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LECO - Q2 2015 Lincoln Electric Holdings Inc Earnings Call

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PRESENTATION

Operator

Greetings, and welcome to the Lincoln Electric 2015 second-quarter financial results conference call. At this time all participants are in a listen-only mode, and this call is being recorded.

It is now my pleasure to introduce your host, Amanda Butler, Director of Investor Relations. Thank you. You may begin.

Amanda Butler - *Lincoln Electric Holdings, Inc. - Director, IR*

Thank you and good morning, everyone. Welcome to Lincoln Electric's 2015 second-quarter conference call. We released our financial results for the quarter earlier today, and you can find our release and this call's slide presentation on the Lincoln electric website a LincolnElectric.com in the Investor Relations section.

Joining me on the call today is Chris Mapes, Lincoln's Chairman, President and Chief Executive Officer; and our Chief Financial Officer, Vince Petrella. Chris will begin the discussion this morning with an overview of the quarter, and Vince will cover the numbers in more detail as well as our uses of cash.

Following our prepared remarks, we will take your questions.

Before we start our discussion, please note that certain statements made during this call may be forward-looking, and actual results may differ materially from our expectations due to a number of risk factors. A discussion of some of the risks and uncertainties that may affect our results are provided in our press release and in our SEC filings on Forms 10-K and 10-Q.

In addition, we discuss financial measures that do not conform to US GAAP. A reconciliation of non-GAAP measures to the most comparable GAAP measures is found in the financial tables in our earnings release.

With that, I will turn the call over to Chris Mapes. Chris?

Chris Mapes - *Lincoln Electric Holdings, Inc. - Chairman, President, and CEO*

Thank you, Amanda. Good morning, everyone. The business navigated through challenging market conditions in the second quarter. The impact of a strong US dollar on our US exports, a contraction in oil and gas, and general slowing in industrials, offset the benefits we achieved from our diversified end market exposure, broad portfolio of solutions, and operational excellence initiatives. We recognized these challenges early and deployed cost reduction initiatives mid-quarter to start to align our cost structure with soft market conditions in an effort to sustain our profit margin, cash flow generation, and return performance.

We did this while continuing to reinvest in innovation in our various commercial programs. We believe these efforts will allow Lincoln Electric to better capitalize on opportunities when demand trends improve, and help us achieve our longer-term 2020 Vision and Strategy goals.

Looking at the quarter in a bit more detail, second-quarter sales declined 8.8% to $665 million. Excluding foreign exchange, second-quarter sales decreased 2.9%, primarily from 6.5% lower volumes, which offset positive price and solid performance from our 2014 Easom Automation acquisition. Our lower volume performance was primarily from a sharp 27% decline in our US exports, a 20% decline in oil and gas sector demand, and weakness in our Asia-Pacific region, specifically in Australia's mining industry and in China, where we continue to reposition the business.

Lower volumes impacted both our reported and adjusted operating income and margin performance. Our second-quarter adjusted operating income margin of 14.7% declined 130 basis points on a challenging year-over-year comparison against a record 16% 2014 operating income margin.

Earnings per share declined in the quarter, with adjusted EPS down 5.9% to $0.95. While share repurchases contributed $0.06 to EPS, unfavorable foreign exchange reduced EPS by $0.04.

Return on invested capital remained steady year-over-year at 18.9% and we generated solid cash flow from operations from working capital improvements. We feel that our year-over-year and sequential improvement in working capital to sales ratio demonstrates the organization's ability to maintain focus and respond rapidly to dynamic conditions.

We returned 100% of cash flow from operations to shareholders through share repurchases and dividends. And we remain committed to our full-year 2015 share buyback goal of $400 million.

Moving on to slide 4 and a bit more detail about our end markets. Even in a challenging environment, we did recognize growth in certain areas. Our global automation portfolio continued to generate solid double-digit growth rates, with strong demand for Lincoln's leading automated pipe and structural solutions.

Looking geographically, while North America volumes were impacted by a sharp decline in US exports and oil and gas, domestic sales performance was steady on a year-over-year basis. We achieved this steady performance as growth in transportation, ship building, non-residential construction, general fabrication, and pipe mills helped offset lower domestic activity in oil and gas and heavy fabrication.

And while European volumes were impacted by lower oil and gas activity across northern Europe, Russia, and the Middle East, we saw double-digit growth in certain Southern European countries. South America and our Asia-Pacific markets remain challenged on weakening macroeconomic conditions. However, we did achieve good growth across most of Southeast Asia.

Harris achieved volume growth in the quarter on solid equipment demand related to strength in the residential construction sector and demand in refrigeration. They also benefited from continued improvement in the retail and wholesale channels.

Moving to slide five. In this environment we are focused on our strategic growth initiatives, achieving continuous improvement in our operations, and aligning costs to current conditions. I'm pleased to report that we are progressing well across each area and are starting to leverage many of the benefits from our efforts. As automation, alloys and aluminum demand remains strong, we continue to invest in these areas. And we remain on track with our key R&D and commercial activities, which we will be showcasing later this year at FABTECH in Chicago.

Near-term, we will continue to execute on our cost reduction actions. Our capital expenditure program has been prioritized to investments that are revenue accretive or will reduce operating costs.

In Europe, we are continuing to optimize our business by ensuring that we will have the correct alignment of staff and operating assets to capitalize on attractive growth applications. And in Asia and South America, we are continuing to invest in teams and technology platforms that will differentiate Lincoln Electric's solutions from local providers, and capitalize on our technical engineering expertise. These are very attractive targeted opportunities for Lincoln Electric long-term, and we will continue to invest in these strategies to serve those markets.

Before I pass the call to Vince, I'd like to emphasize that we are confident in our organization's ability to manage through what we believe will be a challenged macroeconomic environment in 2015. We are confident in the execution of our strategy and our ability to drive long-term value and improve returns for all of our stakeholders.

And now I will pass the call to Vince.

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

Thank you, Chris. Turning to slide 6, you'll see that our consolidated sales decreased 8.8% compared with the second quarter of 2014. We achieved 1.6% higher price, primarily reflecting the hyperinflationary environment in Venezuela; as well as a 2% increase from our Easom Automation acquisition, which we completed in October of last year. These increases were offset by a 6.5% reduction in volumes and a 5.9% unfavorable impact from foreign currency translation. Excluding foreign exchange, our sales decreased 2.9%.

Our second-quarter gross profit margin decreased 40 basis points to 34% compared with 34.4% in the comparable prior-year period. Lower volumes drove the margin decline.

Our SG&A expense as a percentage of sales increased 40 basis points to 19.2% as cost reductions helped to partially offset the impact of lower sales volumes.

Operating income for the quarter decreased 13.8% to $97 million. Our operating margin decreased 80 basis points to 14.6%. On an adjusted basis, we achieved a 14.7% operating margin, which was 130 basis points lower than 2014's peak 16% margin.

While the second quarter benefited from cost reductions, these benefits were offset by the unfavorable impact of lower volumes, a $2.3 million increase in pension expense, and a prior-year $3.9 million gain from an insurance settlement.

Excluding our Venezuelan operations from both years' second-quarter results, our adjusted operating profit margin would have decreased 80 basis points to 15% in 2015 as compared with 15.8% in 2014.

Our interest expense increased by $3.4 million in the quarter to $4.4 million, primarily from an adjustment in the consideration we expect to pay to acquire an additional ownership interest in a majority-owned subsidiary. Interest expense also reflects interest accrued on higher borrowings.

The effective tax rate for the second quarter was 24.9% compared with 32.7% in the prior year. The primary factors driving this lower effective tax rate were the use of foreign tax credits and higher discrete tax benefits of $3.4 million, primarily from the reversal of deferred tax valuation allowances. We expect our second-half 2015 effective tax rate to be in the high 20% range, subject to the mix of earnings by jurisdiction.

Net income for the second quarter decreased 8.3% or $6.4 million compared with the prior year. Adjusted net income decreased 11.9% or $9.7 million to $71.8 million. Foreign exchange translation had an unfavorable $3.2 million impact to net income or $0.04 per diluted share in the quarter.

Our reported diluted earnings per share decreased 2.1% to $0.94 for the second quarter compared with $0.96 per share in the prior year's same quarter. On an adjusted basis, diluted earnings per share decreased 5.9% to $0.95 as compared with $1.01 in 2014.

Venezuelan operations contributed $0.02 per share in adjusted earnings in the second quarter of 2015 as compared with $0.04 of adjusted EPS in the comparable period of 2014. If Venezuelan results and special items were excluded from both periods, our adjusted EPS would have decreased 4% to $0.93 per share versus $0.97 in 2014.

Now moving to the geographical segments on slide 7. Our North American welding segment's second-quarter adjusted EBIT margins declined by 210 basis points to 17.6%, primarily due to lower volumes and mix. Reported sales decreased 3.4% in the quarter on 5.1% lower volumes, as relatively flat domestic demand was offset by a 27% or $17 million decline in US exports. US export demand contracted notably in Asia-Pacific, Russia, and the Middle East, primarily impacted by reduced oil and gas sector activity.

In Europe, our adjusted EBIT margin declined 240 basis points to 9.9% on 2.9% lower volumes. Reported sales declined 21.3% or 3.4%, excluding the unfavorable foreign exchange impact. Volume declined on weaker oil and gas activity in the region and challenging year-over-year comparisons.

Moving to slide 9, the Asia-Pacific welding segment's adjusted EBIT margin increased 380 basis points to 4.3% on mix improvements associated with our strategic repositioning in the region and favorable year-over-year comparisons. Sales in Asia-Pacific were down 26.8% in the quarter on 22.8% lower volumes. The volume decreases were primarily due to our ongoing repositioning of the portfolio as well as persistent end-market weakness in mining, heavy fabrication, and, more recently, transportation sectors. We did achieve sales growth in our strategic focus areas of automation systems and equipment.

South American welding's adjusted EBIT margin decreased 920 basis points to 3.6% as compared with 12.8% in the prior-year period. The margin decline reflects lower volumes and lower margins in Venezuela in addition to weakening macroeconomic conditions in Brazil.

Adjusted EBIT in 2015 includes $1.3 million from Venezuela, which compares with $4.4 million in 2014.

The Harris Products Group expanded second-quarter EBIT margins by 210 basis points to 11.1%. Volumes increased 2.3% in the quarter from growth in equipment in the retail channel, as well as from favorable year-over-year comparisons. Pricing decreased due to lower metal cost, primarily silver.

Moving to slide 12. While our cash flow from operations decreased to $77 million in the quarter, we did voluntarily contribute $25 million to our US pension plans. Excluding this contribution, cash flow from operations would have been relatively steady compared with the prior-year period.

Looking at our first-half 2015 results, our cash flows from operations increased 9.7%, reflecting benefits from working capital improvements and a $25 million tax refund received in the first quarter.

In addition, our first-half cash flows include $47 million in contributions to our pension plans, approximately double last year's contributions. Our average operating working capital to net sales ratio improved 180 basis points to 18% as compared with the prior year.

Looking at our uses of cash, we spent approximately one-third less on capital expenditures versus prior-year at $17 million in the quarter. We now estimate our full-year 2015 capital spending plan to be in the range of $65 million to $70 million. This compares to our previous estimate of $65 million to $75 million. Additionally, we paid cash dividends of $22 million, reflecting this year's 26% higher dividend payout rate.

During the quarter we spent approximately $56 million repurchasing over 846,000 shares for Treasury. For the first six months of 2015, we have spent $158 million on share repurchases. As Chris mentioned in his opening comments, we continue to target the $400 million for share repurchases in 2015.

Now, just a couple of comments on our 2015 outlook before we open the call for questions. Given the slow recovery that we are experiencing in domestic markets and general weakness in developing regions, we do remain cautious about any near-term catalyst in the industrial space. We expect the ongoing strength of the US dollar to continually negatively impact our 2015 reported revenue and earnings, both on a translation basis and in reduced demand for our US-dollar-denominated US exports. We also anticipate continued weakness in the oil and gas sector and its related industries.

Despite the challenges that we face in this environment, we remain focused on improving margins, cash flow generation, and returns. We are confident in our ability to successfully navigate through this slow period. We will continue to reinvest in the business and pursue acquisitions as part of our 2020 Vision and Strategy.

With that, I would like to turn the call over for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Matt McConnell, RBC Capital Markets.

Matt McConnell - *RBC Capital Markets - Analyst*

Could you maybe give a little more insight into the oil and gas decline? Obviously got a little bit weaker here. But customer conversations or anything else that suggests this will get worse in the back half of the year, or just what are your expectations for this market over the next couple quarters?

Chris Mapes - *Lincoln Electric Holdings, Inc. - Chairman, President, and CEO*

Well, Matt, I would say, first, our first quarter of 2015, we didn't have the level of impact that we expected in the oil and gas. We mentioned at that time that we knew that we would begin to see compression in that demand model, and we certainly experienced that in Q2.

I would tell you that we don't have any conversations that we are engaging in that should lead us to believe that it's going to significantly differ as we move forward. But we are also not seeing anything in today's environment that leads us to believe that we're expecting any improvement in that business.

It's not just a US phenomenon. It's also impacting oil and gas and a multitude of segments in our businesses around the world. So our expectation is that we are beginning -- we have seen that in our Q2 results, and are expecting to continue to see that type of activity as we exit through the rest of 2015.

Matt McConnell - *RBC Capital Markets - Analyst*

Okay, got it, thanks. And then separate question on the pace of the buyback; slowed down a little bit in the second quarter. And you are below the pace for the 400. But were you blocked out of the market at any point around the pre-announcement? Or did you just decide to slow it down a little bit in 2Q? Or at what point would that accelerate to get up to the $400 million that you are talking about for the year?

Chris Mapes - *Lincoln Electric Holdings, Inc. - Chairman, President, and CEO*

Matt, it's a little bit of both of those things. We do have a blackout period that runs about two weeks before the end of the calendar quarter. So we've been on a 10b5 plan at a little bit more modest levels of repurchases since that time. So I would expect the acceleration to begin when the new window opens in about three or four days. So we will need to buy more shares than what we have been doing in the last 30, 45 days. And we did slow down a little bit towards the middle/end of this quarter in anticipation to open up the window for the last part of the year.

Matt McConnell - *RBC Capital Markets - Analyst*

Okay, great. Thanks very much.

Operator

Schon Williams, BB&T Capital Markets.

Schon Williams - *BB&T Capital Markets - Analyst*

I wonder if we could just talk about maybe the restructuring and some of the cost controls that were put in place in Q2. From the comments, it sounded like it was more kind of across the board, but then the actual restructuring charges were more isolated to Europe.

Can you just help me understand what actions did you put in place in Q2? And then maybe specifically for Europe, maybe talk about are we -- was the restructuring there mostly people costs? Or are you looking at closing any production? Maybe a little bit more detail on some of the restructuring cost control.

Chris Mapes - *Lincoln Electric Holdings, Inc. - Chairman, President, and CEO*

Yes, Schon, let me talk about Europe specifically, and then I will let Vince comment about some of the broader activities that we have across the portfolio.

So in Europe, we have been continuing to try to drive a higher-performance organization in our European business. We have implemented some new CRM and sales management tools that have assisted us in evaluating the way we are going to market. Most of the restructuring charges that you saw there in the second quarter were the realignment of people relative to being able to achieve that longer-term.

So it was not any physical assets or physical asset closures; it was all around reorganization in our sales and marketing organization, as we have been trying to drive a higher-performance organization there; a business that can drive more solutions for us, where traditionally we had some markets there that were probably more channel-oriented. And we are just trying to continue to execute on that strategy. And that is really the impact that you saw from Europe in Q2.

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

From a broader perspective, the way that we look at our cost savings are we categorize them into two buckets: one being what we would refer to as temporary cost savings, cutting back on discretionary spending, adjusting and aligning our cost base with the volumes that we are now afforded in the marketplace. And that would include eliminating overtime, taking hours down, taking all of those variable type costs down to, again, a better match of our cost structure with our revenue line.

And then the other category would be what we believe to be structural changes. And Chris highlighted what we believed to be a structural change in Europe. And structural changes are situations where we are taking out, we believe permanently, fixed costs in our structure that will not come back when volumes improve.

And our estimates today on both of those categories are that the temporary discretionary type of savings will range, on an annualized basis, of between $10 million and $15 million today. And on the structural side, we have about $4 million to $6 million of annualized cost savings that we could expect going forward through the last half of this year and into next year.

Schon Williams - *BB&T Capital Markets - Analyst*

All right. That's helpful. And then maybe just a question on the markets. I wonder if you could just talk a little bit about the different dynamics that you are seeing at the pipe mills being strong versus pipeline being weaker, maybe just talk a little bit about that. And then also it looked like auto had dropped out as one of your stronger markets. Just maybe if you could comment specifically on what you're seeing in automotive right now.

Chris Mapes - *Lincoln Electric Holdings, Inc. - Chairman, President, and CEO*

Schon, automotive probably dropped out only in that it's not strengthening. It's coming off of a very strong 2014. 2015 has stayed very strong for us also, with strength in some new applications that we are moving into that marketplace, and strength in aluminum portfolios that we continue to move into the automotive industry.

So the pipe mill versus pipeline dynamic -- it's not a perfect equilibrium of demand between what we see in the installation activity in pipe versus what we see in the pipe mill activity. Pipe mills have started back up more strongly on a global basis, with some activity in North America as well as some activity in a couple other regions around the world.

So we have seen that dynamic before. It doesn't surprise us. But we would expect that that would hopefully be able to transition into some other activities in the line portion of the business longer-term. Although Lincoln today is engaged in a couple of very large projects, a project in Latin America and another project globally where we are working with contractors on that portion of the business.

So we would hopefully want to see that some of the pipe mill activity would trend into some of the other areas of the market here over the next three to five quarters.

Schon Williams - *BB&T Capital Markets - Analyst*

All right. Thanks, guys. I will get back in the queue.

Operator

Mark Douglass, Longbow Research.

Mark Douglass - *Longbow Research - Analyst*

Chris, can you talk about North America trends? From what I remember, things took a dip in May and then into June, especially in oil and gas. How are things -- how did the quarter end in June? Are we looking into July, at least on a volume perspective, in North America?

Chris Mapes - *Lincoln Electric Holdings, Inc. - Chairman, President, and CEO*

Well, Mark, you are right. We held up -- I think you have to take a little bit longer look at it. As you recall, our Q1 in 2015, we were a little bit stronger relative to holding up in the North American marketplace. We were concerned about oil and gas and saw more of that trend in our business as we move towards Q2 with, certainly, concerns over some of the things we saw in the marketplace in May.

We saw some improvement in June from the May run rate. I would tell you that our July business -- it's just awfully early, especially in the North American marketplace, where some large industries might be having some summer shutdowns.

So we're not seeing anything significantly different in July from what we've seen in the June run rate for the business. But that's why we've got the cautious outlook as we look forward into Q3 and Q4. I have a difficult time seeing what catalyst is out there to give us confidence that we are going to see any material change in the demand model here in North America as we're looking at Q3 and early Q4.

Mark Douglass - *Longbow Research - Analyst*

Right. But with exports down considerably, still you were relatively flat -- a step down from first quarter, but still. Was a lot of that automation demand to help you stay flat in a market that appeared to be down for others?

Chris Mapes - *Lincoln Electric Holdings, Inc. - Chairman, President, and CEO*

Well, I would just say automation did assist us with that. But I would also say that our teams in the US business and the North American business continue to execute on their strategies and continue to try to drive solutions into the broad marketplace.

Automotive, although we didn't highlight it, strong and continues to stray strong; transportation, very strong. Ship building here in actually the US/North American marketplace -- we've had some very good opportunities that we have executed on. So the team's continued to work very hard to mitigate the impact, although certainly we would love to see some broader demand trends in the North American marketplace to assist us.

Mark Douglass - *Longbow Research - Analyst*

Okay. Then finally, Vince, can you quantify year-to-date how much the portfolio, the product repositioning in Asia-Pac, is affecting the volumes? How much of the volume decline is from the repositioning?

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

Well, year-to-date, the volume impact from Asia-Pacific is about $24 million of a reduction in total sales. So we have about $1.3 billion in total sales -- $1.322 billion. And about $24 million of the decline from last year's $1.413 billion is related to Asia-Pacific volume reduction.

Mark Douglass - *Longbow Research - Analyst*

Okay. Thank you, that was helpful.

Operator

Joe O'Dea, Vertical Research.

Joe O'Dea - *Vertical Research Partners - Analyst*

First question, just on mining and what you're seeing in activity there, with some of the pressure we've seen across mine commodities over the last six months or so. And I think that we had seen some maybe stabilization along a bottom, and now it seems like that there's a little bit more weakness showing up. So if you could just characterize what you are seeing there. and how you expect that to play out over the next couple quarters.

Chris Mapes - *Lincoln Electric Holdings, Inc. - Chairman, President, and CEO*

Look, I think the demand compression we've seen in mining is really driven from a further reduction in copper pricing that has occurred over the last 6 to 9 months. So a lot of the demand models in mining are driven by iron ore, coal, and copper. And copper has had kind of an accelerated deterioration over the last 6 to 9 months. We have recently seen some order trends in the marketplace that show mining continuing to compress.

So mining has been challenged for several quarters. It looks like we are continuing to see that impact within the business, certainly impacting us globally; continue to see challenges in our Australian business, with it being very mining-centric. But I believe that some of the more recent trends that have been negative in mining probably have been driven by further deterioration in the economics around copper.

Joe O'Dea - *Vertical Research Partners - Analyst*

Okay. And then one on non-res, and just the extent to which the energy disruption has created any push-outs that you have seen across non-res; from your comments, still seeing activity and recovery there. But any concerns around product push-outs, or just the indications you are getting on visibility into continued go-forward for planned projects?

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

We don't see anything. As a matter of fact, we look at our structural construction business as one that has actually been strengthening during the course of the year. The sales improvements on a year-over-year basis in North America strengthened from the first quarter to the second quarter. So we see good trending in that particular end-market segment.

Joe O'Dea - *Vertical Research Partners - Analyst*

Okay, thanks very much.

Operator

Walter Liptak, Global Hunter.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

I wanted to ask about the oil and gas in a little bit more detail to see if you've got any more clarity now on how much of that sales that you are seeing decline is coming from product that's going into the upstream versus mid- or downstream.

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

I would tell you that, overall, our oil and gas exposure decline in the second quarter year-over-year is about 20%. And, by far, the greatest proportion of the decline on a year-over-year basis is in the upstream segment. That's over 30%-plus of declines. And certainly midstream and downstream are lot less than that kind of decline. So most of it has been heavily impacted in that upstream subsector.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Okay. Are you seeing that both for capital equipment for machinery as well as the consumables declining at that same rate?

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

We are seeing large declines on both sides of the business, Walt.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Okay. And then I wanted to ask a follow-up on the cost savings, Vince, that you mentioned. The temporary cost savings of $10 million to $15 million annualized -- I wonder how much of that shows up in the back half of 2015, and how much in 2016?

And then with the structural changes, the $4 million to $6 million seemed large compared to the charge that you took in the quarter. I wonder if there's another charge coming, or if that was from prior restructuring.

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

Well, starting with the structural changes, we don't always need to take charges to achieve structural savings. Places like Europe -- those are necessary. But we have structural cost savings across our portfolio of geographic and segment businesses. North America and other segments did not have to take those kinds of charges to achieve the structural cost savings.

As far as the pacing, those are annualized numbers. I would tell you that there will be a little bit more emphasis on those savings in the last half of 2015 versus the first half, because much of these initiatives were accomplished during the latter part of the second quarter. So we see a little bit heavier mix in the second half, certainly, versus the first half.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Okay, great. Okay. Thank you.

Operator

Stanley Elliott, Stifel.

Stanley Elliott - *Stifel Nicolaus - Analyst*

A quick question on the SG&A. Was some of that savings on the reported line -- was that incentive comp that came out, or was that all just cost savings?

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

Well, certainly, yes, incentive comp was down. And that had a fairly significant impact on the quarter-over-quarter comparisons. We also had some compression from foreign exchange currency translations as well. But, yes, the incentive compensation is down year-over-year because earnings are down.

Stanley Elliott - *Stifel Nicolaus - Analyst*

And then switching gears to the automation piece, it's, say, 10%-plus of the overall business. It has been very good. Can you talk about -- the strength that you are seeing now, is that from orders, say, six months, three months ago, before the global slowdown, if you will, has started to materialize or discussions around that? And then can you talk about your visibility within that business, given that it's more of a CapEx-driven product?

Chris Mapes - *Lincoln Electric Holdings, Inc. - Chairman, President, and CEO*

Well, my first comment would be that we don't think about that business as having a host of demand because of orders or activities that were received or achieved prior to the impact in oil and gas. So we don't think about the business that way. The business still, today, even though it's certainly a more significant piece of the business than what it was a few years ago -- as we continue to build that business out, which we feel strongly that that business can be a much larger piece of the portfolio as we execute on our 2020 Vision and Strategy, I would like to see that business maybe gravitate towards more of a $600 million or $800 million business within the portfolio. And as it becomes larger, it will be less choppy in its performance on a quarterly basis.

Some of the various areas within the automation portfolio today, because of their size and because of the fact that they do have, at times, large orders that can be more of a choppy performance for the business.

But we are very focused on executing on our automation strategy. We think that can be a long-term, significant catalyst for us. It's growing at a much higher rate than the core welding business on a global basis. And we see that as a real catalyst for our long-term growth and improved performance.

Stanley Elliott - *Stifel Nicolaus - Analyst*

And I may be wrong, but that $600 million to $800 million number seems higher than what I would have remembered. Is that taking your technologies and putting them into new applications, new end markets? Or what is driving that differential?

Chris Mapes - *Lincoln Electric Holdings, Inc. - Chairman, President, and CEO*

Look, I would probably say both. Look, we have -- as we have been on this journey in building out the automation business, we have just gotten more and more confidence in our ability to execute on this strategy. So we are out there actively around the world looking at acquisition opportunities to expand this portfolio, whether that would be regional or whether that would be on a solutions basis; and just feel confident that we will be able to continue to make this a larger pace of global Lincoln Electric.

Stanley Elliott - *Stifel Nicolaus - Analyst*

Lastly, could you comment on the additional ownership in the subsidiary and maybe give us a little more color about the products there, the regions, anything you would care to share?

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

Well, it's in the automation space, Stanley. And it's a North American business that was acquired, now, over a year ago. And we just had an agreement where we bought a majority ownership interest. And we have, as part of the agreement, the earn-out based on the purchase of a remaining interest at an estimated forecasted future earnings level.

So as the business continues to grow rapidly in that automation space and becoming more profitable, we need to bump up our expected liability that will be paid out by the final interest in this majority-owned subsidiary.

Stanley Elliott - *Stifel Nicolaus - Analyst*

Great. Thank you very much and good luck.

Operator

Liam Burke, Wunderlich.

Liam Burke - *Wunderlich Securities, Inc. - Analyst*

Vince, you talked about adjusting on costs on lower volumes. Is there any need to readjust your budget on the R&D side of the business?

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

Well, we don't think so. We are actually -- our R&D spend in the quarter was up double digits on a year-over-year basis. We are committed to a long-term strategy of driving better and better products into our marketplace. It's not a place that we plan on cutting back at all.

I will remind you, even in the Great Recession, we continued to increase our spending in R&D. We believe it's an area that, no matter what's happening in the markets, we can improve our long-term positioning and strategic advantages in our industry. So we are not going to touch our R&D spend based on temporary fluctuations in demand in our marketplace.

Liam Burke - *Wunderlich Securities, Inc. - Analyst*

Great. Thanks, Vince. And Chris, the highlighted weakness in Asia-Pacific mining, heavy fab, offset by some automation activity -- the EBIT margin year-over-year stepped up nicely on lower volumes. Is there any one-time event in there, or is this a trend that you'd expect to continue?

Chris Mapes - *Lincoln Electric Holdings, Inc. - Chairman, President, and CEO*

No, there are really no one-time events in that P&L. This really comes from our continued work in restructuring and repositioning that business to more of a solutions-based business; focusing on automation and equipment in that marketplace; and mitigating our participation in some of the higher-volume, lower-valued welding activities in the marketplace.

So I do think that that performance may not be as consistent as we'd like. What I mean by that is, we may see a quarter where it steps down slightly. But we are very confident that we are on the right path in repositioning that business in Asia-Pacific.

Our Southeast Asia businesses are performing very well; had a couple of regions that had record performance within that piece of the segment. Australia still challenged, although I can assure you performing at a very good level, considering historically how that business has suffered through other mining cycles. And we've done that through some restructuring and solution-based products that we have moved into that marketplace over the last few years.

Liam Burke - *Wunderlich Securities, Inc. - Analyst*

Great. Thank you very much.

Operator

Justin Bergner, Gabelli and Company.

Justin Bergner - *Gabelli & Co. - Analyst*

I was wondering, on the automation side, if you could provide a little more perspective or numbers around the growth rates that you have seen here today organically in your automation business, and whether or not the margins are below or above the North American or Company average.

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

Right now, our margins in that business are in line with our Company average, Justin. As far as growth rates, we've seen on a constant-dollar basis a good, solid, double-digit increase in revenues, ex-acquisitions and ex-foreign-exchange on a year-over-year basis. So we have some elements of the automation business that have some very attractive growth trajectories in this marketplace. And it's clearly performing at a better growth rate than what we are seeing in some of our more traditional core welding end markets.

Justin Bergner - *Gabelli & Co. - Analyst*

Great, thank you. One more question, if I may. With respect to mix, how is mix affecting margins in your North American segment year-to-date?

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

Well, the export business and oil and gas and energy markets tend to be some of our stronger margin opportunities in the portfolio. So to the extent that we have a greater contraction in those end markets and those product portfolios, it's going to put a little bit more pressure on our margins.

So even though our domestic business held up fairly well as compared with a lot of our international markets, the mix is certainly hurting us as oil and gas declines by 20% and exports decline by almost 30%.

Justin Bergner - *Gabelli & Co. - Analyst*

Thank you. Is that just with respect to the margins in North America and the mix? Is that purely a function of the decrementals on export energy markets, or the actual average margins for those business also somewhat better than the North American average?

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

Well, I'd say it's both of those, surely.

Justin Bergner - *Gabelli & Co. - Analyst*

Okay. Thank you for taking my questions.

Operator

Walter Liptak, Global Hunter.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

I just wanted to see if I could ask a broader question. The comments that you've made this morning on currency and O&G and general industrial slowing -- it doesn't sound like there's any catalyst to start to turn things at all. And you guys have been through these cycles before.

Are you thinking that the cycle bottoms? Is it just oil and gas that we need to start picking up? And how are you positioning for 2016? Are you preparing for this to be a longer U-shape, or something that comes back quickly?

Chris Mapes - *Lincoln Electric Holdings, Inc. - Chairman, President, and CEO*

Well, while, we certainly don't -- as we have expressed this morning, we have not been able to identify that catalyst that gives us any confidence that the demand model shifts any near-term. So as we're exiting through the rest of 2015, we think we're going to continue to execute on our strategies, work on our cost models; certainly believe that we can perform well during this window, but a pretty challenged demand model.

Expect our automation business to continue to perform well. Expect to have pockets of industries and regions that continue to perform well, I think much like you've seen in our Q2 results. I think it's going to be more difficult at this point to put much color on 2016. Obviously, if we were to see a significant change in some of the commodity prices, or in the oil and gas pricing, then we would see some of those markets move back more quickly.

I've also experienced -- I think we have here at Lincoln where sometimes those markets overshoot some of the expectations and maybe compress a little more quickly. And then we may see some opportunities next year, at least relative to where their demand models have been in 2015. But we certainly don't see any catalyst towards the end of this year. And we will be watching, certainly, those industry segments and the large customers that we have relationships with as we move into 2016.

Walter Liptak - *Global Hunter Securities, LLC - Analyst*

Okay. All right, thank you. I appreciate your thoughts on the outlook.

Operator

This concludes our question-and-answer session.

I would like to turn the call back to Vincent Petrella for closing remarks.

Vince Petrella - *Lincoln Electric Holdings, Inc. - EVP, CFO, and Treasurer*

I just want to thank everyone for joining us on the call today and for your continued interest in Lincoln Electric. Very much look forward to reporting on our third-quarter results in October, and our progression and executing on our strategies. Thank you very much.

Operator

This concludes today's teleconference. You may now disconnect your lines at this time and thank you for your participation.
