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LECO - Q3 2015 Lincoln Electric Holdings Inc Earnings Call

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OVERVIEW:

Co. reported 3Q15 net loss of $60.5m or $0.82 per share.

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CORPORATE PARTICIPANTS

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

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

Vince Petrella *Lincoln Electric Holdings Inc - CFO*

CONFERENCE CALL PARTICIPANTS

Matt McConnell *RBC Capital Markets - Analyst*

Schon Williams *BB&T Capital Markets - Analyst*

Mig Dobre *Robert W. Baird & Company - Analyst*

Walter Liptak *Seaport Global Securities - Analyst*

Robert Wertheimer *Barclays Capital - Analyst*

Joe O'Dea *Vertical Research Partners - Analyst*

Tom Hayes *Northcoast Research - Analyst*

Liam Burke *Wunderlich Securities, Inc. - Analyst*

Stanley Elliott *Stifel Nicolaus - Analyst*

Steve Barger *KeyBanc Capital Markets - Analyst*

Justin Bergner *Gabelli & Company - Analyst*

PRESENTATION

Operator

Greetings, and welcome to the Lincoln Electric 2015 third-quarter financial results conference call.

(Operator Instructions)

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 of IR*

Thank you, Chelsea. Good morning, everyone. Welcome to Lincoln Electric's 2015 third-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 at 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 risk factors 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

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conform to US GAAP. And a reconciliation of non-GAAP measures to the most comparable GAAP measure is found in the financial tables in our earnings release.

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

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

Thank you, Amanda. Good morning, everyone.

Our third-quarter results illustrate solid execution of our 2020 Vision and Strategy, operational excellence, and the benefit of cost-reduction actions initiated in the second quarter. Headwinds continue to persist, as industrial end markets weakened throughout the third quarter from the same forces and factors other industrial firms have noted. Additionally, we faced challenging year-over-year comparisons in our three largest segments. This resulted in 9.9% lower sales in the third quarter, as an approximate 3% growth from both pricing actions and acquisitions were offset by a 10.2%, or $73 million, decline in volumes, and a 5.9%, or $42 million, decline from unfavorable foreign exchange.

Despite these challenges, we achieved a 15.1% adjusted operating income margin, up 40 basis points versus the prior year, primarily on cost-reduction actions and operational improvements. We achieved an adjusted earnings per share of $0.89. While share repurchases contributed $0.06, this benefit was offset by a $0.05 unfavorable impact from foreign exchange.

We generated solid cash flow, with 143% free-cash-flow-conversion-to-net-income ratio. Return on invested capital, when adjusting for our special items, was solid at 21.4%, and we continued to return cash to shareholders. In the quarter, we returned $161 million, or approximately 150% of cash flow from operations. And given our confidence in cash flow generation, we remain committed to our $400 million 2015 share repurchase target.

Additionally, earlier this week we announced a 10.3% increase in our dividend pay-out rate to $1.28 per diluted share for next year. As outlined in our press release, we incurred $181 million of pre-tax special charges in the third quarter, which Vince will walk through in more detail in his prepared remarks.

Looking at sales trends in a bit more detail on slide 4, the 10.2% volume decline reflected broad and weakening demand trends, as well as challenging year-over-year comparisons for the Organization. We achieved double-digit percent growth in our automation portfolio, both on a reported and organic sales basis. However, this growth was offset by further declines in both equipment systems and consumables across broader end sectors and geographies, as customers increasingly opted to defer capital investments and reduce production volumes in the quarter.

Our US export business declines moderated in the quarter, down 16%, while global oil and gas sales declines held study, down 20% versus the prior year. North American organic sales performance declined approximately 9% in the quarter. We associate this weakening on challenging year-over-year comparisons and a broader decline in demand, reflecting the impact of energy markets, as well as many of the industrial sectors we serve in the region. European organic sales also declined in the quarter, largely on challenging year-over-year comparisons due to strong volume performance in 2014, but also broad oil and gas weakness persisted across northern Europe, Russia, and the Middle East.

Looking at end sectors, we continued to see modest growth in transportation, non-residential construction, and in pipe mills, but at decelerating rates in the third quarter. General fabrication, which had previously been flat to positive, declined in the third quarter, along with further weakening in heavy fabrication as commodity prices continued to contract, impacting heavy equipment.

Moving to slide 5, we remain focused on investing for long-term profitable growth, and aggressively working to ensure costs remain aligned to current conditions. Looking at our growth investments, I am pleased to report that our investments in automation and in our education portfolio continued to drive growth, even in this challenging part of the cycle. These areas increased at a double-digit percent pace in the third quarter, and we continue to launch new solutions and invest in acquisitions to accelerate our presence in these attractive areas.

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In the quarter, we announced the acquisition of the automation asset, Rimrock, with emphasis on the subsidiary, Wolf Robotics. Wolf Robotics is a leader in robot integrations for the heavy fabrication sector in North America, so their addition expands our heavy fabrication capabilities and our presence in the western region of the US.

Additionally, we acquired SWP, based in Australia, which further exposes us to specialty alloy and hard-facing applications and services in the region. In education, we recently announced our $30 million investment in a new state-of-the-art welding technology center on our Euclid, Ohio, campus that is targeted to open in 2017, and ensure that Lincoln is the standard in welding education globally.

We're also excited about the strength of our product pipeline and new launches for a variety of our segments, including the new Square Wave TIG 200 for the commercial and light-industrial user, which builds on the success of the POWER MIG 210 Multi-Process Welder. In addition, we launched the Process Z solution for welding galvanized steel in the automotive industry, and complementary specialized consumable feeding systems for robotic aluminum and steel welding that enhances quality and productivity.

We're seeing good traction in key markets like shipbuilding in the US, where the unique value propositions of our solutions, like the new expanded range of UltraCore flux-cored consumables and our welding processes are enabling us to grow in an otherwise weak end sector. We continue to believe that all of these investments will allow us to better capitalize on growth opportunities when demand trends improve.

Given continued weakness in demand, we initiated further actions as part of our cost-reduction plan. The combined benefit of actions taken in the second and third quarters is expected to generate $20 million to $25 million in annualized temporary benefits, and $10 million to $12 million in annualized structural cost savings.

Although we expect that these benefits will help manage margin performance in the fourth quarter of 2015, we expect the fourth quarter to be very challenging, given compressing revenue trends, extended OEM shutdowns in the quarter, and challenging year-over-year comparisons. Given these factors, we expect fourth-quarter revenue to compress, as compared to our third-quarter revenue performance. While the benefits of our cost-reduction actions will help us manage margins, we do expect these benefits to not fully offset the anticipated unfavorable impact from volume and foreign exchange.

Before I pass the call to Vince, I'd like to emphasize that we will continue to manage our Business aggressively in this environment, and we remain confident in our Organization's ability to navigate through these challenging conditions. We will remain focused on our strategy to generate long-term value and improved returns.

Now I would like to pass the call to Vince.

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

Thank you, Chris.

Turning to slide 6 for a review of income statement highlights, our consolidated sales decreased 9.9% compared with the third quarter of 2014, on 3.3% higher price, primarily reflecting the hyper-inflationary environment in Venezuela. Excluding the impact of Venezuelan price increases in the quarter, overall pricing was relatively flat. We also achieved a 3% increase from our most recent Rimrock and SWP acquisitions, as well as Easom Automation, which we closed in October of 2014. These increases were offset by 10.2% lower volumes and a 5.9% unfavorable impact from foreign currency translation.

Our third-quarter gross profit decreased 17.7%, or $42.7 million, as the benefits from cost reductions and lower input costs were offset by the unfavorable impact of lower volumes, a $22.2 million special charge related to the Venezuelan currency remeasurement loss, and a $12.8 million impact from foreign currency translations. Our third-quarter reported gross profit margin decreased 300 basis points to 30.8%, compared with 33.8% in the comparable prior-year period on the impact of special charges. Excluding special items, our gross profit margin increased 50 basis points to 34.3%, primarily reflecting a benefit of cost-reduction actions.

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Our SG&A expense as a percentage of sales increased 80 basis points to 19.9%, due to the foreign currency and Venezuelan remeasurement loss of $4.3 million recorded in SG&A. Excluding this special item, our SG&A ratio was essentially flat year over year at 19.2%.

We incurred an operating loss of $84 million on the $181 million of pre-tax special items that I will review in more detail on the next slide. On an adjusted basis, we achieved a 15.1% operating profit margin, which was 40 basis points higher than 2014's 14.7% margin. Furthermore, excluding our Venezuelan operations from both years' third-quarter results, our adjusted operating profit margin would have increased 30 basis points to 15.5% in 2015, as compared with 15.2% in 2014.

Our interest expense increased by $4.6 million in the quarter to $5.8 million, primarily from the $2.9 million adjustment and the consideration we expect to pay to acquire an additional ownership interest in a majority owned subsidiary. Interest expense also reflects higher interest accrued on higher borrowings.

The effective tax rate in the quarter was affected by the special items previously mentioned. In the prior-year period, we recognized a 42.4% effective tax rate, due to an asset impairment charge which had no associated tax benefit. Looking ahead to the fourth quarter, we expect our effective tax rate to be in the high 20% range, subject to the mix of earnings and the utilization of US tax credits.

We recorded a net loss for the quarter of $60.5 million due, to the previously mentioned special items. Adjusted net income decreased 11.6% or $8.7 million to $66.2 million. Foreign exchange translation had an unfavorable $3.4 million impact to net income, or $0.05 per diluted share in the quarter.

The net loss of $0.82 per share for the third quarter includes the impact of $1.71 per diluted share of special items. This compares with earnings of $0.57 per share in the prior-year period. On an adjusted basis, diluted earnings per share decreased 5.3% to $0.89, as compared with $0.94 in 2014. Our Venezuelan operations were breakeven in the third quarter of 2015, as compared with a $0.01 per share loss to adjusted earnings in the prior-year period.

Now moving to third-quarter special charges on slide 7, as previously mentioned, we incurred $181 million of pre-tax special charges in the third quarter, of which $169 million were non-cash. As announced in August, we incurred a $136.3 million non-cash pre-tax charge primarily related to the pension annuity contract that we purchased from the Principal Financial Group for our existing US retirees in the defined benefit pension plan. The annuity contract reduces our US defined benefit pension plan obligation by approximately 49%, and reduces volatility and risk to our financial statements. We do not anticipate that the reduced obligation will have a material impact to pension expense or annual contribution amounts in the future. The balance of the defined benefit pension plan for current participants remains fully funded.

We also incurred a $26.5 million non-cash pre-tax charge related to the Venezuelan currency remeasurement loss. This charge reflects a lower of cost or market inventory adjustment of $22.2 million recorded in cost of goods sold, and a remeasurement loss of $4.3 million recorded in SG&A.

We have adopted the SIMADI exchange rate of VEF199.4 to the $1 at the end of September. This compares to the SICAD I rate we previously used of VEF13.5 to the $1. We believe the SIMADI rate more appropriately approximates the rates used to transact business in our Venezuelan operations. As a result, we expect our translated Venezuelan financial results to be significantly lower moving forward.

Additionally, we incurred an $18.3 million pre-tax special charge from rationalization and asset impairment charges in the quarter. The rationalization charge of $12.2 million is related to continued workforce reductions in our Asia-Pacific segment to further align headcount with operating needs as part of our strategic repositioning in that region, as well as a US voluntary separation incentive program that was initiated to further align costs with business conditions.

Lastly, we incurred a non-cash impairment charge of $6.1 million, primarily related to certain long-lived assets and goodwill of a business unit. After tax, we incurred $126.7 million in special charges, which had a $1.71 loss per diluted share.

Now moving to the geographical segments on slide 8, our North American welding segment second-quarter adjusted EBIT margins performed well, up 30 basis points to 18.3%, primarily from the benefits of cost-reduction activities. Reported sales decreased 7.1% in the quarter, as a 4.5%

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benefit from acquisitions and a 90-basis-point increase in pricing was offset by 10.2% lower volumes. While we did achieve double-digit percent organic sales increases in our automation portfolio, equipment and consumables sales were lower, as we saw a broad decline in demand across most end sectors and regions.

Domestically, organic sales declined 9.3%, and our export markets declined approximately 16%, as a strong US dollar and weaker oil activities continued to impact international markets. In Europe, our third-quarter results reflected challenging year-over-year volume and margin performance comparisons. Adjusted EBIT margin declined 380 basis points to 9.8% on lower volumes. Reported sales declined 25%, while organic sales declined 10.4% because of broad weakness in energy markets and challenging year-over-year comparisons.

Moving to slide 10, the Asia-Pacific welding segment's adjusted EBIT margin increased 470 basis points to 4.2% on mix improvements associated with our strategic repositioning. Reported sales in Asia-Pacific declined 20.7% in the quarter. Our organic sales declined 17.7% on 16.7% of lower volumes. Volume declines reflect repositioning of the portfolio and end-market weakness in oil and gas, as well as welding-intensive end market sectors such as mining, heavy fabrication, and transportation. We continue to generate growth in the strategic areas of automation and equipment systems.

South American welding's adjusted EBIT margin increased 570 basis points to 3.9% on easier year-over-year comparisons. Margin performance reflects 6.3% lower volumes from weakening macroeconomic conditions in the region, particularly Venezuela and Brazil.

Moving to slide 12, the Harris Products Group third-quarter EBIT margins declined 130 basis points to 9.8%. Sales declined 19.7%, or 15.3% organically. Volumes decreased 8.4% in the quarter on challenging year-over-year comparisons and broad end-market weakness. Pricing decreased 6.9% on lower metal costs, primarily silver.

Moving to slide 13, our cash flow from operations in the quarter was $105 million, which represented a 143% conversion of free cash flow to net income rate. Looking at our uses of cash, we invested $34 million towards acquisitions in the quarter, capital expenditure spending declined 29% to $11 million in the quarter, or approximately $40 million for the first nine months.

We now estimate full-year 2015 capital spending to be in the range of $60 million to $65 million. This compares to our previous estimate of $65 million to $70 million. Additionally, we paid cash dividends of $22 million, reflecting the higher dividend pay-out rate.

During the quarter, we accelerated spending on share repurchases, and spent approximately $139 million repurchasing over 2.4 million shares for treasury. For the nine months of 2015, we have spent $298 million on share repurchases, and continue to target $400 million for share repurchases this year.

Just a couple of comments on our outlook for the balance of the year and into early 2016 before we open the call for questions: Through October, we have continued to experience weakening industrial demand trends in our end markets, including a broad decline in industrial demand in North America. Combined with challenging year-over-year comparisons through the first quarter of 2016, we expect year-over-year sales trends to further weaken from what we saw in the third quarter. In this environment, we will continue to focus on managing margin performance.

We expect the additional cost-savings actions implemented in the third quarter to benefit the Business in the fourth quarter. We do not expect these benefits to fully offset volume headwinds or the unfavorable impact of foreign exchange. In this environment, we will continue to invest in our long-term 2020 growth strategies, our robust pipeline of new solutions, and ongoing M&A activity. We do remain confident in our cash flow generation, the strength of our balance sheet, and in our ability to invest in the Business. We will continue to return cash to shareholders through the cycle.

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

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Matt McConnell, RBC Capital Markets.

Matt McConnell - *RBC Capital Markets - Analyst*

I appreciate all the insight into the different end markets and what you are seeing this quarter. Could you roll that forward and share an early read on what you are expecting for 2016?

I know, Vince, you just mentioned the comps are still tough in the first quarter. But what are some of your underlying assumptions that support the cost structure you have now or how is your planning for 2016?

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

Matt, as you said, we are concerned because the comps are very tough in the first quarter for us. We were not pulled into some of negative demand trends from oil and gas as quickly as some other industry participants. We are expecting that the transportation side stays very steady in 2016, automotive and broad transport still looks good. We're expecting structural to stay good.

We actually believe that there is some indication that pipe may actually be more favorable in 2016 than 2015, although that is certainly a small element of the segment. We are confident that those areas are going to continue to be a very good portion of the business for us. We are confident in some of the new products that we're migrating out into the portfolio and confident that automation should continue its growth trajectory.

But certainly some of the segments that have been challenged for us as it relates to ag and mining, we certainly are expecting to be challenging in 2016. All I can tell you about oil and gas is the only thing that is probably occurred in that marketplace over the last couple of quarters is at least we have seen some stabilization in oil pricing within a range of at least where the investors in that particular marketplace from a capital perspective are probably getting a little bit more confidence over the stability of pricing. Which hopefully can return some greater investment dollars into that segment in 2016.

Matt McConnell - *RBC Capital Markets - Analyst*

Okay, great. Thanks. That's helpful. Just a follow-up maybe on margins. In North America, specifically, how close are you to the minimum hours that you commit to there. Another way to ask that is, how much flexibility do you have to reduce near-term capacity if you do see any more incremental end market weakness?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

We've offered a voluntary incentive separation program that over 100 people accepted during the course of the quarter. We also are working our productive staff at a little less than a full workload. So there is a bit of room to move hours down if we take another step down in order and sales patterns going forward.

Matt McConnell - *RBC Capital Markets - Analyst*

Okay. Great. Thank you.

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Operator

Schon Williams, BB&T Capital Markets.

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

Would you guys be willing to quantify, what is the sequential savings you expect to realize from the current action in Q4 versus Q3?

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

We announced at the end of the second quarter, savings that were roughly half of the aggregate savings that we have updated at the end of the third quarter. As you might recall, Schon, we said that we would have a run rate of $10 million to $12 million of temporary cost savings beginning the third quarter and $4 million to $6 million of permanent savings beginning in the third quarter.

Now we can layer in on top of that to aggregate $20 million to $25 million of temporary savings and $10 million to $12 million of permanent that we believe will pretty quickly in the fourth quarter be at a full run rate realization. We took about one-half of those savings in the third quarter and we are now pretty much doubling what we announced at the end of the second quarter for the fourth quarter.

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

All right. So I should think of it as a temporary savings plus the permanent -- you realized some of that in Q3, but there should be at the full run rate in Q4. Is that correct?

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

That is correct.

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

Okay. Then maybe just a little bit on the Harris Products turned -- organic volumes there turned quite negative. I know it was a tough comp, but traditionally that is more housing exposure so I would have maybe expected it to hold off a little bit better. Can you just talk about what is driving the end market weakness there?

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

My comment would be it was a little shallow in the third quarter on the equipment side of that business. You would also be at the point in the housing cycle for those products that you would be at the end of their particular season. Some of our international shipments out of the Harris business were little shallow to our expectations, on the equipment side, as well as the consumables side.

I will point out that, that business has performed very well in 2015. It had very strong results for us in the first and second quarter. And again although a little shallow in Q3, I do not think materially shallow and we do not see anything from a share of market perspective for that particular business.

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

That's helpful. Then one more, if I may. Vince, any guidance on interest expense as we move into the fourth quarter here?

I know there's a couple of moving pieces there with the payout and increased debt levels. But should we assume the $5.8 million, is that a good run rate or anything that pushes that up or down?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

No, I would expect it to come down. As I said in my prepared comments, a contingent consideration required a forecast update based on the results of this business that we bought.

I would tell you that the way it looks today, it would probably be something like $3 million to $4 million unless there's another forecast adjustment to the outgoing forecast of the business. So it is going to come down, barring any significant adjustments to contingent consideration. So I would think $3 million to $4 million is not a bad estimate at this point in time for one quarter.

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

All right. That's helpful, guys. I'll see you at the FABTECH show here in a couple of weeks.

Operator

Mig Dobre, Baird.

Mig Dobre - *Robert W. Baird & Company - Analyst*

My first question is just a little bit of clarification, trying to understand how you are really framing the outlook. Things, I presume, sequentially, have gotten weaker, hence the additional action on the cost side.

But I am trying to frame -- how much of this is really related to difficult comps as you frame it out to looking out to the first quarter? As opposed to you seeing some sequential deceleration in the business that would require maybe additional actions on a cost side as we get into next year? I'm trying to separate out the tough comps versus business fundamentals deteriorating, if that makes sense, or end markets?

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

I know, as you say, we need to break it out. It is a tough comp. We had a very strong Q4 and a solid Q1 that is up against us for the next couple of quarters. But when we look at the actual organics within the business and the trends within the business, as we stated, this has been a compressing market.

We do believe that a multitude of industrials are challenged by this particular marketplace. Quite frankly, it has been compressing into Q2 and compressed into Q3. And as we stated, we saw a little bit further compression from an organic perspective in these key end markets as we are entering into Q4. Granted, it is only the first two or three weeks of Q4, but we have seen some sequential and trend data continuing from a demand perspective that has been slightly shallower.

I will tell you, as it shows in our margin performance, we have done a very good job of managing the business and getting ahead of our cost structure. Certainly some of those benefits will be provided into the business, expecting that those will help us make some improvements in Q4.

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But as we stated in the remarks, concerned that quite frankly the revenue trends and the challenges that we have from a comp and FX may make it difficult for us to perform at the level that we would otherwise like to.

Mig Dobre - *Robert W. Baird & Company - Analyst*

I appreciate that. Thank you for the clarification.

Maybe a big picture question, with you looking at your internal data. One of your big competitors has highlighted a tale of two economies. You've got some industrial manufacturing commodity exposed to the market that are struggling. You've highlighted that, as well

Then you've got some others that are maybe -- consumer, construction, and auto, et cetera, that are doing well. This divergence in and of itself, how unusual is that to you? And do you think that such a divergence is sustainable as we look into 2016?

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

It is a great question. I would tell you that we would say this type of divergence is usually a unique market attribute.

We'd maybe seen it an earlier cycle one time that we talked but here within Lincoln. The positive side of that is that those areas of the economy that have been performing well in 2015, that automotive space, the structural space, the consumer side, we believe are going to continue into 2016 at a solid level.

The industrial spaces that have been challenged continue to be challenged. Not a lot of clarity as it relates to mining and ag and hopefully stability within oil and gas, as we move forward, but we do see the divergence of a couple of our segments.

I would also point out it is one of the advantages that we believe we have within our portfolio at Lincoln Electric. That because of the multitude of segments that we participate in, in this type of environment, we do have the benefits associated with those other segments that are stronger at this point, the regional diversification. And certainly some of the strength that we have seen within the investments in our automation portfolio that we have certainly emphasized within the business over the last two to three years.

Mig Dobre - *Robert W. Baird & Company - Analyst*

All right. Thank you.

Operator

Walter Liptak, Seaport Global.

Walter Liptak - *Seaport Global Securities - Analyst*

I want to ask about some of the geographic trends. In North America, wondering about any inventory destocking. If you can tell us, did you get a look into distributors or OEs and what they're doing with their own inventory levels, and if that may be exasperating things in the back part of the year?

And then in Europe, I'm curious about just any monthly trends you have seen that was -- we were all expecting it to be weak, but hoping for stability. Anything in the sectors that might be bottoming and turning more positive?

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

I will start, Walt, by answering the European question, which I will tell you, we just have not seen anything in the data that gives us any confidence at any level of stability. We're not seeing any material shift within the business, but we're certainly not seen the stability that we would like to see within that particular market.

Certainly some of the activities that they have in Europe to generate some growth and some stability would be very favorable for us. But when I think about that market, I still am seeing us being challenged because of Europe's connection to Russia and the export market there into Russia, which continues to be challenging for a host of those particular industries and markets, which may make it difficult for us. And for that market to really start to pick up some steam and start to move out of the downward compression in their demand model.

Walter Liptak - *Seaport Global Securities - Analyst*

Okay. Great. And then the North America question on the distributor OE destocking?

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

The fortunate thing relative to where we are at in the cycle is that if you think about oil and gas and mining and ag, those segments that, quite frankly, have been trending more negatively and compressing through the last couple of quarters. We have had enough time within the cycle that we are not experiencing any bubble associated with further inventory reduction that we are expecting. Certainly not seeing that with any of our large channel partners.

The only element relative to those segments that may be something that we see in 2015 versus 2014 is that, because of some of the challenges with demand, we may see some of those large OEMs take larger shutdowns during the traditional holiday windows. So we are expecting that, potentially, we could see more productive days pulled out by some of the OEs in some of those segments, but that is not really relative to inventory.

Walter Liptak - *Seaport Global Securities - Analyst*

Okay. Fair enough. Thanks for the color.

Operator

Robert Wertheimer, Barclays.

Robert Wertheimer - *Barclays Capital - Analyst*

This is a follow-up to the last question. I'm just wondering if you can, with the more granular data that you see, give your opinion on whether there is a confidence crunch. In other words, in the areas where there shouldn't necessarily be weakness, people have stopped spending on equipment versus consumables, if you see what I mean?

You mentioned both are down, but whether you think that equipment is trending below activity as people seize up or not? I am wondering if, aside from the obvious areas of weakness, if you are seeing people pinch it a little bit more than that in anticipation of slower times ahead?

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

Rob, that is the case. What we have seen in previous cycles is on the downside of volume contractions, our equipment or machine business fall more than the consumables because it is more of a CapEx discretionary, perhaps, type of spend. We see that in the last couple quarters now at Lincoln, where our equipment business is contracting a bit more than the consumable business.

There is certainly an element of that. And the strong dollar is exasperating that effect in international markets as well. Your point is a valid one, in terms of a little bit of pulling in of the horns when it comes to CapEx spending right now.

Robert Wertheimer - *Barclays Capital - Analyst*

Okay. Then just a quick one on pricing on equipment, especially North America. What are your thoughts on how that is going to play out this cycle?

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

I do not think there's going to be much pricing in this environment. So I would expect us to have a flat type of pricing environment the next quarter or two.

Robert Wertheimer - *Barclays Capital - Analyst*

But you do not anticipate declines? Obviously, there's some cost pass through throughout the chain, where some folks are seeing a little bit of down, not necessarily margin down, but down?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

Our history has been one where we have been able to hang on to price pretty well and we do not expect this cycle to be any different than our historical performance and behavior. If there is a price that is given up, it would be relatively modest.

Robert Wertheimer - *Barclays Capital - Analyst*

Great. Thanks so much.

Operator

Joe O'Dea, Vertical Research Partners.

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

On the M&A front, and as you see continued softening and uncertainty in end markets, is that in any way raising the possibility of an acceleration in acquisition activity, just as you see maybe more things that have bid on the sidelines, a willingness to come forward, valuation coming down a little bit potentially?

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

You would think that in this particular marketplace, where some of the segments become more challenge, that there may be more assets that are available, people evaluating whether they want to manage their business through an uncertain cycle. I will tell you not sure that, philosophically,

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we're thinking about it that way. We have invested a lot of money from a human resource perspective and from a strategy perspective to be able to evaluate acquisitions.

We know how critical it is to us to our long-term strategy. I certainly was excited about closing the Rimrock acquisition and the SWP transaction in the quarter. Hopefully -- maybe we will have more assets that become available, but I can assure you that, even before we saw this downturn, we were actively looking around the world for technologies and products and people that could advance our strategy.

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

Okay. Then on the cost actions taken or announced through the quarter, you announced some at the end of Q2 and then further actions in 3Q. It sounds like you implemented much of that over the course of 3Q, and now you see continued sequential softening into 4Q. Does that raise the possibility of additional actions or do think what you have now announced encompasses what you think you need to do for the current environment?

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

We'll have to understand exactly where these demand trends move over the next couple of months. We have been very aggressive in managing that side of the cost model and certainly believe that we exhibited that and managed that in Q3. If we were going to see an elongated period of further demand declines, which we're not forecasting at this point, that we would obviously continue to evaluate our cost structure and make sure that we continue to keep that aligned.

But at this point, especially with us pretty much being through the month of October, we have probably accomplished at least any major type of reductions that we're going to be able to accomplish as it relates to Q4. And we will be evaluating those demand trends as we're moving into 2016.

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

All right. Thanks very much.

Operator

Tom Hayes, Northcoast Research.

Tom Hayes - *Northcoast Research - Analyst*

As it relates to Venezuela, looking at the adjusted results, you're still essentially breakeven. Just wondering if you could provide some thoughts on your position in the market and how can you move profitability forward?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

Our position in the market is still very strong. As you know, Tom, we're really the only local manufacturing there. It is a growingly challenged environment.

The economy there is contracting significantly, it is hyper-inflationary. Our view of Venezuela is that our expectations are modest, that we want to continue to maintain our position there, and eke out whatever type of profitability is possible under the current conditions.

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I wouldn't expect us to have a whole lot of in the near term or maybe the intermediate term from an earnings or sales perspective coming out of Venezuela. But it is still our position that we are there for the long term, and we are hopeful that, the economy can get back on track and take advantage of some of the world's largest oil reserves sometime in the future.

Tom Hayes - *Northcoast Research - Analyst*

Okay, great. Then a follow-up.

The acquisition of Wolf Robotics in the quarter was a nice addition to the automation offering. Perhaps you could touch on how you position the complete Lincoln automation offering to the clients, especially as you called it out as a meaningful growth driver going forward?

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

As it relates to the Wolf Robotics acquisition, it provides a couple of real catalysts for us in the way we're moving to the market with automation. The first would be it provides us an operation in Fort Collins, Colorado for the western portion of the United States, for us to be able to touch customers more easily within that group.

I was out there recently just a couple of weeks ago, meeting with the employees. I will tell you that it is an enormous amount of talent. People were very focused on welding technologies and automation. And they have really had a leadership position in a host of large OEMs and believe they can help us take those capabilities into other markets and other OEMs.

The second catalyst that I see from the automation business for our customers is quite frankly the scale we are building. The fact that as we continue to aggregate up more of these businesses, we bring in more capabilities like we have at Wolf Robotics, where they had some unique applications that they had been engaged with.

As we bring more and more scale of our global automation capabilities, our ability to service global OEMs is going to be enhanced. We see that as part of the fundamental strategy that we started two or three years ago when we said we were going to migrate down a long-term investment payoff in welding automation. Very, very excited about the recent acquisitions with Wolf, as well as our continued investment in that space.

Tom Hayes - *Northcoast Research - Analyst*

Great. Thank you.

Operator

Liam Burke, Wunderlich.

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

Chris, how is the -- as you grow the automation business, how is the competitive environment different from your more traditional arc welding business?

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

The one difference is that it tends to be very much directly with the end user because you are really talking about developing a solutions base that's very specific to their particular application. There are a multitude of our products that are enormously focused with the end user application. But there are some of our products that, quite frankly, are more closely aligned with management of the channel or support from the channel.

But the automation business generally is working with an OEM because you are going into solve a larger solution for the OEM from a welding perspective. One of the challenges with that it is much larger project management, not just creating the solution, but many times being there with the solution from installation and an engineering perspective. So we believe it is a deeper relationship.

It is a relationship that requires us to have a different type of resource at times to support that OEM. But I've got to tell you, we think it is greatly aligned with our strategy because we want to be a solutions-based, technology-driven Company and automation provides us another capability for us to bring that to the marketplace.

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

Are you running into a broader set of competitors here or how does that landscape look?

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

We do run into different competitors, although I would tell you that we believe we have a unique value proposition. At the end of the day, when an OEM is seeking these types of solutions, they are just not seeking automation. They are seeking a welding solution. We, quite frankly, believe we know more about welding and welding technologies than any of the other individuals that would be bringing these solutions to the marketplace.

So if you are just an integrator of automation, or if you are a line builder within automation, and there are companies out there that do that, and some companies that do that well, I would share with you that we believe the real issue is you have got a welding issue. The welding proposition and our knowledge of that technology and the ability to bring that solution within automation as a solution creates a real competitive advantage and creates a compelling value proposition when we talk about that with our customers.

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

Great. Thank you, Chris.

Operator

Stanley Elliott, Stifel.

Stanley Elliott - *Stifel Nicolaus - Analyst*

Going back to the automation side, have you seen any of the other larger, more global welding companies start to accelerate their investments in automation like you all have?

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

I would say that we haven't seen anything to the level that Lincoln has, because of the acquisitions that we've been making to the space, and certainly the public side of those particular disclosures. A multitude of other players have some presence in the space, but we certainly are excited about our continued investment in what we believe to be our market-leading position in welding automation.

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Stanley Elliott - *Stifel Nicolaus - Analyst*

The success you guys have had, is that changing your thought that maybe doubling this business through the 2020 process might actually be conservative to where this business could grow in excess of $500 million?

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

I think the real challenge associated with that will be, as we continue to execute on the current strategy, what the longer-term growth rates are for automation within the welding space. Because as we think about the business, we certainly want to have a leadership position and that leadership position might lead us to a larger business model than what we were initially thinking of as we developed and are executing on the strategy.

My confidence is that the strategy is working for Lincoln and that we believe that it is a value creation for our business and our shareholders and we're more than willing to continue to look at investments in the space. Probably forecasting out what the size of that business would be is just a little beyond where we are comfortable today until we really get a broader understanding of the adoption rates in welding automation globally over the next several years.

Stanley Elliott - *Stifel Nicolaus - Analyst*

Understood. If I could sneak one more in, you all mentioned returning cash to shareholders through the cycle with the big repurchase activity this year. Would you guys care to comment on what investors could expect to see in the coming year?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

Stanley, we haven't -- were not in the position today to announce what our 2016 share buyback targets will be. As you know, we are on pace for $400 million this year. We still have a planning process to get through in December to button down what our views are on 2016.

But what I can tell you is that you can expect a very robust share repurchase number for 2016, in line with our previous discussions surrounding our revised capital allocation strategy. I would expect there to be a very significant share buyback activity in 2016, as well.

Stanley Elliott - *Stifel Nicolaus - Analyst*

Great. Thank you, guys.

Operator

Steve Barger, KeyBanc Capital.

Steve Barger - *KeyBanc Capital Markets - Analyst*

Vince, you talked about that $26 million price benefit in South America. How much of that flowed through to operating income in that segment?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

South America doesn't have a whole lot of operating income, but the $26 million was really a charge related to the Venezuelan foreign currency remeasurement process. It wasn't a cost savings, Steve, as much as a special item charge.

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Steve Barger - *KeyBanc Capital Markets - Analyst*

No, I'm talking about on the volume acquisition price in FX [walk], the positive $26 million is that the same charge?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

No, that is actually the hyper-inflationary economy in Venezuela. You are raising your prices on a weekly basis in line with a very high inflation rate, but your costs are going up by a commensurate, or some months, a greater amount. It is really offset -- those price increases are offset with cost increases. It doesn't really translate into higher earnings.

Because, as you may know, Venezuela has a fair price law, which only allows you to mark up your pricing a little bit more than what your costs are rising at. You're almost locked into a position there currently, where if prices -- your costs are going up 100%, you can maybe raise your pricing by 112%.

Steve Barger - *KeyBanc Capital Markets - Analyst*

Got it.

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

So you're just trying to hold serve their and not really expand margins.

Steve Barger - *KeyBanc Capital Markets - Analyst*

Understood. Would -- and I know it is always hard to predict in an environment like that -- but would you expect to see a price benefit like that in 4Q as well, just as we think about our models?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

No. I don't think so.

With this move from the CCAD1 rate to the SIMADI rate, that is going to temper the price increases that I think you're seeing through a new translation mechanism. So the numbers are going to come down at least near term fairly significantly when we think of the size of the top line in Venezuela.

Steve Barger - *KeyBanc Capital Markets - Analyst*

Okay. Next, moving to North America, thinking about the $45 million volume decline that you saw, how much of that was export versus domestic? And based on the commentary for what you are seeing so far in 4Q, would you expect to see that same level or more of a volume decline in 4Q?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

The export part of that decline was about $8 million out of the US, year-over-year, so about $36 million, let's call it, was domestic declines. Then as far as the trending is concerned, my expectation based on what we are seeing in our North American business for October is that it will likely be

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larger than that. That the trends that we saw throughout the quarter and what we have on the book for October, unless something turns around in November and December, we will have a greater decline in volumes in the fourth quarter than the third.

Steve Barger - *KeyBanc Capital Markets - Analyst*

Got it. These volume declines, you haven't really seen, if my historical data is right, since 2009, so really remarkable margin preservation on that front. Can you tell us what the EBIT loss was on that $45 million decline before cost savings?

And obviously you have gotten in front of those EBIT declines very well. How much of a direct offset was there from specific cost actions in the quarter?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

We had previously disclosed a run rate of about $10 million to $12 in temporary savings and $4 million to $6 million on permanent. So we think we got the full quarterly run rate on that. We also achieved in the overall business about 11% decremental margin, which is unusually strong for our business, historically speaking.

We're very pleased with the cost savings activities that we have engaged in during the course of this double-digit decline in volumes. And I believe, Steve, our performance in this quarter, and frankly, the last couple of quarters, is better than what our decrementals have been last time we have been through this a volume decline by a wide margin.

Steve Barger - *KeyBanc Capital Markets - Analyst*

No question about it. So what I'm trying to get to is, is that decremental of 11% versus the -- I think it was -- 18% in 2Q, and maybe closer to 30% in 1Q, are your cost saves going to allow you to keep that decremental at a low double-digit pace in 4Q or does some of that volume decline catch up with you?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

I would tell you we could, but it depends on the volume declines that we have in the fourth quarter. The trending would suggest that, that might be difficult, but we are outperformed previous same type volume declines.

Our decrementals will likely be a bit better but sometimes it can be difficult to get ahead of another step-down in volume declines within a quarter. So I am fairly optimistic that we will be able to maintain a better-than-historical profile but it is, again, all dependent upon how we end up in volumes in the fourth quarter.

Steve Barger - *KeyBanc Capital Markets - Analyst*

All right. Thanks very much.

Operator

Justin Bergner, Gabelli & Company.

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Justin Bergner - *Gabelli & Company - Analyst*

I wanted to address the question of margins a different way. I don't think there has been a discussion yet today about any benefit from declining input costs. Was that a factor in the third quarter, and if so, could you give us some idea as to how much of a factor?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

We did have a LIFO credit in the third quarter of about $4.2 million, which is reflective of a lower input cost environment. Our year-to-date benefit from that is about $7 million, so we did have some compression in raw material costs in the quarter that benefited us from a LIFO credit perspective by a little over $4 million.

Justin Bergner - *Gabelli & Company - Analyst*

Okay. Is there any additional portion that doesn't flow through LIFO that would have been on top of that?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

I wouldn't be able to put a number on that for you, but LIFO is a good indicator of what your current cost environment is doing on a quarterly basis.

Justin Bergner - *Gabelli & Company - Analyst*

Okay. That's helpful.

Then I noticed that in North America your price ticked up a bit versus prior quarters, which was certainly impressive given the underlying environment. Is there any factor there that we should be noting in terms of mix or source of that strengths on the price driver?

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

North America includes Canada and Mexico, those foreign jurisdictions. And the bulk of the pricing improvement was really the dynamic of selling products from our US business into those legal entities, who in turn, have to raise prices to try to make up for a stronger US dollar.

So the weakness in the Canadian dollar and the Mexican peso against the US dollar, and this is true in all markets, not only North America, will require the local subsidiary to try to recoup that greater cost through pricing increases. So the bulk of that really is a foreign currency inter-Company pricing dynamic. In the domestic market, pricing was relatively flat.

Justin Bergner - *Gabelli & Company - Analyst*

Okay, great. That's helpful.

One final question. I'm not sure if you've spoken to this before, but can you perhaps give us a sense as to whether automation margins are in line with the Company average, and in line with the North American average as it relates to the North American component of automation?

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

Currently, the automation product line margins are a bit less than both North America and the consolidated group, but they're pretty close to where we are from a consolidated group perspective. But as you know, North America is a fair bit higher than the consolidated numbers. But they are a little bit less at this point in our integration process, including in a lot of new acquisitions over the past couple, two, three years.

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Justin Bergner - *Gabelli & Company - Analyst*

Okay. That's helpful. Do you expect them to be able to get to the Company level or perhaps even the North American level in your mid-term plan?

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

We fully expect them to achieve the consolidated business level, and maybe even a tick higher. But North America margins are maybe a little bit farther out than the near or even the intermediate term.

Justin Bergner - *Gabelli & Company - Analyst*

Okay. Great. Thank you for taking all my questions this morning.

Operator

Matt McConnell, RBC Capital Markets.

Matt McConnell - *RBC Capital Markets - Analyst*

You mentioned that deferred customer capital spending is impacting equipment sales, as it typically does, but it sure doesn't seem to be impacting automation sales. That is a pretty big capital outlay obviously, so how has that been stronger? Is that you are just outperforming the market? Just a little more insight into the increase in automation sales this quarter would be helpful?

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

That is a great question, actually. Historically automation has moved largely with our equipment portfolio. And this really might harken back to the previous question I was asked today about end market segments and the divergence between those segments in our business.

But one of the segments that is strong for us right now is automotive. Automotive is perhaps one of the heaviest concentrations of automation sales activity in welding automation.

So I would attribute to a good part of the divergence in automation to its end market exposure in the area of automotive at the current time. It is really relevant to what our exposures are from an end market perspective. And we have some end market strengths in the automation space.

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

I would also add, we're still in an extremely low cost of capital environment. So as some of these segments are struggling, they are still looking for productivity, and quite frankly, needing productivity. So there may still be some investments in some space that, quite frankly, is not growing from a demand perspective, but those OEMs are seeking solutions to drive higher levels of productivity.

Matt McConnell - *RBC Capital Markets - Analyst*

Great. Thanks. That's helpful.

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Operator

This concludes our question-and-answer session. I would now like to turn the call back to Vincent Petrella for closing remarks.

Vince Petrella - *Lincoln Electric Holdings Inc - CFO*

Thank you, Chelsea. I just wanted to thank everyone for joining us on the call today and for your continued interest in Lincoln Electric.

We look forward to showcasing our solutions at the upcoming FABTECH Expo in Chicago on November 10 with analysts, and discussing the progression of our strategic programs and 2020 strategy on our next earnings call in February 2016. Again, thank you very much.

Operator

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

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