

Graco Inc. (GGG)

\$57.38 (As of 08/11/20)

Price Target (6-12 Months): **\$60.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 12/24/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

1-Strong Buy

Zacks Style Scores:

VGM:D

Value: F

Growth: D

Momentum: C

Summary

In the past three months, Graco's shares have outperformed the industry. The company seems well-placed to gain from its exposure in new markets, global expansion, buyouts and end-user conversion in the long term. In the near term, an efficient management team, product innovations, solid customer base and focus on capacity expansion might help in dealing with the pandemic-related stress. Rewarding shareholders and keeping adequate liquidity will likely aid too. In second-quarter 2020, its earnings and sales surpassed estimates by 37% and 12.5%, respectively. However, earnings declined 26% year over year on top-line and margin weaknesses. For 2020, the company is wary of the uncertainties related to the pandemic and so refrained from providing any projections for the year. Also, high costs and expenses, and forex woes might be concerning.

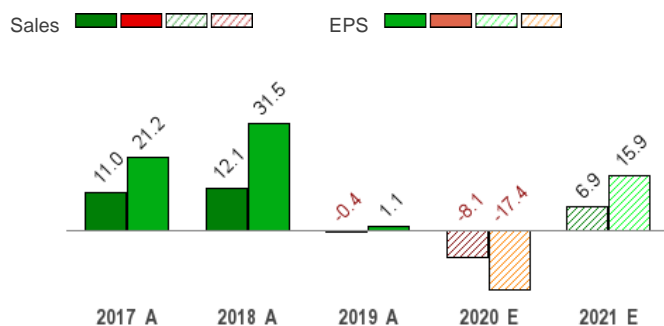
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$57.78 - \$38.43
20 Day Average Volume (sh)	654,452
Market Cap	\$9.6 B
YTD Price Change	10.4%
Beta	0.61
Dividend / Div Yld	\$0.70 / 1.2%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Top 49% (124 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	37.0%
Last Sales Surprise	12.5%
EPS F1 Est- 4 week change	17.5%
Expected Report Date	10/28/2020
Earnings ESP	0.0%
P/E TTM	34.2
P/E F1	36.6
PEG F1	3.2
P/S TTM	6.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	389 E	433 E	403 E	411 E	1,617 E
2020	374 A	367 A	381 E	392 E	1,513 E
2019	405 A	428 A	401 A	412 A	1,646 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.45 E	\$0.51 E	\$0.44 E	\$0.46 E	\$1.82 E
2020	\$0.38 A	\$0.37 A	\$0.41 E	\$0.42 E	\$1.57 E
2019	\$0.47 A	\$0.50 A	\$0.45 A	\$0.48 A	\$1.90 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/11/2020. The reports text is as of 08/12/2020.

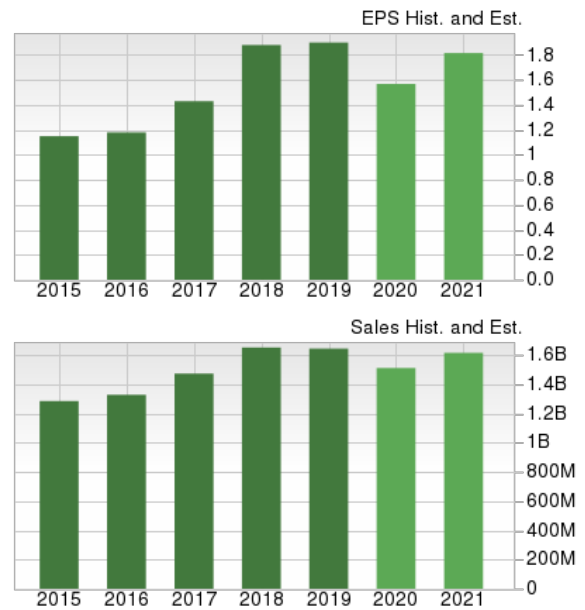
Overview

Graco Inc. manufactures, designs and sells equipment and systems used to measure, move, control, spray and dispense fluid as well as powder materials. This Minneapolis, MN-based company was founded in 1926.

The products offered by the company are produced in the United States, Italy, the U.K., Belgium, Switzerland, China and Romania. The products are mainly sold through the company's authorized distribution centers.

Graco reports its results in terms of three operating segments:

- **Industrial** (36.3% of total revenues in the second quarter of 2020) segment includes Applied Fluid Technologies and Industrial Products divisions. The company provides pre-engineered and equipment packages for paints, sealants, coatings, adhesives and other fluids under this segment.
- **Process** (21.2% of total revenues in the second quarter of 2020) segment includes Oil and Natural Gas, Process and Lubrication divisions. The company provides valves, pumps, accessories, and meters to dispense and move chemicals, wastewater, oil and natural gas, petroleum, lubricants, food and other fluids under this segment.
- **Contractor** (42.5% of total revenues in the second quarter of 2020) segment provides sprayers. These sprayers are used to paint structures like walls and other product models that can be used by professional painting contractors as well as homeowner.



Reasons To Buy:

- ▲ Over the past month, Graco's shares have gained 17.9% compared with the industry's growth of 14.7%. In second-quarter 2020, the company's earnings and sales surpassed estimates by 37% and 12.5%, respectively. Also, its cash flow from operations improved from \$54 million in the first quarter to \$89 million in the second quarter. Further, cash and cash equivalents of \$432.7 million at the end of the second quarter reflected an increase of 5.3% from the previous quarter. In the near term, the company seems well-equipped — with operations running globally, efficient management team, sound customer base and focus on keeping the production lines active — to handle the challenges related to the coronavirus outbreak. Also, the company noted that its available liquidity and operating cash flows are enough to run the operations effectively. In the past 30 days, the company's earnings estimates have increased 17.2% for 2020 and 9.6% for 2021.
- ▲ The company invests in product innovation and capacity expansion. It plans to invest \$80 million to roll out machinery and equipment in 2020, including \$50 million for the expansion of facilities. In June 2020, the company unveiled HydroShield Waterborne system, while also launched its E-Flo iQ adhesive and sealant dispense system. Also, it introduced three high-production GrindLazer drum scarifiers — DC1520 E, DC1525 P and DC1538 G — and the new line of SaniSpray HP airless sprayers in July. In the long term, the company anticipates gaining from the exposure in new markets, product development, global expansion, buyouts and end-user conversion.
- ▲ Graco tries to provide higher remuneration to shareholders. In the first half of 2020, the company distributed dividends worth \$58.5 million to its shareholders, suggesting an increase of 10.2% from the year-ago comparable period. Share repurchases during the period amounted to \$102.1 million, up from \$2.4 million bought back in the first half of 2019. It is worth mentioning here that the quarterly dividend rate was hiked 9.4% to 17.5 cents in December 2019.

Investments in capacity expansion and innovation as well as solid shareholder-friendly policies will likely aid Graco, going forward. Also, a healthy liquidity position places the company to honor its financial obligations.

Reasons To Sell:

- ▼ Graco's stock currently looks overvalued compared with the industry on a P/E (TTM) basis, with respective tallies of 34.16x and 26.72x. Also, the company's second-quarter earnings declined 26% year over year on top-line and margin weaknesses. Sales in the quarter decreased 14.3% year over year due mainly to a 15% fall in organic sales. Further, sales performance was weak in the Americas, EMEA and Asia regions. For 2020, the company remains wary of the uncertainties caused by the coronavirus outbreak and so refrained from providing any earnings or sales projections.
- ▼ In the second quarter, Graco's gross margin fell 320 basis points (bps) year over year due to forex woes, unfavorable product and channel mix, and weak factory volume. Operating margin in the quarter also decreased 450 bps year over year. We believe that the persistence of the headwinds in the quarters ahead might hurt the company's margin profile. In addition, rise in costs and expenses (corporate expenses are predicted to be \$30 million in 2020) might hurt margins.
- ▼ Geographical diversification is reflective of a flourishing business of the company. However, the diversity exposed it to headwinds arising from geopolitical issues and unfavorable movements in foreign currencies. In the second quarter of 2020, forex woes adversely impacted the company's sales growth by 1%. For 2020, it expects forex issues to have no impact on revenues, while hurt earnings by 1%.

Graco is likely to face the adverse impacts of the coronavirus outbreak. Also, high costs and expenses, and forex woes remain concerning for the company in the quarter ahead.

Last Earnings Report

Graco Earnings Surpass Estimates in Q2, Decline Y/Y

Graco delivered better-than-expected results for the second quarter of 2020. Its earnings and sales surprise was 37% and 12.5%, respectively.

Adjusted earnings in the quarter under review were 37 cents per share, surpassing the Zacks Consensus Estimate of 27 cents. On a year-over-year basis, earnings decreased 26% due to weak revenue generation and a fall in margins.

The quarterly earnings exclude the impact of 20 cents per share of impairment charge (non-cash) incurred in connection with the valve business based in the U.K. Notably, Graco completed the divestment of the business in the ongoing third quarter of 2020.

Quarter Ending **06/2020**

Report Date	Jul 22, 2020
Sales Surprise	12.50%
EPS Surprise	37.04%
Quarterly EPS	0.37
Annual EPS (TTM)	1.68

Revenue Details

In the reported quarter, the company's net sales were \$366.9 million, suggesting a 14.3% decline from the year-ago quarter. Volume and price adversely impacted sales by 15%, while forex woes had an adverse impact of 1%. However, acquisitions contributed 2%.

However, the company's net sales surpassed the Zacks Consensus Estimate of \$326.1 million.

On a geographical basis, quarterly sales generated from the Americas fell 10% to \$228 million. In EMEA, sales were \$71 million, decreasing 30% year over year (or slipped 28% at a constant-currency rate), while sales from the Asia Pacific were \$68 million, declining 7% year over year (or were down 5% at a constant-currency rate).

The company reports revenues under three segments. A brief discussion of the quarterly results is provided below:

The Industrial segment's revenues totaled \$133.3 million, reflecting a 29.3% decrease from the year-ago quarter. Volume and price had an adverse impact of 28% on sales, and forex woes too lowered sales by 1%. The segment's sales accounted for 36.3% of the company's net revenues in the quarter.

The Process segment's sales of \$77.8 million were down 8.6% from the year-ago quarter. Acquisitions contributed 8% to sales growth, while volume and price had an adverse impact of 16% in the quarter. Forex woes lowered sales by 1%. The segment's sales accounted for 21.2% of net revenues in the reported quarter.

The Contractor segment's revenues inched up 0.7% year over year at \$155.9 million. The improvement was driven by a 1% contribution from volume and price. The segment's sales accounted for 42.5% of net revenues in the reported quarter.

Margin Profile

In the reported quarter, Graco's cost of sales declined 8.4% year over year to \$184.4 million. It represented 50.3% of the quarter's net sales versus 47% in the year-ago quarter. Gross profit decreased 19.6% year over year to \$182.5 million, while margin was down 320 basis points (bps) to 49.8%. The fall in margin was triggered by unfavorable product and channel mix, forex woes and weak factory volume.

Operating expenses (including product development; selling, marketing and distribution; and general and administrative expenses) declined 10.3% year over year to \$102.8 million. It represented 28% of net sales in the reported quarter versus 26.8% in the year-ago quarter.

Adjusted operating profit decreased 29% year over year to \$79.8 million. The results suffered from unfavorable movements in foreign currencies and a fall in volumes. Operating margin, adjusted, decreased 450 bps year over year to 21.8%.

Interest expenses in the reported quarter decreased 5% year over year to \$3.3 million. Effective tax rate (adjusted) in the quarter was 19.1%, down 1.2 percentage points from the previous-year quarter.

Balance Sheet & Cash Flow

Exiting the second quarter, Graco had cash and cash equivalents of \$432.7 million, suggesting a 5.3% increase from \$456.7 million recorded in the last reported quarter. Long-term debt remained stable sequentially at \$400 million.

In the first half of 2020, the company generated net cash of \$142.6 million from operating activities, reflecting a decline of 13% from the year-ago comparable period. Capital spent on the addition of property, plant and equipment totaled \$32.6 million versus \$70.2 million in the first half of 2019.

The company distributed dividends worth \$58.5 million and repurchased 2.3 million shares for \$102.1 million during the first half of 2020.

Outlook

In the near term, Graco seems well-equipped — with operations running globally, efficient management team, sound customer base and focus on keeping the production lines active — to handle the challenges related to the coronavirus outbreak.

However, the company — being wary of the uncertainties caused by the pandemic — did not provide any sales or earnings projections for 2020. On the contrary, it did mention that capital expenditure for the year is now expected to be \$80 million (including \$50 million for the expansion of facilities), up from \$70 million mentioned earlier.

Corporate expenses (unallocated) are estimated to be \$30 million (maintained). Unfavorable movements in foreign currencies are estimated to adversely impact earnings by 1% in 2020, while are not expected to hurt sales.

Effective tax rate for the third quarter of 2020 is predicted to be 20-21%.

Recent News

On **Aug 5, 2020**, Graco paid a quarterly cash dividend of 17.5 cents per share to shareholders of record as of Jul 20.

On **Jul 8, 2020**, Graco unveiled the new line of SaniSpray HP airless sprayers. Dubbed as user-friendly, the SaniSpray HP products help in improving the speed and efficiency of cleaning, disinfecting and deodorization tasks.

On **Jul 1, 2020**, Graco introduced three new high-production GrindLazer drum scarifiers. The newly added products under the company's scarifiers product portfolio are DC1520 E, DC1525 P and DC1538 G. The self-propelled GrindLazer DC15 DCS drum scarifiers facilitate performing heavy-duty tasks like grooving, leveling, inlay, scarifying and stripping coatings.

On **Jun 24, 2020**, Graco launched its E-Flo iQ adhesive and sealant dispense system. Developed to boost efficiency in manufacturing processes across several industries, the single-component system also enables manufacturers in reducing costs of operations.

On **Jun 9, 2020**, Graco unveiled HydroShield Waterborne system. As noted, the system eases out the use of electrostatics for spraying waterborne materials.

Valuation

Graco shares are up 10.4% in the year-to-date period and 23.6% in the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Industrial Products sector are down 3.1% and 1.6% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are up 9.3% and 12.5%, respectively.

The S&P 500 index has moved up 4.2% year to date and 15% in the past year.

The stock is currently trading at 33.36x forward 12-month earnings per share, which compares to 27.49x for the Zacks sub-industry, 22.17x for the Zacks sector and 22.8x for the S&P 500 index.

Over the past five years, the stock has traded as high as 36.19x and as low as 17.27x, with a 5-year median of 23.78x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$60 price target reflects 35x forward 12-month earnings per share.

The table below shows summary valuation data for GGG.

Valuation Multiples - GGG					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	33.36	27.49	22.17	22.8
	5-Year High	36.19	27.49	22.17	22.8
	5-Year Low	17.27	15.6	12.55	15.25
	5-Year Median	23.78	19.7	17.48	17.58
P/S F12M	Current	6.07	3.52	2.96	3.67
	5-Year High	6.07	3.52	2.96	3.67
	5-Year Low	2.63	1.58	1.52	2.53
	5-Year Median	4.37	2.25	2.04	3.05

As of 08/11/2020

Industry Analysis Zacks Industry Rank: Top 49% (124 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Flowserve Corporation (FLS)	Outperform	3
Colfax Corporation (CFX)	Neutral	3
The Carlyle Group L.P. (CG)	Neutral	3
IDEX Corporation (IEX)	Neutral	3
Ingersoll Rand Inc. (IR)	Neutral	3
ITT Inc. (ITT)	Neutral	3
MUELLER WATER PRODUCTS (MWA)	Neutral	3
Nordson Corporation (NDSN)	Neutral	2

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	GGG	X Industry	S&P 500	CFX	IEX	NDSN
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	1	-	-	3	3	2
VGM Score	D	-	-	C	B	D
Market Cap	9.57 B	1.33 B	23.61 B	4.17 B	13.14 B	11.80 B
# of Analysts	6	3	14	10	7	6
Dividend Yield	1.22%	0.00%	1.69%	0.00%	1.15%	0.74%
Value Score	F	-	-	C	D	D
Cash/Price	0.05	0.10	0.07	0.02	0.06	0.03
EV/EBITDA	20.37	13.13	13.32	15.90	20.50	21.66
PEG Ratio	3.18	3.32	2.95	5.04	3.63	2.93
Price/Book (P/B)	9.31	2.01	3.22	1.23	5.81	7.14
Price/Cash Flow (P/CF)	25.57	11.88	12.79	7.59	25.33	26.03
P/E (F1)	36.55	28.94	22.02	26.07	36.31	38.06
Price/Sales (P/S)	6.16	1.28	2.57	1.32	5.51	5.44
Earnings Yield	2.74%	2.96%	4.29%	3.83%	2.75%	2.63%
Debt/Equity	0.39	0.51	0.77	0.69	0.46	0.76
Cash Flow (\$/share)	2.24	2.49	6.94	4.64	6.87	7.86
Growth Score	D	-	-	D	B	C
Hist. EPS Growth (3-5 yrs)	13.64%	10.21%	10.41%	8.33%	13.05%	NA
Proj. EPS Growth (F1/F0)	-17.46%	-23.70%	-6.51%	-41.97%	-17.36%	-8.40%
Curr. Cash Flow Growth	0.13%	0.16%	5.22%	27.59%	4.80%	-1.46%
Hist. Cash Flow Growth (3-5 yrs)	7.47%	7.19%	8.55%	3.20%	7.29%	7.90%
Current Ratio	3.35	2.06	1.34	1.62	3.48	3.17
Debt/Capital	28.03%	34.34%	44.59%	40.92%	31.60%	43.03%
Net Margin	17.42%	4.34%	10.13%	-0.33%	15.71%	15.70%
Return on Equity	28.29%	10.81%	14.59%	6.54%	18.15%	21.32%
Sales/Assets	0.86	0.76	0.51	0.40	0.61	0.61
Proj. Sales Growth (F1/F0)	-8.10%	-7.25%	-1.45%	-17.27%	-9.11%	-5.92%
Momentum Score	C	-	-	A	B	D
Daily Price Chg	4.31%	0.40%	-0.17%	2.56%	1.64%	1.48%
1 Week Price Chg	2.80%	4.95%	2.30%	14.55%	1.65%	3.01%
4 Week Price Chg	11.59%	8.72%	6.41%	20.27%	6.90%	8.04%
12 Week Price Chg	23.88%	23.95%	15.42%	31.00%	15.13%	18.67%
52 Week Price Chg	23.64%	0.00%	2.88%	33.89%	5.68%	47.34%
20 Day Average Volume	654,452	60,682	2,007,486	1,020,400	387,241	260,444
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	15.65%	0.00%	0.00%
(F1) EPS Est 4 week change	17.48%	3.44%	1.84%	11.28%	2.82%	0.28%
(F1) EPS Est 12 week change	16.46%	4.81%	2.40%	11.63%	2.82%	0.81%
(Q1) EPS Est Mthly Chg	18.50%	3.49%	0.72%	22.82%	1.42%	0.64%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	F
Growth Score	D
Momentum Score	C
VGM Score	D

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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