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# EDITED TRANSCRIPT

GGG.N - Q1 2026 Graco Inc Earnings Call

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## OVERVIEW:

Company Summary

## CORPORATE PARTICIPANTS

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

**Mark Sheahan** *Graco Inc - President and Chief Executive Officer*

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

## CONFERENCE CALL PARTICIPANTS

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

**Mitch Brian Moore** *KeyBanc Capital Markets - Analyst*

**Bryan Blair** *Oppenheimer & Co Inc - Analyst*

**Matthew Summerville** *DA Davidson & Co - Analyst*

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

**Joe Ritchie** *Goldman Sachs International - Analyst*

**Andrew Buscaglia** *Exane Bnp Paribas - Analyst*

**Walter Liptak** *Seaport Research - Analyst*

**Sanjiv Gupta** *Graco Inc - Chief Financial Officer and Treasurer*

## PRESENTATION

### Operator

Good morning, and welcome to the first quarter conference call for Graco Inc. If you wish to access the replay for this call, you may do so by visiting the company's website at [www.graco.com](http://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 the future. These remarks constitute for 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 2025 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 and Chief Accounting Officer*

Good morning, everyone, and thank you for joining the call. I'm here today with Mark Sheahan, David Lowe, and Sanjiv Gupta. I'll begin with a brief overview of our first quarter results and then turn the call over to Mark for additional commentary.

Yesterday, Graco reported first quarter sales of \$540 million, up 2% from the same quarter last year. Acquisitions contributed 5% growth and currency translation added 3% growth, partially offset by a 6% decline in organic sales.

Reported net earnings were \$119 million down 5% or \$0.70 per diluted share. Excluding excess tax benefits from stock option exercises, adjusted non-GAAP net earnings were \$0.66 per diluted share, down 6%.

Gross margin decreased 60 basis points versus the first quarter last year. The benefit from our pricing actions helped offset higher product costs from lower factory volume, lower margin rates from acquired operations, and incremental tariffs. Tariffs increased product costs by \$7 million in the quarter.

Operating expenses increased \$9 million or 7% in the quarter. Excluding \$5 million in incremental expenses from acquired operations and the effects of currency translation, expenses were flat.

In the quarter, the operating margin rate in both our contractor and expansion market segments was 24%, consistent with the same period last year. Industrial segment operating margin was 32%, down from 34% in the prior year quarter. The decline is due primarily to unfavorable volume and tariffs that were not offset by price realization.

Total company operating earnings decreased \$6 million or 4% in the quarter. Operating earnings as a percentage of sales were 26% compared to 27% in the same period last year. The adjusted effective tax rate was 20%, in line with our expected full year adjusted tax rate of 20% to 21%.

Cash provided by operations totaled \$120 million for the year, down \$5 million or 4%. Cash provided by operations as a percentage of adjusted net earnings was 107% for the quarter. Year to date, uses of cash include share repurchases of 189,000 shares totaling \$16 million, dividends of \$49 million and capital expenditures of \$12 million. These uses were partially offset by share issuances of \$40 million.

A few comments as we look forward to the rest of the year. Based on current exchange rates and assuming similar volume, product mix and business mix as in 2025, currency is expected to have a 1% favorable impact on net sales and a 2% favorable impact on net earnings for the full year 2026.

For the full year, we continue to expect unallocated corporate expenses of \$40 million to \$43 million and capital expenditures of \$90 million to \$100 million, including approximately \$50 million for facility expansion projects. 2027 will be a 53-week year with an extra week occurring in the fourth quarter.

And finally, in the attached materials, we updated our outlook slide to highlight performance by segment and region, with the size of each color dot indicating its relative size versus the others.

With that, I'll turn the call over to Mark for more details on our segment and regional performance.

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**Mark Sheahan** - Graco Inc - President and Chief Executive Officer

Thank you, Chris. Good morning, everybody. Overall sales increased 2% in the quarter with acquisitions contributing 5% and foreign currency adding another 3%. That growth was partially offset by a 6% decline in organic revenue. Organic revenue started the year slower than expected, particularly in January. The business activity improved steadily as the quarter progressed, with bookings up 3% at actual currency rates, driving nearly a \$26 million increase in backlog, primarily in our Industrial segment. If those orders have been converted to revenue at the end of the quarter, organic revenue at actual currency rates, would have increased 2% and total sales, including acquisitions, would have been up 7%.

The Middle East region represents about \$35 million of sales on a full year basis for Graco. To date, we've not seen any significant impact on demand or operations, though the environment remains uncertain. We are staying close to our customers and channel partners and are monitoring order patterns and logistics carefully. From an exposure standpoint, the Contractor segment will be the most impacted primarily related to our protective coating product application.

Let me provide some additional color on our segments and regions.

In the Contractor segment, sales increased 2% in the quarter, with acquisitions and currency translation each contributing 3%, partially offsetting a 4% decline in organic revenue. Within the segment, our form polyurea and protective coatings businesses continued to be bright spots, supported by strong global demand tied to infrastructure, border wall, and data center projects. That said, construction demand remains softer than we would like, particularly in the Americas. Housing starts are expected to be relatively flat year over year with fewer new home sales and only modest improvement in existing home sales. Overall, the market has shown limited growth over the past four years, and we expect those conditions to persist this year.

Turning to the Industrial segment. Sales increased 4% in the quarter, with acquisitions contributing 8% and currency translation adding another 4%. This growth was partially offset by an 8% decline in organic revenue. Despite the organic decline, bookings were up 5% at actual currency rates, driving a \$23 million increase in backlog. If those orders have been converted to revenue within the quarter, organic revenue at actual currency rates would have increased 6%.

Industrial Americas performed well delivering revenue growth despite lower project-based activity in our Powder group. Bookings in the region were up double digits, supported by broad-based strength across multiple end markets. EMEA and Asia Pacific were more heavily impacted by the timing of completion and acceptance of project-based activity, which drove the decline in the quarter. That said, both regions saw activity improve as the quarter progressed, with quoting levels moving higher.

In our Expansion Markets segment, organic revenue declined 5% in the quarter, driven primarily by our semiconductor business, which was coming off an exceptionally strong prior year comparison. Semiconductor delivered its largest quarter of the year in 2025, growing 51%. Despite the tough comparison, semiconductor demand remained solid with first quarter bookings up at least 20% in each region.

We're also seeing improvement in our environmental business. While the year started slowly, activity has picked up meaningfully with a strong start to the second quarter, and bookings are trending positive year to date.

Moving on to the outlook. Despite the slow start to the year, we're encouraged by demand trends across our broader end markets. We saw a meaningful pickup in both ordering and quoting activity in our industrial and semiconductor businesses throughout the quarter. And based on current order rates, strength in these areas should help offset continued softness in the Contractor segment. As a result, we're maintaining our 2026 revenue guidance of low single-digit organic growth on a constant currency basis and mid-single-digit growth, including contributions from acquisitions. Looking ahead, second half comparisons are more favorable, reflecting an easier contractor comparison in the third quarter and the expected timing of project activity in the industrial businesses towards the end of the year.

Finally, I'd like to take a moment to welcome Sanjiv Gupta to Graco. Sanjiv comes from General Motors, where he spent more than 20 years in finance and operating roles across the globe, most recently as CFO of GM International. He brings deep experience across corporate finance, operations, manufacturing, and supply chain and a strong track record of leading global teams.

In addition, I want to recognize and thank David Lowe for his more than 30 years of dedicated service as he prepares for retirement. David's leadership, deep financial expertise, and steady guidance have played an important role in shaping our company and supporting our long-term success. On behalf of the entire organization, I want to thank David for his many contributions and wish him the best in his next chapter.

In closing, I want to take a moment to recognize an important milestone for our company. On April 26, we will celebrate our centennial. This milestone reflects the strength of our people, the durability of our business model, and the deep relationships we've built with customers and partners around the world.

While we're proud of our history, this anniversary is really about the future, continuing to invest in innovation, supporting our customers, and building on the foundation that has sustained the company for a century.

That concludes the prepared remarks. Operator, we'll open it up 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 I add my welcome to Sanjiv and to wish David all the best? Since we're in an uncertain macro here, Mark, maybe you can just take us through the major verticals and what surprised you versus expectations? I know housing remains tough, but semiconductor looks like that's a positive side. And then just same thing on the geographies. And if you could elaborate a bit more on the Middle East exposure for contractor.

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### Mark Sheahan - Graco Inc - President and Chief Executive Officer

Yeah. I guess I'd start at a high level and just say that our industrial bookings in the quarter were actually up mid-single digits, which was good. And unfortunately, we weren't able to convert that into revenue that you all saw.

But in terms of how that mid-single-digit booking growth took place, it was really across multiple product categories. Look at liquid finishing, process, our lubrication businesses, both ALE, automatic lubrication, as well as our vehicle service business, and a little bit of pressure in our sealant and adhesive business offset some of that. But overall, I was pretty happy with the growth in industrial in the quarter.

The powder business, again, was influenced mostly by some project activity on the bookings front that booked right at the end of the quarter that we just couldn't convert. Now those projects usually take time between booking and billing. And then the overall Gema or powder business, again, in aggregate, was in line with our long-term expectation for the full year of the low single-digit organic growth, constant currency.

Obviously, the home center and the paint channel continue to be a little bit of a headwind for us. I wouldn't characterize them as down significantly, but they were down in the quarter.

We did see nice growth in the areas that I mentioned in my script on the high-performance coatings and foam business that wasn't quite enough to offset all of the headwinds that we had in the traditional paint and home center channels. But overall, booking for the quarter was only down 1%, which is okay in an environment where we're still experiencing some pain.

When it came to the environmental business, yeah, the bookings and for semiconductor the bookings were fantastic. We're starting to see a little bit of a pickup on our environmental business. And I would say that the HIP high-pressure business that's in there as well is also experiencing growth within line of what we're expecting for the full year.

Geographically, you've seen the numbers, but Europe is doing okay. Asia is somewhat influenced by the adhesive business that I referenced previously on the industrial side. So we're off to a bit of a slower start, but the team is pretty optimistic that we'll be able to make that up as we finish out the next three quarters of the year. And North America has been okay here so far this year, where booking rates are up in our low single digit -- low to mid-single-digit guide.

So all in all, I wish we would have been able to convert more of the bookings into billings. It's only 13 weeks, and we do feel like we've got -- given the order momentum, that we've got a good chance to be able to get to our low single-digit guide for the full year.

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

Great. And then just if you could follow up with any specifics around the Middle East exposure, you called out contractor. And then I'll give you my follow-up question. Just you said tariffs were a \$7 million bad guy for the quarter. Can you talk about pricing? How much price action have you taken? And is this a potential year of a second price increase? What's your crystal ball say?

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**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

Yeah. So I'll handle the Middle East and give just a quick thing on the tariffs, but I welcome my colleagues here to chime in on those as well.

Middle East has not been a problem for us so far. As I said, we're monitoring the situation. We don't have any hung up orders or anything like that that we're really that concerned about. Maybe the bigger concern would be, with respect to if this blockade extends for a longer period of time, it will create some pressure with respect to the materials that we move.

So you think about paints, adhesives, those are materials that require quite a bit of petroleum-based products. And to the extent that there is pressure there and those products increase in cost to consumers, et cetera, that may eventually make its way into our business.

Right now, we're not that worried about it. My personal belief is that things will get cleaned up and we'll be able to move forward. But that's probably the bigger unknown risk for Graco and every other company that's out there moving those kinds of materials, at least here in the short term.

On the tariff front, I would say, overall, we're doing a good job. I think we've really offset the cost pressures that we've seen in the P&L from input costs so far year to date. And really, the pressure that we saw in the gross margin line in the quarter was really in a couple of areas.

One, obviously, volume, running a little bit below what we were planning for, really due to the cadence of the orders coming in at a softer pace at the beginning of the quarter versus what we saw at the end of the quarter. Our pricing actions are really offsetting a lot of that activity that we've had.

I also point out that the mix in the quarter, the mix of the products that came in, was a little bit unfavorable for us as well. So I really have no concerns on the gross margin line for the rest of the year.

I think the teams are doing a great job managing operating expenses, which are actually flat to down slightly in the quarter. So we're managing the P&L appropriately given the level of business that we had in Q1. Any other comments from you guys?

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

Well, on the pricing side, I think that we have -- the way that we are looking at it, we have covered tariff costs. And there have been some volume-related things that made that a little less effective.

But we have for the -- in most of our businesses beginning last year, we were -- we have been pursuing around the world our annual pricing adjustment drumbeat. In fact, we started a little earlier in the regions than we would ordinarily. Here in North America, we have a handful of key channel partners that we have agreed to pricing adjustments that are going to begin to become, call it, live early or sometime in Q2. So we're feeling really good about the implications of what those can also help us with as we get through the balance of the year.

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**Operator**

Jeff Hammond, KeyBanc Capital Markets.

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**Mitch Brian Moore** - *KeyBanc Capital Markets - Analyst*

This is Mitch Moore on for Jeff. Just on the low single-digit organic guide. Just maybe with the start -- with the slower start of the year, I think it implies mid-single digit-ish growth through the remainder of the year. Could you just help us frame the segment level building blocks to get you there? And what's giving you confidence in that outlook?

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**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

Yeah. If I had to point to one thing, I'd say we're up low single digit on our bookings for the first quarter. So I think our bookings rate lines up with what the guide was. And so that gives us the confidence that we're going to be able to get within that guided range when we look out through the whole year. I don't know if you guys have any other comments you want to make.

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

I'll also say that, as Mark mentioned, the backlog build in the quarter. But also subsequent to the end of the quarter into April here, we've also seen another \$21 million build in the backlog. So the order rates are there to support it. It might be a little bit lumpier on a quarter-by-quarter basis, but we have confidence we'll get there by the end of the year.

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**Mitch Brian Moore** - *KeyBanc Capital Markets - Analyst*

Okay. Great. And then just for my follow-up. I know we touched on tariffs a bit, but just -- is there any update you guys can provide with the updates to the Section 232 tariffs and if that changes your expectations for price costs for the year?

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

I will say that the change with the 232, where they're moving from a direct aluminum and steel to the full component, we're still working on assessing how much that's going to impact us. We do have some highly manufactured equipment.

So when you switch to a full value of the imported goods, it would imply a higher tariff. But for us, a lot of our stuff is already manufactured here. So a lot of the import of the aluminum and steel is typically in its raw form.

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**Operator**

Bryan Blair, Oppenheimer.

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**Bryan Blair** - *Oppenheimer & Co Inc - Analyst*

Welcome, Sanjiv. And congratulations, David, I think you ended up a little short of Dale's tenure, but a great run nonetheless.

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

Hey, I can stay at -- maybe, consider staying another 18 years.

**Bryan Blair** - *Oppenheimer & Co Inc - Analyst*

All right. I would like to follow up on the backlog expansion in Q1 and then Q2 to date just to level set. How much of the total build has been your Gema business? Have there been project deferrals or is this strictly a matter of order timing? And is this type of backlog build or the magnitude of it significantly out of the ordinary for the early part of the year?

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**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

Yeah. I think that they're pretty similar. I think if I look across the legacy Graco Industrial businesses and the backlog that we've built there as well as the backlog that we built in the Gema business, including projects, et cetera, I didn't see anything jump off the page at me that says that they're heavily weighted toward the powder business. I think it's generally pretty consistent across both those segments.

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

And I would add, especially the orders that we've seen since the close of the quarter, it's been quite balanced in the -- to use our internal terminology -- the Industrial division, which is the legacy Graco, the original legacy Graco plus the Gema business.

As part of this exercise, we ran some stress tests. And being an old sales guy, I kicked the tires pretty hard on not only just the industrial side but also on the contractor side. And I kept coming to the same place that, given the level of activity we're seeing in industrial and not really relying on a meaningful uptick in contractor, low single digit is achievable.

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**Bryan Blair** - *Oppenheimer & Co Inc - Analyst*

Okay. I appreciate the color. And following up on the revised tariff framework again, just to level set. Is there a meaningful assumed change in net cost impact for your operations? And perhaps more importantly, as a largely domestic manufacturer, do you see any incremental competitive advantages or opportunities under the new structure?

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**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

Yeah, I don't think there's any obvious competitive advantages. And the way I'm thinking about the tariffs here, short term and long term.

The big question is, I think, what is going to stick. Are we going to have -- the tariffs that are in place today, obviously, the Supreme Court ruled the way they did, but they put in new tariffs. So when you look at -- if they stick incrementally, it's not going to have a big impact to Graco in terms of the absolute level that we're paying.

I will note, and we did talk about this, we will be applying for our tariff refunds like every other company. And as those come in, we -- our intention would be to highlight those in results so that you know what they are as they come in.

At this point, until we actually see the refunds, we're not really going to talk about the levels or the amounts or anything like that. So I think from a modeling perspective, it would probably make some sense just to leave them out. And when they come in, we'll break them out and then you can know what they are.

But to answer your question again, to reiterate, when you just think about the absolute level of tariff that this company is incurring, with the new structure that's in place, it's pretty similar to what we experienced before the new structure was put in place.

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**Operator**

Matt Summerville, D.A. Davidson.

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**Matthew Summerville** - *DA Davidson & Co - Analyst*

Maybe just a minute on contractor. Can you talk about what sell-in, sell-through trends you're seeing in both the home center and pro paint channel? And then can you also talk about how we should be thinking about the new product load-in this year maybe relative to last? And then I have a follow-up.

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**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

Yeah. In terms of sell-in, sell-through, there's not a big difference. I think most of the channel partners that we do business with have been pretty careful with their inventory. And I think that they're continuing to be careful with their inventory. So I would characterize our sales and our bookings to be really pretty similar to what they're experiencing on an out-the-door basis, which I think makes sense given the environment that they're playing in.

We do have, as every year, products that we're launching; and we're planning to launch products here in Q2. I would not be baking in any large incremental increase compared to last year. I think it's a fairly stable, fairly similar new product launch here for the contractor business, what we've experienced in the past.

We've got a couple of things that we're excited about for sure that we can talk about after they're actually launched. But again, I think it will be a similar year to what we saw in '25. David, if you got any --

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

Yeah. I -- just a coincidence, I had a conversation with commercial management earlier this morning and just to underline two of Mark's points.

On the home center side, the positive side of the story is the foot traffic has not deteriorated year over year. And the -- although it still remains off the record levels that we saw in '20 and '21 and such. So there's an opportunity for recovery there. Those channel partners do, I would say, a very good job managing their working capital, and we feel pretty good the inventory level there is satisfactory.

On the paint store side, always of interest to us, I think the key point there is we feel -- I'd say at the ground level of the business, our commercial team indicates that the sell-through has been satisfactory. And so that -- in that really important space for us, call it, the retail demand is pretty -- is also pretty close to the wholesale, which is important, especially as we get some of these new products launched to that channel.

And so I think that the -- where we are at vis-a-vis our partners is they're ready to go and ready to order when they see retail demand, out the door demand, increase .

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**Matthew Summerville** - *DA Davidson & Co - Analyst*

Got it. And then as a follow-up, maybe can you guys comment on how you're thinking about the M&A outlook, funnel actionability to the funnel depth, if you will, and where you may be seeing most activity?

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**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

Yeah, I'd characterize the market as still pretty favorable. I think that there's properties out there that we're interested in. Our pipelines are well populated. We're having discussions with a lot of different companies.

I do think there's been over the last year or so, a renewed appetite on the part of sellers to take a look at opportunities to realize value and they're looking at strategic buyers in a lot of cases. And we're going to remain active. We like businesses that -- where we can add value.

I see a fair amount of opportunities within the Industrial segment, in particular. Contractor also has a couple of things, but there's probably more lively stuff in the industrial side right now.

Interestingly, I did go back and I looked at some information back from 2012 until the end of last year, and 2012 was the year that we acquired Gema. About 30% of Graco's revenue that we finished the year with in 2025 is acquired businesses.

So we have had a pretty good track record of acquiring businesses, integrating them, maintaining and improving our profitability over that time horizon. And that's really what we're trying to do with our M&A growth going forward.

We have a target long term, 10% top line growth, one-third coming from M&A. And if you look back historically, we've been able to do that. So we're proud. The teams are doing a good job and hopefully, we get some more opportunities here as we finish out the year.

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**Operator**

Brad Hewitt, Wolfe Research.

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

So at the gross margin line, it looks like incrementals were about 25% in the quarter. Should we think about that year-over-year margin pressure is largely driven by price cost or are there any other factors you would highlight there?

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**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

I think it's mostly mix and a little bit on the volume side. But Chris, if you could probably give more color on that.

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

It was mixed volume and acquired businesses that really impacted for the quarter. Price cost was not a headwind outside of having lower factory volume to absorb the overhead.

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

Okay. Great. And then maybe switching over to the backlog side of things. Just curious if you can elaborate a little bit more on visibility of expected backlog conversion as it relates to the rest of the year? And do you see any risk of project cancellations or maybe slippage of backlog conversion into next year?

**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

Yeah, I don't think we see any risk at this point. It's always there, it could happen, but nothing that we're concerned about on stuff that we've already booked and they're in our backlog. And I think that we said in Chris' comments that we expect most of that will convert in the second half of the year. It's hard sometimes to know the exact timing, but this is not something that we're going to keep on the books for more than that period of time.

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

Yeah. The risk of -- Mark is right. The risk cancellation, be it in our legacy business or in even our Gema business. with their direct system sales activity, in my experience is quite low. In the legacy business, typically, -- our stuff is among -- I'm thinking of an industrial application for sealant equipment or for something in the paint shop.

Our stuff is some of the last that is actually ordered in a project. And -- so for example, the expansion of a paint line. I mean, we're literally being dropped in a month or two before it's going to be commissioned and come on stream. So things that we have in our pipeline in that business is quite tangible and rarely is it canceled altogether.

On the Gema powder equipment side, I'd say that program -- that organization is even one step more sophisticated in direct sale activity for systems is to accept an order requires a down payment, a very meaningful down payment, approaching half the project cost.

And so the buyers are very committed if an order receives gets developed to that point and shows up in our backlog. In my experience, I was involved with the team at Gema for a few years. I think in the eight or nine years, I was involved over all that time, one project was canceled.

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**Operator**

Joe Ritchie, Goldman Sachs.

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**Joe Ritchie** - *Goldman Sachs International - Analyst*

David, thank you for all the help throughout the years. Wish you the best in retirement. And Sanjiv, welcome. So yeah. So maybe my first question, I just want to make sure that I fully understand the -- like the backlog conversion on the powder finishing systems.

So was this simply that just the orders that you were expecting to come through in the first quarter came through later than you expected them to come through? Or was there anything else related to either supply chain or manufacturing that also impacted the conversion?

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**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

Yeah, I don't think there was any crazy stuff. We did get a couple of nice orders right at the end of the -- right at the end of the quarter, but we were also converting on to the backlog that we had built in the month of February out at that same time.

So they offset one another. But no, we're not constrained in our operations. We're not constrained with the supply chain. It's really just the cadence of these orders coming in, and we will get them out the door. We just didn't get them off the door by the end of March.

**Joe Ritchie** - *Goldman Sachs International - Analyst*

Okay. All right, helpful. And I know you touched on the margin headwind, I think, in the first quarter being largely driven by lower volumes. I'm just curious, like with the acquisitions also coming through the industrial segment, how much of an impact did the acquisitions have to the margin degradation in 1Q?

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

On a total company basis, it's about 50 basis points related to the acquired revenue on a total company basis. So the stuff going through industrial was by far the majority.

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**Joe Ritchie** - *Goldman Sachs International - Analyst*

Okay. All right. Cool. And then one last one. So last quarter, I think we talked a little bit about these like upfront licensing revenues that you were seeing from some of your OEM customers. I didn't hear it get called out today. Just any progress on that specifically would be helpful.

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**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

Yeah. We've got a couple of other ones that we're working on, but we didn't really book anything here in Q1. So that's why we were silent on it. We still like the prospects for potential to get future license agreements with a lot of the technology.

We've got it running through Graco products. Every time we meet with customer or an OEM, they're excited about the compact size of these motors, the fact that they take less material that they're high torque. So we're hopeful that we're able to do more in that area, but nothing in Q1.

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

Yeah. I know we've talked about this before, Joe. It's strategic -- it's a master class in strategic selling. Frequently, we are cultivating very large companies with large decision-making bodies and organizations and keeping their processes moving. One large organization can be relatively responsive, quick, and enthusiastic. Another organization can be equally enthusiastic, but the decision-making process moves at a different pace.

So I think the nature of this is, while we're excited and Mark is right about the technology, the visible results that you're going to see over time are not going to have the same degree of predictability as our standard products business.

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**Operator**

Andrew Buscaglia, BNP Paribas.

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**Andrew Buscaglia** - *Exane Bnp Paribas - Analyst*

So yeah, so it seems starting out a little bit of a repeat with two years ago -- same scenario, all end markets are down. And that year, you struggled to overcome things.

So my question is, we're two years later in the same setup. And the question does arise amongst investors. Like is there something -- this seems to be cyclical, but is there something more structural? And maybe does Graco needs to think about -- I don't know if it's a change of tack in terms of how you get volume, whether it's to touch your pricing or what.

But I think at this point, you're three years in, and it just seems like the top line can't grow. So are there other discussions you guys have around anything around if there is anything under the hood structurally that's changed in the last three years?

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**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

I will just say that we have grown the top line. And I will say that, of course, every day, we come in here and we're doing everything we can to grow the business.

When you're reporting every 13 weeks, sometimes the quarters can look better than maybe the overall business might look and sometimes they don't look as good. We have been fighting some pretty substantial headwinds with respect to half of the revenue of the company that's tied to contractor and construction.

And if you look at the macro data on anything, any metric that you look at over the last four to five years, that has been a really tough market to be in. And I'm proud that our teams have actually been able to drive the results that we have driven given the environment that we're in.

We get up every day. We're working hard. We're pushing our teams. We're launching products. Our teams are incentivized around growth. So there's absolutely no reason why they shouldn't be driving for better results.

There's nothing structurally wrong with the company. It's still extremely profitable. It still generates a tremendous amount of cash. And we have been also very active on redeploying that cash, both through the form of share buybacks as well as M&A.

So no, there's nothing here that I think we need to do that's different. I think that we're doing everything that we can as we always have done.

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**Andrew Buscaglia** - *Exane Bnp Paribas - Analyst*

Well, on that note, I think there's a little bit of there's some enthusiasm with this recent reorganization that there's something outside of what the market is giving you that you can find some incremental growth. And I guess where are we seeing that or to date, like -- where is that evident in your numbers? And will we see more a more pronounced impact going forward from that change you guys made a year ago? .

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**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

Well, again, we did guide to low single-digit growth, organic constant currency for the full year. For the quarter, our industrial business was up mid-single digit growth, which was nice to see. Our expansion markets group is up high single digits growth.

And those were offset by the fact that our contractor business was down 1%. So again, going back to the earlier comments, we're happy with what we're seeing. We'd like it to be better, obviously. We're pushing the team hard. We still feel confident that we're going to get to the guide that we talked about a couple of months ago.

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**Operator**

(Operator Instructions) Walter Liptak, Seaport Research.

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**Walter Liptak** - *Seaport Research - Analyst*

I wanted to ask just get a better understanding of the monthly trends. You talked about January being weak. I wonder if you could attribute that to anything. And then February, we have the war heating up. But it doesn't seem like, from what you said about orders, that that has been impacting the trend for orders too much.

But -- so I guess I'm asking like what are you hearing from customers, both in North America and other parts of the world? And as we got more of this behind us, are you getting more confidence that the customers can just work through these macro uncertainties?

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

Well in our businesses, there's different kinds of decision makers. On the contractor side of the business, maybe the decision making you typically can be quicker or a little more reactive because generally, the buyers represent -- they're smaller organizations or entrepreneurs and such.

There, I would say not -- despite all the challenges of the world in our contractor business, which, again, Mark reminds -- is reminding us that it's 50% of our overall construction broadly defined. The largest market there is here in North America and specifically the US.

And really, we haven't seen a change in the, I call it, the momentum of that business for a while and certainly not in the last couple of months despite all the global noise because the fundamental issues are -- remain the ones that you're familiar with about affordability and even mortgage rates.

I would say that, focusing on the micro and not the macro, I was really excited when for a few days, the 30-year mortgage rate got below 6% in late February. And now of course, it's, I want to say, about 6.30% or 6.35% currently.

I think it gets more the world and decision-making when you look at industrial companies and how they make their decisions. And while I've got a list here I'll spare everybody in the interest of time, for example, we would say, oh, the auto industry market was slow for us. The auto OEM market was slow for us. We had some tough comps, and we didn't see too much activity in the first quarter.

But actually, we feel pretty good about our pipeline in the automotive industry, even in some markets like China where think of combustion conversion to EV and requiring additional investments in the body and the paint shop. We're seeing greater inquiries and expanded pipeline from before the end of the quarter, even through the current period.

And it suggests to me that big picture, big manufacturers, they know the world is a noisy place. But if they're committed to moving in certain directions, they're going to make those investments. So it's a long-winded way of saying I don't see a lot of demand implications on the things -- on the new things that we have been absorbing here in the first four months of the year.

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**Walter Liptak** - *Seaport Research - Analyst*

Okay. Great. And then I guess thinking about the second quarter and maybe the delays of the timing of shipments, especially for some of those powder orders, do we get like a normal seasonal bump up in the second quarter plus some of the orders that should have shipped in the first? Is that how we should think about it?

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**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

Yeah. I think for the contractor business, our history has always been that Q2 is the top quarter. So I don't see any changes to that cadence. And I think on the orders that we just got in and recently, I mean, those are probably going to go off more in the back half with respect to the powder business. But for the legacy industrial business, we should be able to move those a little bit quicker.

**Walter Liptak** - *Seaport Research - Analyst*

Okay. Great. And then maybe a last one for me is on buybacks. You guys weren't too aggressive in the first quarter. How are you thinking about buybacks versus M&A deals? Can you do both?

**Sanjiv Gupta** - *Graco Inc - Chief Financial Officer and Treasurer*

This is Sanjiv Gupta. So I -- maybe I'll take a shot at it. So again, I think very consistent with how we've always done it. We will be very disciplined with our capital allocation framework. And obviously, the goal here is to drive shareholder return while maintaining our financial flexibility. So a strong balance sheet, we'll continue to preserve that.

And then whatever operating cash flow we generate, which we have been generating very positively, we'll be using that cash to fund our growth. We've talked about internal growth that will be invested in projects which meet our return thresholds.

And second priority would be the growth, which is external growth through disciplined M&A. Mark talked about it. And that really needs to meet our share -- needs to create the shareholder value and meet the return and integration threshold for us. And you've seen that recently with our current acquisitions, COROB, Color Service, and Radia.

And then in terms of shareholder return, obviously, we'll continue with the dividend. And any excess cash will be returned to the shareholders, and we'll be doing it very opportunistically as we've always done. So in summary, very consistent with our capital allocation framework, which we have deployed in the market, that that will continue.

**Operator**

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

**Mark Sheahan** - *Graco Inc - President and Chief Executive Officer*

Okay. Thank you very much for participating today. I look forward to seeing you some time down the road here, and thanks again for your interest in Graco.

**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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