Graco Inc. (GGG)

Updated July 28th, 2022, by Eli Inkrot

Key Metrics

Current Price:	$65	**5 Year CAGR Estimate:**	10.4%	**Market Cap:**	$11 B
Fair Value Price:	$62	**5 Year Growth Estimate:**	10.0%	**Ex-Dividend Date:**	07/15/22
% Fair Value:	104%	**5 Year Valuation Multiple Estimate:**	-0.8%	**Dividend Payment Date:**	08/03/22
Dividend Yield:	1.3%	**5 Year Price Target**	$100	**Years Of Dividend Growth:**	25
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Rating:**	Hold

Overview & Current Events

Graco Inc. (GGG) is a manufacturing company, which designs, manufactures, and markets systems and equipment used to move, measure, control, dispense and spray fluid and powder materials. It operates through the following segments: Industrial, Contractor and Process. The Industrial/Automotive unit accounted for 42% of 2021 sales; Contractor, 38%; Process, 20%. 42% of 2021 sales originated from international customers. The $11 billion company was founded by Russell Gray and Leil Gray in April 1926, is headquartered in Minneapolis, and has about 3,800 employees.

On July 27th, 2022, Graco released its second quarter 2022 results for the period ending July 1st, 2022. For the quarter, the company reported revenue of $548.5 million, an 8% increase compared to Q2 2021. This result was led by a 10% increase in Industrial segment sales and a 28% increase in Process segment sales, as the Contractor segment was largely unchanged. Adjusted net earnings were $117 million for the quarter and adjusted earnings-per-share equaled $0.68, up 8% and 10% respectively, compared to $108 million and $0.62 in the year ago period.

Previously Graco provided a positive outlook for 2022, expecting revenue growth to be in the high single-digits. This quarter the company said that demand in the Americas remained strong, but end markets in EMEA slowed due to unfavorable macroeconomic conditions and significant cost increases. Graco is planning on implementing a second round of global price increases starting in August to offset these pressures.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS[1]	$0.76	$1.00	$1.07	$1.09	$1.18	$1.45	$1.90	$1.90	$1.92	$2.52	**$2.70**	**$4.35**
DPS	$0.31	$0.34	$0.38	$0.41	$0.45	$0.49	$0.56	$0.66	$0.71	$0.77	**$0.84**	**$1.35**
Shares[2]	182	183	178	167	168	169	165	167	169	170	**169**	**169**

Graco's long-term earnings growth track record is strong, with the company's earnings-per-share stabilizing in 2018 and growing thereafter to $2.52 in 2021. Over the last five years, the average EPS growth rate is 13.2%, which is well above the 9.1% rate for this industry.

We expect the company to grow its earnings-per-share by 10% per year on average over the next five years. The company remains well-positioned in its markets and could continue to grow through new product developments, new markets, global expansion, and acquisitions. Supply-chain issues (related to component availability) and logistic problems will be challenging for Graco. Our intermediate-term growth rate is slightly lower than the company's EPS expectations for 2022.

The company has a long history of paying dividends and has increased its payout for 25 consecutive years. In December 2021, the quarterly dividend increased by 12% from $0.1875 to $0.21 per share. Over the last five years, the average annual dividend growth rate is 11.4%.

[1] Diluted earnings; excludes nonrecurring items.
[2] In millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Avg. P/E	21.6	22.3	23.7	21.9	21.9	25.3	23.6	25.2	28.8	30.5	**23.9**	**23.0**
Avg. Yld.	1.9%	1.5%	1.5%	1.7%	1.7%	1.3%	1.2%	1.4%	1.3%	1.0%	**1.3%**	**1.4%**

During the past decade shares of Graco Inc. have traded with an average price-to-earnings ratio of about 25 times earnings and today, it stands at 23.9. We are using 23 times earnings as a fair value baseline, implying the potential for a valuation headwind. Graco's dividend yield is currently 1.3% and the dividend raises in the last few years contributed modestly to total returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	41%	34%	36%	38%	38%	34%	29%	35%	37%	31%	**31%**	**31%**

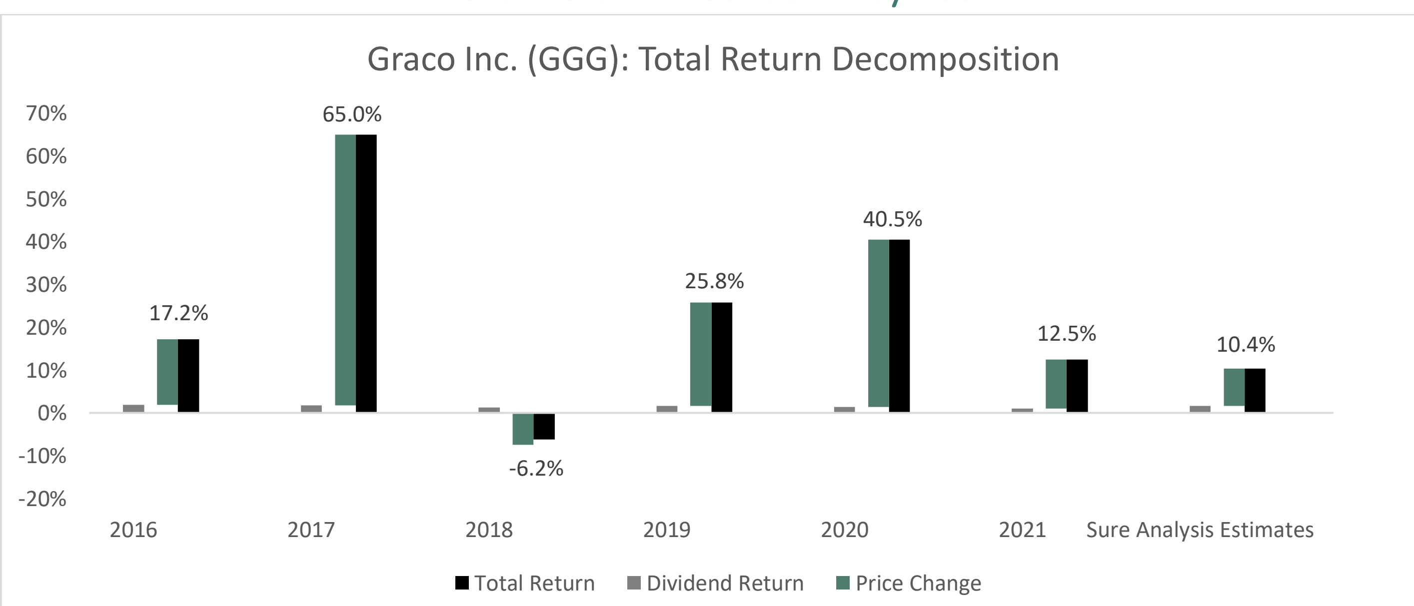
During the past five years, the company's dividend payout ratio has averaged around 33%. The payout ratio is not very high, which makes us believe that the dividend looks quite safe. Given the expected earnings growth, there is still room for the dividend to continue to grow and extend the track record of consecutive dividend increases which is an important factor for dividend growth investors.

Graco's industry is not one with outstanding growth rates, but the company has established itself as a major player that continues to grow profitably year over year. The annual price increases will continue to boost sales and profits. Important elements of Graco's business model are manufacturing excellence, service excellence (same-day delivery) and their extensive reach with 30,000+ outlets/distributors. The company's experienced management and strong fundamentals, such as an above-average return on capital (28%), are also competitive advantages.

Final Thoughts & Recommendation

We expect the company to grow its earnings-per-share by 10% per year on average over the next five years. The expected total returns for Graco are 10.4% per year, driven by earnings growth and a 1.3% dividend yield. We are enthused about the business model and long-term growth potential, but current economic and geopolitical conditions could have an impact in the short-term. Shares earn a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	1,012	1,104	1,221	1,286	1,329	1,475	1,653	1,646	1,650	1,988
Gross Profit	551	607	667	685	711	795	883	860	855	1,034
Gross Margin	54.4%	55.0%	54.6%	53.2%	53.5%	53.9%	53.4%	52.2%	51.8%	52.0%
SG&A Exp.	277	276	304	324	338	357	383	368	356	423
D&A Exp.	39	37	36	45	48	46	48	49	55	59
Operating Profit	225	280	309	302	313	379	436	424	427	531
Operating Margin	22.2%	25.3%	25.3%	23.5%	23.6%	25.7%	26.4%	25.8%	25.9%	26.7%
Net Profit	149	211	226	346	41	252	341	344	330	440
Net Margin	14.7%	19.1%	18.5%	26.9%	3.1%	17.1%	20.6%	20.9%	20.0%	22.1%
Free Cash Flow	171	220	211	150	234	298	314	291	323	323
Income Tax	68	78	90	129	56	95	70	62	44	69

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	1,322	1,327	1,545	1,391	1,243	1,391	1,473	1,692	1,988	2,443
Cash & Equivalents	31	20	24	52	52	104	132	221	379	624
Accounts Receivable	172	183	215	226	218	266	275	267	315	325
Inventories	122	134	160	202	202	239	284	273	286	382
Goodwill & Int. Ass.	336	341	472	625	440	464	463	473	511	508
Total Liabilities	868	693	949	756	669	668	721	667	704	734
Accounts Payable	29	34	39	41	40	49	57	54	58	78
Long-Term Debt	565	418	620	409	315	233	277	172	172	193
Shareholder's Equity	454	634	596	636	574	723	752	1,025	1,284	1,709
LTD/E Ratio	1.24	0.66	1.04	0.64	0.55	0.32	0.37	0.17	0.13	0.11

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	13.6%	15.9%	15.7%	23.5%	3.1%	19.2%	23.8%	21.7%	18.0%	19.9%
Return on Equity	38.4%	38.7%	36.7%	56.1%	6.7%	38.9%	46.2%	38.7%	28.6%	29.4%
ROIC	18.1%	20.4%	19.9%	30.6%	4.2%	27.4%	34.4%	30.9%	24.9%	26.2%
Shares Out.	182	183	178	167	168	169	165	167	169	170
Revenue/Share	5.47	5.86	6.59	7.27	7.78	8.46	9.54	9.59	9.59	11.39
FCF/Share	0.93	1.17	1.14	0.85	1.37	1.71	1.81	1.69	1.88	1.85

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.