

Graco Inc. (GGG)

\$55.05 (As of 01/28/20)

Price Target (6-12 Months): **\$58.00**

Long Term: 6-12 Months | **Zacks Recommendation:** **Neutral**
(Since: 12/24/19)
Prior Recommendation: Underperform

Short Term: 1-3 Months | **Zacks Rank:** (1-5) **1-Strong Buy**
Zacks Style Scores: VGM:C
Value: D | Growth: C | Momentum: A

Summary

Over the past three months, Graco's shares have outperformed the industry. In the long term, it anticipates gaining from the exposure in new markets, product development, global expansion, buyouts and end-user conversion. Its focus on rewarding shareholders handsomely will likely work in its favor. In fourth-quarter 2019, the company's earnings and sales surpassed estimates by 23.1% and 5.2%, respectively. For 2020, it anticipates organic sales growth in low-single digits. Organic sales will likely be flat for the Asia Pacific, while growing in low-single digits for Americas and EMEA. Solid demand for products is estimated to aid Contractor segment, while difficult end-market conditions will likely adversely impact Process and Industrial segments in the first half of 2020. Also, forex woes might be spoilsports in the first half.

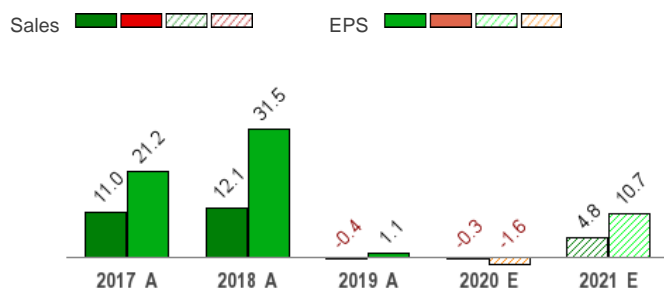
Price, Consensus & Surprise



Data Overview

52 Week High-Low **\$55.34 - \$41.36**
20 Day Average Volume (sh) **679,571**
Market Cap **\$9.2 B**
YTD Price Change **5.9%**
Beta **0.98**
Dividend / Div Yld **\$0.70 / 1.3%**
Industry [Manufacturing - General Industrial](#)
Zacks Industry Rank **Bottom 20% (203 out of 255)**

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise **23.1%**
Last Sales Surprise **5.2%**
EPS F1 Est- 4 week change **0.3%**
Expected Report Date **04/22/2020**
Earnings ESP **2.2%**

P/E TTM **29.0**
P/E F1 **29.4**
PEG F1 **2.6**
P/S TTM **5.6**

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					1,720 E
2020	396 E	420 E	400 E	392 E	1,641 E
2019	405 A	428 A	401 A	412 A	1,646 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.51 E	\$0.55 E	\$0.53 E	\$0.50 E	\$2.07 E
2020	\$0.46 E	\$0.51 E	\$0.48 E	\$0.42 E	\$1.87 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 01/28/2020. The reports text is as of 01/29/2020.

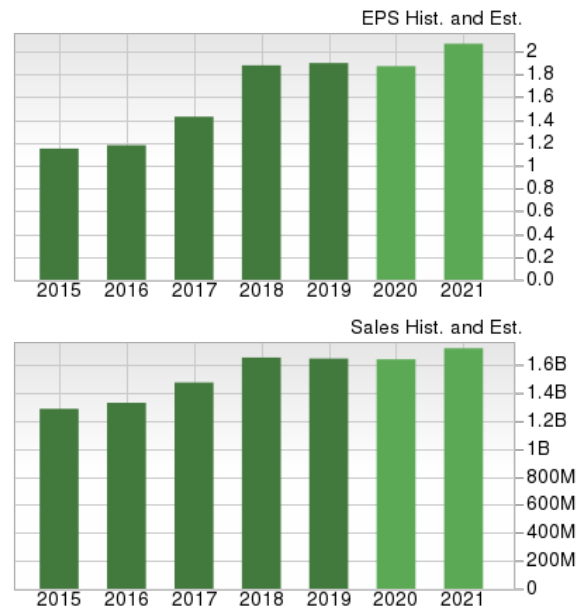
Overview

Graco Inc. manufactures, designs and sells equipment and systems used to measure, move, control, spray and dispense fluid as well as powder materials globally. 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** (47.2% of total revenues in the fourth quarter of 2019): The 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** (21.6%): The 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** (31.2%): The company provides sprayers under this segment. 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 three months, Graco's shares have gained 20.1%, outperforming the industry's growth of 3.7%. In the fourth quarter of 2019, the company's earnings and sales surpassed estimates by 23.1% and 5.2%, respectively. Sales improved 1.5% year over year, driven by the Contractor and Process segments, partially offset by the Industrial segment. For 2020, the company anticipates organic sales growth in low-single digits. Solid demand for products is anticipated to boost Contractor's performance. For the Americas and EMEA, organic sales are predicted to increase in low-single digits in 2020.
- ▲ Graco invests in product innovation and capacity expansion. It plans to invest \$70 million to roll out machinery and equipment in 2020. This includes \$30 million for mortar and brick. In the fourth quarter of 2019, the company launched Sealed 4-Ball Plus Lower pumps. These circulation pumps can deliver fluids at the lowest cycle rates. In January 2020, it unveiled the Compact Dyna-Star automatic lubrication system as well as GLC X automatic lubrication controller and Auto Lube app. In the long term, the company anticipates gaining from the exposure in new markets, product development, global expansion, buyouts and end-user conversion. It targets achieving revenue growth of 10% (CAGR) and earnings improvement of 12% (CAGR) in the long run.
- ▲ Graco tries to provide higher remuneration to shareholders on increased cash generation. The company repurchased common shares worth \$9.5 million and paid out dividends worth \$106.4 million in 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. Organic sales will likely grow in low-single digits in 2020.

Reasons To Sell:

- ▼ In the fourth quarter of 2019, Graco's sales suffered from weakness in the Asia Pacific region, with sales down 17% year over year. For the Industrial segment, sales declined 2.4% year over year. The company believes that the Process and Industrial segments' performances will be adversely impacted by difficult end-market conditions in the first half of 2020. Organic sales for the Asia Pacific are expected to be flat year over year.
- ▼ Rising cost of sales has been a major cause of concern for the company. In the fourth quarter of 2019, the metric moved up 2.6% year over year, while gross margin declined 60 basis points due to unfavorable product and channel mix, forex woes (explained below), and adverse factory volume. Also, costs of raw materials were high in the quarter, while favorable pricing was a relief. We believe, rising costs, if unchecked, might adversely impact the company's near-term margins. Graco predicts corporate expenses of \$30 million for 2020.
- ▼ 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 fourth quarter of 2019, forex woes adversely impacted sales growth by 1%. The company predicts modest adverse impacts of forex woes in the first half of 2020.

Weakness in Process and Industrial segments, high costs, and unfavorable movements in foreign currencies remain the major causes of concern for Graco.

Last Earnings Report

Graco Q4 Earnings and Sales Surpass Estimates, Up Y/Y

Graco delivered better-than-expected results for the fourth quarter of 2019. Its earnings and sales surpassed estimates by 23.1% and 5.2%, respectively.

Adjusted earnings in the quarter under review were 48 cents per share, surpassing the Zacks Consensus Estimate of 39 cents. On a year-over-year basis, earnings increased 11.6%, driven by sales growth in the Americas and EMEA, partially offset by weakness in the Asia Pacific. Also, improved operating margin and lower taxes were reliefs.

For 2019, the company's adjusted earnings were \$1.90 per share, above the Zacks Consensus Estimate of \$1.81. Also, the bottom line expanded 1.1% from the previous year's number of \$1.88.

Quarter Ending **12/2019**

Report Date	Jan 27, 2020
Sales Surprise	5.23%
EPS Surprise	23.08%
Quarterly EPS	0.48
Annual EPS (TTM)	1.90

Process and Contractor Segments Drive Revenues

In the reported quarter, Graco's net sales were \$412.3 million, suggesting a 1.5% increase from the year-ago quarter. Volume and price positively impacted sales by 1%, while acquisitions contributed 1%. However, forex woes had an adverse impact of 1%.

The company's net sales surpassed the Zacks Consensus Estimate of \$391.8 million.

On a geographical basis, quarterly sales generated from the Americas grew 4% to \$232 million. In EMEA, sales were \$112 million, increasing 11% year over year (or grew 14% at a constant-currency rate), while sales from the Asia Pacific were \$68 million, declining 17% (or were down 16% 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 \$194.8 million, suggesting a 2.4% decline from the year-ago quarter. Volume and price had an adverse impact of 1% on sales, and forex woes too lowered sales by 1%. The segment's sales accounted for 47.2% of the company's net revenues in the quarter.

The **Process** segment's sales of \$88.9 million were up 0.7% from the year-ago quarter. Acquisitions contributed 5% to sales growth, while volume and price had an adverse impact of 4% in the quarter. The segment's sales accounted for 21.6% of net revenues in the reported quarter.

The **Contractor** segment generated revenues of \$128.6 million, reflecting an 8.4% increase from the year-ago quarter. Volume and price had a positive impact of 9% on sales, while forex woes adversely influenced sales by 1%. The segment's sales accounted for 31.2% of net revenues in the reported quarter.

For 2019, the company's net sales were \$1,646 million, reflecting a 0.4% decline from the year-ago quarter's figure. However, the top line surpassed the Zacks Consensus Estimate of \$1.63 billion.

Operating Margin Up Y/Y

In the reported quarter, Graco's cost of sales increased 2.6% year over year to \$202.9 million. It represented 49.2% of the quarter's net sales versus 48.6% in the year-ago quarter. Gross profit grew 0.3% year over year to \$209.4 million, while margin was down by 60 basis points (bps) to 50.8%. The fall in margin was triggered by unfavorable product and channel mix, forex woes and adverse factory volume. As noted, high costs of raw materials were offset by favorable pricing.

Operating expenses (including product development; selling, marketing and distribution; and general and administrative expenses) declined 6.2% year over year to \$105.2 million. It represented 25.5% of net sales in the reported quarter versus 27.6% in the year-ago quarter.

Operating profit increased 7.9% year over year to \$104.2 million. Margin grew 150 bps year over year to 25.3%. Interest expenses in the reported quarter decreased 31.3% year over year to \$2.5 million. Effective tax rate in the quarter was 16%, down 2 percentage points from the previous-year quarter.

Balance Sheet & Cash Flow

Exiting the fourth quarter, Graco had cash and cash equivalents of \$221 million, suggesting 24.6% increase from \$177.3 million recorded in the last reported quarter. Long-term debt was down 14.5% sequentially to \$164.3 million.

In 2019, the company generated net cash of \$418.7 million from operating activities, 13.8% above the previous year. Capital spent on the addition of property, plant and equipment totaled \$128 million versus \$53.9 million in 2018.

The company distributed dividends worth \$106.4 million and repurchased 160,000 shares for \$9.5 million during the year.

Outlook

For 2020, Graco anticipates organic sales (at a constant-currency rate) to grow in low-single digits. The company believes that Process and Industrial segments' performances will be adversely impacted by difficult end-market conditions in the first half of 2020. Meanwhile, solid demand for products will help boost Contractor's performance.

For the Americas and EMEA, organic sales (at constant-currency rates) are predicted to increase in low-single digits in 2020. Organic sales for the Asia Pacific are expected to be flat year over year.

The company predicts capital expenditure of \$70 million in the year. This includes \$30 million for mortar and brick. Corporate expenses (unallocated) are estimated to be \$30 million. Impact of foreign currency movements is predicted to be immaterial in 2020. However, modest adverse impacts of forex woes can be expected in the first half of the year. Effective tax rate is predicted to be 20% for the year.

Recent News

On **Jan 16, 2020**, Graco unveiled Compact Dyna-Star automatic lubrication system. As noted, this product helps in catering to the lubrication requirements of heavy-duty earth-moving machines.

On **Jan 14, 2020**, Graco unveiled the GLC X automatic lubrication controller and Auto Lube app. Given its strong differentiating capabilities for several lubrication metrics, the GLC X controller helps in simplifying automatic lubrication tasks.

On **Dec 6, 2019**, Graco's board of directors approved the payout of a quarterly cash dividend of 17.5 cents per share to shareholders on record as of Jan 21, 2020. The dividend will be paid out on Feb 5, 2020. Notably, the quarterly dividend rate was hiked 9.4%.

Valuation

Graco shares are up 27.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Industrial Products sector are up 21.9% and 10.7% over the past year.

The S&P 500 index has moved up 20.2% in the past year.

The stock is currently trading at 29.31x forward 12-month earnings per share, which compares to 20.7x for the Zacks sub-industry, 17.67x for the Zacks sector and 18.62x for the S&P 500 index.

Over the past five years, the stock has traded as high as 31.88x and as low as 17.27x, with a 5-year median of 23.1x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our price target of \$58 reflects 30.78x 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	29.31	20.7	17.67	18.62
	5-Year High	31.88	22.58	19.91	19.34
	5-Year Low	17.27	15.2	12.6	15.18
	5-Year Median	23.1	18.95	16.54	17.45
EV/EBITDA F12M	Current	18.73	12.81	17.82	12.66
	5-Year High	18.73	12.81	18.22	12.66
	5-Year Low	10.73	8.3	10.69	9.08
	5-Year Median	14.71	10.7	14.03	10.78
EV/Sales F12M	Current	5.24	2.78	3.14	3.26
	5-Year High	5.38	2.78	3.14	3.37
	5-Year Low	2.94	1.67	1.76	2.3
	5-Year Median	4.21	2.31	2.28	2.78

As of 01/28/2020

Industry Analysis Zacks Industry Rank: Bottom 20% (203 out of 255)



Top Peers

Colfax Corporation (CFX)	Neutral
The Carlyle Group L.P. (CG)	Neutral
Flowserve Corporation (FLS)	Neutral
IDEX Corporation (IEX)	Neutral
Ingersoll-Rand PLC (Ireland) (IR)	Neutral
ITT Inc. (ITT)	Neutral
MUELLER WATER PRODUCTS (MWA)	Neutral
Nordson Corporation (NDSN)	Neutral

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	GGG Neutral	X Industry	S&P 500	CFX Neutral	IEX Neutral	NDSN Neutral
VGM Score	C	-	-	B	C	C
Market Cap	9.18 B	1.96 B	23.90 B	4.33 B	13.03 B	10.12 B
# of Analysts	7	3.5	13	7	7	5
Dividend Yield	1.27%	0.00%	1.8%	0.00%	1.17%	0.87%
Value Score	D	-	-	C	D	D
Cash/Price	0.02	0.05	0.04	0.03	0.04	0.02
EV/EBITDA	19.39	13.23	14.05	22.15	20.49	18.79
PEG Ratio	2.56	2.18	2.00	2.18	2.85	1.70
Price/Book (P/B)	8.96	2.52	3.28	1.38	6.02	6.38
Price/Cash Flow (P/CF)	24.53	12.64	13.57	10.06	26.36	22.30
P/E (F1)	29.44	18.50	18.76	16.75	28.55	28.08
Price/Sales (P/S)	5.58	1.41	2.63	1.15	5.21	4.61
Earnings Yield	3.40%	5.34%	5.33%	5.96%	3.50%	3.56%
Debt/Equity	0.16	0.56	0.72	1.32	0.39	0.69
Cash Flow (\$/share)	2.24	2.51	6.89	3.65	6.50	7.86
Growth Score	C	-	-	C	B	B
Hist. EPS Growth (3-5 yrs)	13.95%	5.37%	10.68%	4.49%	12.58%	NA
Proj. EPS Growth (F1/F0)	-1.43%	7.72%	7.63%	10.75%	3.04%	6.37%
Curr. Cash Flow Growth	0.14%	15.00%	13.04%	-19.54%	18.92%	-1.46%
Hist. Cash Flow Growth (3-5 yrs)	8.54%	7.16%	8.78%	4.18%	8.19%	7.90%
Current Ratio	2.77	2.03	1.24	2.32	3.21	2.12
Debt/Capital	13.82%	36.44%	42.99%	56.84%	28.18%	40.69%
Net Margin	20.89%	6.22%	11.47%	-12.40%	17.05%	15.36%
Return on Equity	34.45%	13.11%	17.21%	9.06%	21.28%	22.74%
Sales/Assets	1.01	0.83	0.54	0.41	0.70	0.63
Proj. Sales Growth (F1/F0)	-0.33%	1.86%	4.10%	1.82%	1.63%	1.94%
Momentum Score	A	-	-	A	C	C
Daily Price Chg	7.10%	0.18%	0.90%	1.91%	0.88%	1.34%
1 Week Price Chg	-2.29%	-2.29%	-1.09%	-2.50%	-2.11%	0.87%
4 Week Price Chg	5.87%	-0.03%	0.46%	1.02%	-0.42%	7.67%
12 Week Price Chg	17.18%	0.01%	4.15%	3.61%	6.69%	6.67%
52 Week Price Chg	26.58%	11.48%	18.27%	48.85%	23.13%	36.90%
20 Day Average Volume	679,571	42,993	1,730,811	946,294	302,207	227,575
(F1) EPS Est 1 week change	0.31%	0.00%	0.00%	0.00%	-0.25%	0.00%
(F1) EPS Est 4 week change	0.31%	0.00%	0.00%	0.03%	-0.14%	0.00%
(F1) EPS Est 12 week change	0.46%	-0.38%	-0.13%	0.71%	-0.63%	-3.89%
(Q1) EPS Est Mthly Chg	2.22%	0.00%	0.00%	0.00%	0.00%	0.00%

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	D
Growth Score	C
Momentum Score	A
VGM Score	C

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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