com. Graco has additional information available in the 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 future. These remarks constitute forward-looking statements for the purpose of the safe harbor provision of the Private Securities Litigation Reform Act. Actual results may differ materially from those indicated as a result of the various risk factors, including those identified in Item 1A of the company's 2022 annual report on the 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 Chris Knutson, Executive Vice President, Corporate Controller.

Christopher D. Knutson - *Graco Inc. - Executive VP, Corporate Controller & Principal 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 fourth quarter sales of $567 million, an increase of 2% from the fourth quarter of last year. The effect of currency translation increased sales by 1 percentage point or approximately $6 million. Reported net earnings decreased 13% to $110 million for the quarter or $0.64 per diluted share. In December, the company transferred $147 million of its pension obligations to an insurance company through the purchase of an annuity contract. In connection with the transfer, we recognized a noncash pretax pension settlement charge of approximately $42 million recorded in other nonoperating expense. Excluding the impact of this pension settlement loss, certain nonrecurring tax provision adjustments and excess tax benefits from stock option exercises, adjusted non-GAAP net earnings were $137 million or $0.80 per diluted share, an increase of 10%.

The gross margin rate increased 370 basis points in the quarter. Strong price realization and lower product costs were more than enough to offset lower factory volumes. Total operating expenses increased $10 million or 8% in the quarter, mainly due to volume and rate-related increases of $3 million as well as higher sales and earnings-based expenses of $3 million. Gross margin rate improvement more than offset these increased operating expenses during the quarter, resulting in operating margin rate growth of 2.5 percentage points.

The adjusted effective tax rate was 19% for the quarter. Cash provided by operations totaled $651 million for the year, an increase of $274 million from last year, mostly driven by higher net earnings and a reduction in inventory purchases. Cash provided by operations as a percent of net earnings is 129% for the year. Significant year-to-date use of cash include dividends of $158 million, share repurchases of $102 million, which were offset by share issuances of $60 million, debt repayment of $75 million and capital expenditures of $185 million, including $108 million of facility expansion projects.

A few comments as we move forward to 2024. Based on current exchange rates, assuming the same volumes, mix of products and mix of business by currency as in 2023, movement in foreign currencies would have no impact on net sales or net earnings for the full year. Unallocated corporate expenses are projected to increase to a range of $41 million to $44 million with the increase related to share-based compensation.

The effective tax rate is expected to be 19.5% to 20.5%, excluding any impact from excess tax benefits related to stock option exercises and other onetime items. We expect capital expenditures to be approximately $120 million, with $60 million for facility expansion projects. Since 2018 and through 2024, we will have invested nearly $500 million to expand our global manufacturing capacity. By the end of this year, we will have completed expansion projects for nearly all of our operations, which should set us up for several years of growth.

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

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

Thank you, Chris. Good morning, everyone. All my comments this morning will be on an organic constant currency basis. Sales in the fourth quarter were up low single digits, resulting in quarterly and annual records for both revenue and operating earnings.

Our Industrial and Process segments saw record annual sales, and I'm encouraged by the fourth quarter sales growth in our Contractor segment. All segments finished the year with record annual operating earnings. Pricing actions implemented in late 2022 and at the beginning of 2023 drove sales growth and gross margin expansion during the quarter and for the year. Our strong price realization across all businesses and regions, combined with improved product availability, stable product costs, and favorable product and channel mix and contractor resulted in meaningful improvement in our gross margin rate.

These improvements resulted in company-wide incremental margins of nearly 150% for the year. Adjusted net earnings expressed as a percentage of sales was 24% for the year, which is the highest in company history. Pricing actions taken in early 2024, closely resembled traditional levels in terms of size and cadence with all segments and regions initiating price increases at the beginning of the year.

At the end of 2023, our consolidated backlog was $280 million, which was $75 million below last year's ending backlog. Backlogs have returned to normal levels within most product categories but continue to remain slightly elevated in our semiconductor and powder coatings businesses.

Now turning to some commentary on our segments. Contractor segment sales improved in the fourth quarter, growing at low single digits, soft demand in the home center channel and challenging global construction markets remain headwinds. However, new product introductions and continued strength in the Protective Coatings and spray foam product categories were more than enough to offset these headwinds in the quarter.

Operating earnings were 29% for the quarter and for the year as contractor benefited from pricing actions and favorable product mix by selling larger professional units and fewer home center units. Heading into 2024, we're cautiously optimistic about business conditions based on improving global construction indicators. As affordability improves new and existing home sales are predicted to increase throughout the year, along with expected growth in commercial and nonresidential spending.

The Industrial segment achieved record sales and earnings for the year despite a 1% revenue decline in the fourth quarter compared to last year. Growth in liquid finishing and sealant and adhesive product lines were not enough to offset the impact of lower powder finishing system sales in EMEA and Asia Pacific in the quarter.

Fourth quarter 2022 represented peak revenue for our powder finishing group as projects delayed during the pandemic were completed and placed into service. Our Process segment grew 4% in the quarter and 11% for the year. For the year, we saw growth in all regions and reported record earnings. Increases were posted for the quarter in many business units and across all reportable regions, led by double-digit growth in vehicle services and process pumps.

Price realization and increased volume drove incremental margins of 89% in the fourth quarter and 83% for the full year. We had broad-based revenue growth in all our businesses this year, resulting in record operating profit margins for the segment.

Moving on to our outlook. As we enter 2024, we're keeping a close eye on incoming order rates and global economic indicators. Despite difficult macroeconomic environment, we remain committed to our core strategies of launching new products, entering new markets, expanding our global channel and pursuing strategic acquisitions. As a result, we're initiating revenue guidance for full year 2024 of low single-digit growth on an organic constant currency basis.

That concludes the prepared remarks. Valerie, we're ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Deane Dray of RBC Capital Markets.

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

Maybe we could start with pricing. And Mark, you gave the kind of the broad brush comments that it's back into the single price increase and it's representative of what would be normal price across the board. Maybe talk about the expectation for new product introductions. And then where does the -- on the cost equation, it sounds like labor inflation is still around. Is there anything else? Are we back to normal on the rest of the cost side?

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

Yes. So the pricing actions, again, there -- I'd say they're more in line with what we've done historically, kind of inflationary plus or minus a little bit. All the business units are implementing increases as are all the regions. So we feel pretty good about that getting back to a normal cadence there. Of course, if things change, we know we can make an adjustment if we need to, but it doesn't look like that's going to be the case this year.

Our cost pressures for the full year in the plan were still unfavorable compared to what we were expecting them to be. But we did start to see a little bit of light at the end of the tunnel here as we work through the year in the fourth quarter, things turned slightly favorable. So if those trends continue, I am hopeful that we would see some impact -- some favorable impact on the gross margin line as we kind of work through the year.

Labor is tight. We did just raise our wages in line with what the market is. But even though it's tight, we have not really experienced any major difficulties in terms of attracting people to join Graco. It's a great company. We're growing. We have a great story to tell. And even though we have people retiring all the time, we're able to fill those positions pretty readily. So feel pretty good as we enter into the year, and we'll see what happens.

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

Great. And then just as a second question, going to our favorite traffic light slide, can you just comment on the changes versus last quarter? So improved outlook in Industrials America, but Industrials, Asia Pacific dipping and Process Americas look also has worsened. I know you touched on the powder finishing impact, but kind of reconcile some of those changes with what's actually going on in the business and order expectations.

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

Okay. This is David Lowe. As far as North America Industrial goes, what we have seen there is pretty good project activity throughout the second half of 2023, the team reports strength in a number of our core markets, I'll just ramble off 2 or 3. E-Mobility has continued to be strong here in the home market, aerospace, solar panel, agricultural equipment. And we're hopeful that suggests that we're going to have positive momentum going into '24. So we thought that was worthy of refinement.

I think on the Industrial Asia Pacific side, we clearly have a mixed picture in Asia, and one of the -- I'd say, the most impacted markets for us has been -- it falls into industrial, but it's the construction activity that drives powder coating applications, and that continues to be soft space for us. And the picture, especially in China, remains murky at best. So I think that's at least a reflection of how we see the business today. And finally, on Process in the Americas overall, as Mark touched on, the business has been strong. But we continue to see some softening in orders in the semiconductor space, sort of consistent with the messaging that's going on around in the industry here. I should add, the business continues to be strong in markets outside of North America.

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

That's really helpful. Just a quick clarification, David, please. You mentioned the weakness in China. We had a company report this morning that referenced weakness in China, no less than 14x in their prepared remarks, do you have -- has there been any discernible downshift in China? It's been weak pretty consistently, but let's say, in the last couple of months, as it turned more negative for you? Just any color there would be helpful.

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

I would say the quick answer. I've got a cheat sheet here. I'd say it has not. I'm going to check this, while I'm...

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

I think that the overall China has been weak for us. And I would say that the couple of the areas that have been the weakest have been our contractor business and our powder coating business. But overall, it's kind of been an ongoing theme for us throughout the year.

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

I would say the throughout -- Mark is exactly right. Throughout the whole year, it's been soggy on the order rates, I would say we saw modest for what it's worth. We don't really think of our businesses these ways is turning around in a couple of months or a quarter, but the rate of -- I would say the rate of softness has decreased, I mean, partly because we're working through the period of the toughest comps in 2022.

Operator

Our next question comes from the line of Michael Halloran of 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, 2023 was a massive year for margins across the board here. We're talking about more normalized price, how do we think about what the right run rate looks like as we work through this year. Process had a mini step down in the fourth quarter, but was 30% plus all year, Industrials at these really large levels. You compare that to '22 and earlier it was just a sea change. So is this sea change at this higher level, the right run rate across the businesses? Or should we be thinking about something different?

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

Yes, I feel good about it. I really think that the businesses are performing extremely well. I think the factories are doing well on lower volumes. It's really be a volume game for us here in '24. If we get volume growth above what we're guiding, it's going to be pretty nice. We've got capacity to utilize and I really feel like the factories are in good shape to be able to deliver higher revenue. We have the low single-digit guide mostly because if you look out at the global trends, they are trending below normal levels, I would say.

And we also have a little bit of inflation sticking around the world, too, and you never really know how that's going to play out. And then you've got other factors that all kind of went in that low single-digit number, even though we're getting some pricing and we've got really nice new products coming out.

So if we get volume growth, Mike, things will be great. If volumes hang in there at the low single-digit level, I don't see any deterioration in terms of the overall performance. And there could be some upside in terms of some of the initiatives we have on the cost side to make sure that we're taking advantage of all the opportunities that we have available to us. There's plenty of work for us to do here.

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

Thanks for that Mark and then you mentioned initiatives. How do you think the internal M&A efforts are going? Maybe some conversations on pipeline actionability and any thoughts on the broader landscape on the M&A side?

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

Well, we're hearing that '24 might be a little bit more favorable than '23, just in terms of overall M&A activity levels. I feel good about our pipeline. I think I've said this before, but I think that today, I could pull any of the names on our pipeline. I'm going to know how big the company is, what the strategic fit is actionability, what kind of contact we've had with those companies. And so it's really just a matter of are they ready to get into a transaction or not.

I think Graco is in a good spot to be able to look at those opportunities. I think we have a lot to offer. We have world-class manufacturing operations. We have a global distribution channel. We have professional marketing and sales. So if we get the right opportunity with the right management team, we're ready to go. And like I said, I think we feel pretty good about the overall shape of the pipeline these days.

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

I would just add to that, that I think our experience in '23 really reflects what we saw industry-wide with declines in deal volume. Certainly, the deal supply slipped. I think as maybe in some cases, sellers withheld moving forward, trying to figure out where private equity fits in all of this. And at least on some transactions, we followed pretty closely multiples remain elevated. With that said, the work is ongoing with respect to pipeline management, reaching out and cultivating transactions. It's long-term retail work.

But I think that any time we can find opportunities where we could work on them on an exclusive basis as opposed to an auction basis, that remains a real opportunity for us. And as Mark said, in addition to the, I'd say, our operating philosophy and our channel management skills and some other things that we're proud of is that, quite frankly, given our financial situation, when the opportunity comes along, we can move very quickly.

Operator

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

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

So you typically say low single-digit growth in all regions and segments, but you kind of admitted that today. So maybe just talk about where you expect to see higher or lower growth within the guidance of low single digits for 2024.

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

I don't think we've fine-tuned it. I think we just decided that we're going to go with the overall macro, and I don't think we're smart enough to know like what's going to be up, what's going to be down, but I feel very confident at this point that overall, that's where the number should be at.

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

What are your customers talked about commercial sales maybe weakening in the second half of this year due to lower completions. Maybe just talk within contractor about how you're thinking about the resi and commercial completions within your guidance in 2024.

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

Yes. I do think that commercial is expected to slow down, but it's still going to grow in '24. At least that's what they're predicting right now. I'm probably a little bit more bullish on the residential side than maybe what some of the headlines are. I do believe that rate stabilization, the fact that the Fed is going to cut rates gives people more confidence to purchase new homes, and I think that the builders are going to pick up on that and hopefully, we see more activity there.

We also expect to see more turnover in the North America market. Once people can see that they're not going to be locked into these low mortgage rates and maybe they can move into new houses. I think that will be favorable for our Contractor business, too. I'm also really excited about the new products coming out in CED.

We had great success with the QuickShot product that we launched last year that really helped, and we've got some new products coming out here in '24, including a new line of electric sprayers, a new, what we're calling a ProShot, which is basically taking that QuickShot technology and applying it to all our installed base of sprayers in the marketplace.

We've got some new guns coming out on the Industrial side. We have a new gun coming out in the spray foam category. We have some 2 component flooring products coming out in CED. So pretty excited about the launches that are happening in '24 gives us confidence that hopefully we'll be able to grow the revenue in line with what we had projected.

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

And maybe just add 1 more. Your Industrial margins at 37% in the quarter. I think it's the highest it's ever been. So maybe just think about that as starting off point, how you're thinking about price cost in 2024, the volume impact, just how you think about industrial margins as you think about 2024 and beyond.

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

Yes. I think they can go higher if we get the volume. Like I said earlier, I think that there's a lot of capacity in the factories. Volumes have not been as strong lately as they had been historically. Most of the growth in '23 came from our pricing actions. So there's no lid on the industrial margins that I am aware of.

Operator

Our next question comes from the line of Joe Ritchie of Goldman Sachs.

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

So just my first question, like look, I agree with what Mike said earlier, just the performance this year on the margin with really no volumes is pretty impressive. As I kind of think about your product cost initiatives, how far along would you say you are? And maybe if you could just provide a little bit more color on how that's impacting margins as well, that would be great.

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

Are you talking about the purchased items in the factories when you say product cost?

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

Yes, just that you're continuing to lower product costs. I would imagine that you're simplifying your line and also from a sourcing perspective, probably also benefiting. But any color that's really kind of driving lower product cost across your portfolio?

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

Yes. We have -- each of the business units has engineers that are looking for ways to take cost out of products. We do that continuously. And then of course, when we launch a new product, a lot of times, we're looking at how do we take cost out of the old one. So we get kind of a double whammy there if it works the way according to plan.

When it comes to the factory input costs, we did start to see a little bit of favorability creep in, in the late -- in the third quarter and into the fourth quarter in terms of what we call PPV, purchase price variance. And so if that trend continues here into 2024, I think that, that should be more or less a tailwind at this point. I don't want to predict it, but we don't really see the big inflationary pressures hitting the way we have over the last couple of years. So our hope is that if we keep our price increase in line and we can do a good job on the cost that there could be decent potential for gross margin expansion in '24. That's sort of what we baked into our internal plans.

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

Got it. That's great to hear. And I guess, look, you took a look across the different regions in your segments and what does stand out to me is what's happening in the industrial segment in the U.S. or in the Americas. The growth has been really good, had been in 2023. I guess we've been talking a lot and writing a lot about mega projects and ultimately, what that means for industrial growth going forward, whether it's this year or next. How are you thinking about the investment that's happening in the U.S. and ultimately, like when you start to see it flow through your own P&L?

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

I think it should be good for us. I can't say that we've actually started to experience it. I can't point to specific projects that we've gotten as a result of that. But for sure, any time they move a factory around from 1 location to another, they usually don't rip out the old Graco equipment and put it into a new facility. They usually just rebuy the stuff because in terms of the overall capital outlay, our stuff really isn't all that expensive and it's just easier and better if they take advantage of that.

In North America Industrial, they've really done a nice job executing on some of the initiatives that we've got around electric vehicles and battery production. And in addition to that, I think that the powder business in North America has actually performed a little bit better than where it had outside of the North America marketplace. So feel good about the team there and the growth and what they're working on. I think they got their eye on the ball and they're focused on the right things.

And some of the products that they got coming out as well in the electric pump category should drive some incremental growth because a lot of these customers if they're moving into a new facility, they're also looking at their energy consumption. And if they can put in an electric drive pump instead of an air drive pump, they save a lot of energy. And so we think that there's going to be the potential to get some incremental business with those new builds, but also we can go back into old customers as well and try to persuade them that there's a payback and ROI if they move to an electric platform. So lot of good things happening in industrial, and I think they'll have -- I think they're in a good spot to have a decent 2024.

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

Yes. And I would say, just adding to Mark's comment that there are opportunities for reshoring or near-shoring whatever you want to call it, that I think does play out over time. For example -- I can use an example in my own finishing experience, where about a decade ago, the -- a couple of large Japanese automotive OEMs decided to start a couple of greenfield facilities in Central Mexico, sort of away from where the traditional automotive manufacturers were operating. And from the time they initiated the project when they started making cars, took about 5 years.

And the reason for that is it took the better part of 5 years to flesh out a vendor base that was suitable for the standards of Japanese car companies. So on the higher end of projects, I think it should be a positive as alluded to over the next several years. But things like supply chains and so forth don't come together overnight, especially in the higher value-added product categories.

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

Got it. That's great color. If I could just fit 1 more in, just real quickly on the pension settlement. What's left on the pension at this point? I know that you did the $147 million this quarter, but what's left on the liability side?

Christopher D. Knutson - *Graco Inc. - Executive VP, Corporate Controller & Principal Accounting Officer*

I think we have about $127 million remaining from the PBO after we did this round of the derisking.

Operator

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

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

Just on process, I mean it's just had a tremendous run of growth and I think the growth stepped down 4Q and you're saying it fits in that low single digits. I just -- are you seeing any real moderation within that business? Or are we just finally kind of catching up the tough comps.

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

Yes. I think that -- like David said earlier, the semiconductor business is probably the one that we would expect to see a little bit of a pullback in '24. The expectation is that they will actually start to ramp up their spend again kind of midyear 2024. But of course, last year, at this time, we had these huge backlogs of orders from customers and while we haven't worked down all of those, we worked on quite a bit of it. So outside of that, I don't really see much in terms of things that have us concerned.

The vehicle service side still looks pretty solid. Our industrial lube side looks good. We still have plenty of opportunity there to gain market position. The process pumping business looks decent. We have an electric drive diaphragm pump that we're pretty excited about getting put into customers to drive some incremental growth there. So I feel overall pretty good about all of the business units in there with the slight exception of the semiconductor space.

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

Okay. And then -- so this looks to be your last year of kind of growth capital. Should we expect into '25 that you start settling back in that $60 million CapEx? Or is there a new funnel of projects?

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

No, I think we're in great shape facility-wise once we get through 2024, and I would highly expect that our normal maintenance CapEx plus improvements is going to be somewhere in that $50 million to $60 million range.

Operator

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

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

Just a couple of quick ones. With respect to the performance you saw in contractor, can you maybe just touch on the divergence in the home center channel versus pro paint and whether you see that trend continuing in '24, given kind of new product cadence you're looking for?

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

Yes. I'll be honest with you, Matt, a year ago, somebody might have told me that full year CED is going to be up or down 1%. I think we all would have said, we'll take that just given all the doom and gloom that was out there in the marketplace, everything from DIY was way overbought to the housing market. It's going to collapse and creator and all that negative stuff. But as I -- I think I reminded people at one point, that business is made up of a lot of different things, and you've got line striping, you've got spray foam, you've got protective coatings, which are all kind of more in the professional camp as well as all the pro sprayers that we sell through the professional paint stores.

And that side, the pro paint held up probably better than what we would have expected. And then the other pieces that I mentioned were actually fairly robust with a lot of the infrastructure spend that's been going on and opportunities to go in and reinsulate homes, for example, with spray foam. So all in all, I feel pretty good about that.

I feel like the home center in terms of their inventory levels, has gotten to a point where they're comfortable and they're at the level that they're seeing in terms of foot traffic in the stores from a demand standpoint. So I feel like we've already been through most of the pain there in terms of reductions. We do have some new products going in there this year. We'll see what happens with that. If the level of activity remains where it is, and we do a good job on the new products, we'd actually see some potential growth in the home center in 2024. We'll just have to see how things shake out.

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

Got it. And just as a follow-up, how do you guys think about balance sheet optimization, especially to the comment made earlier, this big multiyear kind of CapEx cycle for Graco starting to roll off in '24, essentially abating in '25, and yet you're sitting here with $0.5 billion in net cash. How should we think about whether or not you guys are likely to step up and get more aggressive with repurchases if the M&A pipeline maybe doesn't play out as you hope? How should we be thinking about kind of optimizing the balance sheet for Graco?

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

Well, for sure, top priority would be to do some acquisitions that make sense, strategic ones, and we can add value, we can put points on the board that pay back nice rates of return for our investors. And I think David alluded to the fact that pricing has been a little bit of a challenge here. We'll see what happens. I like the pipeline. We will be active. That would be my top choice and I think the top choice of our management team. We've always had the, I'll call it, the happy problem of generating more cash than we can plow back into the business. And historically, we've taken care of that through buying back our stock and doing some acquisitions. But for sure, it's front and center in terms of things that we're keeping an eye on.

We do have $0.5 billion in cash on the balance sheet, but we are a $14-plus billion -- or $1 billion market cap company. So in terms of the overall leverage, it looks big, but again, given the size and scale of Graco, I don't really view it as a significant problem at this point. I don't think anyone has a gun to David Lowe's head or my head saying that we have to deploy that capital, we sure would like to. We'll do our best to be able to take advantage of opportunities on the share buyback side and M&A going forward. But it's a great problem to have. The company performs extremely well. We're fortunate to have this happy problem.

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

I should leave well enough alone because that's a good summary. I'll just add the 2 things. Number one, I think we like the flexibility that the position gives us to move quickly when opportunities and such come along. And some of you have heard me talk about before, while I don't think of our stock as a classic cyclical Wall Street does because of the markets we serve.

And what that means is from time to time, without a lot of change in our business, cyclical stocks go on a discount and I think our record over the last couple of decades has been pretty good at buying in most recently in '22, also in '20, back in '15 and '16 when we were, I think, experiencing a 30% haircut. And it's nice to know that, that remains a real option for us when the opportunity comes along.

Operator

(Operator Instructions)

Our next question comes from the line of Andrew Buscaglia of BNP.

Andrew Edouard Buscaglia - *BNP Paribas Exane, Research Division - Research Analyst*

Just looking at your margins, I think everyone's kind of trying to figure out if you can exceed the sort of watermark, which is -- you guys have had such strong margins this year on low growth. I'm wondering you talked a lot about new products you're introducing, is there -- and you're always introducing new products, is this a greater kind of new product cycle we're upon? It seems like you have quite a bit of commentary on that.

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

Yes. I would say that for sure, new products is oxygen for Graco, right? I mean it's our primary growth lever. And I really do believe that this year, in the contractor business, in particular, is a strong lineup of new products coming. And we also have decent products in the other business units as well. So if you were to take like an average of a new product year for Graco, this '24 looks like it could be a little bit stronger than average.

Andrew Edouard Buscaglia - *BNP Paribas Exane, Research Division - Research Analyst*

Yes. Okay. Interesting. And is there a bit more pricing leverage, therefore, in contractor versus the other segments, both price cost, but also those new product initiatives -- or not initiative, but new product expectation?

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

I wouldn't say there's more pricing leverage. I would say that we are able to charge a nice price for new technology when we bring it to the marketplace. And typically, we're also looking to maybe reduce some of the costs if we're replacing a legacy item with something new. But being the first to the customer with new technology is really the name of the game. And if you can do that consistently, like we've been able to do, you really can drive more organic growth than, say, other companies that are playing catch up.

Andrew Edouard Buscaglia - *BNP Paribas Exane, Research Division - Research Analyst*

Yes. Okay. And you're talking -- I know acquisitions are your preference. How do we think about margins with new deals? Are these deals you're looking at, I'm assuming would be margin dilutive, but can you just kind of remind us what your hurdle rates are and what your expectations are for that?

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

Yes. We don't really have a targeted, let's say, operating margin for a business that we're going to acquire. But for sure, in most cases, their operating margins are going to be below Graco's or their EBIT margins or EBITDA margins. So what we're really looking for is a good business where we understand the product line. We understand the customers. We think we can bring some value, particularly on operational side of the business and take their existing margin rate and improve it over time. I think we've got good experience with the deals that we have done in that -- with that kind of a playbook. And that's really what we'd be looking for with M&A as we're scouring the market for opportunities.

Operator

If there are no further questions, I'd like to turn the call back over to Mark Sheahan for closing remarks.

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

Okay. Thanks very much. I'd like to thank our customers, employees, all of our channel partners around the world for a great year in 2023, their dedication and loyalty and unwavering commitment to Graco is really what provides us with the winning edge in the marketplace. I thank you all for participating on today's call. That concludes the call for today.

Operator

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